



SUBJECT: Hydro Business Plan

TO: Committee of the Whole

FROM: Finance Department

Report Number: F-04-23

Wards Affected: Not applicable

File Numbers: 125-01

Date to Committee: February 1, 2023

Date to Council: February 14, 2023

Recommendation:

Receive and file finance department report F-04-23 regarding the Hydro 2023 business plan.

PURPOSE:

This report is to provide committee with an overview of the 10-year Hydro business plan on the following key areas:

- 10-Year Forecast of net income
- Capital expenditures
- Balance sheet
- Dividend flow
- Shareholder risks

Vision to Focus Alignment:

- Support sustainable infrastructure and a resilient environment

Background and Discussion:

The shareholder direction to BEC (Burlington Enterprises Corporation) is a document that sets out the accountability, responsibility and relationship between the Board and the Shareholder. Article 6 of the direction details reporting requirements to the shareholder. Specifically, section 6.1 requires that “not later than 45 days prior to the end of each fiscal

year, the Board will approve and submit to the Chief Financial Officer of the shareholder a business plan for the next five fiscal years.”

The business plan is to include;

- a) The strategic direction and any new business initiatives which Burlington Hydro or its subsidiaries will undertake;
- b) An operating and capital expenditure projection for each fiscal year thereafter, including the resources necessary to implement the Business Plan;
- c) Pro forma unconsolidated Financial Statements for each fiscal year, including projected dividend payments to the shareholder;
- d) An acquisition budget setting forth the nature and type of capital expenditures proposed to be made in the following fiscal year, supported by explanations, notes and information upon which the budget was based;
- e) Energy conservation programs and environmental plans; and
- f) Any material variance from the Business Plan then in effect.

This information is important to the City as it assists the City, as shareholder to understand the financial and operational aspects of the distribution business and other businesses of the corporation. The City is in receipt of the following financial information, including 10-year forecasts, with regards to BHI (Burlington Hydro Inc.) and BESI (Burlington Electricity Services Inc):

- Business Assumptions
- Balance Sheet
- Statement of Changes in Cash Flow
- Profit & Loss Statement
- Capital Forecast

Each year the Board of Directors conducts a strategic planning process which helps formulate company objectives and strategic goals for the coming year. Understanding that as a shareholder the City of Burlington has a low tolerance for risk, the BHEI Board has directed management towards a risk-adverse strategy. The following strategies have been developed to support achievement of key objectives in 2023:

- Responsible Financial Management – LDC (Local Distribution Company) profitability and revenue growth
- Community commitment – customer satisfaction, corporate communications campaigns, customer focus performance metrics
- Operational effectiveness – information technology, improve organizational design
- Employer of choice – strengthen employee culture, meet safety metrics, strengthen customer/contractor communications

The strategic principles that support the objectives are:

- Optimize revenue considering capital requirements
- Institute a culture of continuous improvement identifying areas where effectiveness of the organization can be improved
- Refine and develop tools and training for customers and staff to help with education on prevailing issues
- Identify and pursue opportunities to grow revenues through non-regulated activities
- Evaluation of M&A (mergers & acquisitions) proposals using key principles that include adding value for the City and positioning the utility strategically for the future
- Survey and consult staff on the level of job engagement

BEC remains focused on the needs and priorities of the community into the future. In alignment with the City's 25-year vision, the key strategic directions were identified for the future state 25 years out. Elements of the vision include:

- Strong shareholder relationship
- Unsurpassed reliability
- Excellent shareholder value
- Customers engaged and satisfied
- Unmatched safety record
- GREEN leader
- Top employer

The corporation is well positioned in the context of the City of Burlington's 25-year vision and its companion document From Vision to Focus which details more specific action plans for the next four years. Specifically, Burlington Hydro can contribute to supporting sustainable infrastructure and a resilient environment.

BURLINGTON HYDRO INC.

BHI Net Income Forecast 2023-2032

Forecasted net income ('000 millions) before tax for the next ten years is presented as follows:

2022 Update	2022 Budget	2023 Budget	2024 FCST	2025 FCST	2026 FCST	2027 FCST	2028 FCST	2029 FCST	2030 FCST	2031 FCST	2032 FCST
3.960	4.082	4.022	4.082	4.439	7.147	7.207	7.365	7.734	8.171	8.974	9.537

The 2022 update of \$3.960 million presents a negative variance of approximately \$122K from the 2022 budget of earnings before tax of \$4.082 million.

Factors affecting the 2022 update are as follows:

- Distribution revenue is forecast to drop below budget by \$116K. Primarily driven by lower demand in Jan-Apr for large commercial and industrial customers.
- Other Operating revenue is forecast lower than budget by \$283K. The variance to budget is due to the reduction of deferred revenue in 2022 due to delays in capital work. Also, late payment charges due to the OEB (Ontario Energy Board) mandated increase in days to pay from 16 to 20.
- Operating expenses are forecast to be unfavourable to budget by \$181K. Favourable variances in operations and maintenance costs of \$284K and billing & collection of \$162K are offset by an unfavourable variance in Administration Department of \$627K.
- Net finance costs are forecast to be favourable by \$193K due to the timing of the drawdown of the \$10M term debt and the ensuing interest costs.
- Depreciation expense is forecast to be favourable by \$264K due to the timing of capital projects.

The results achieved by BHI are of importance to the shareholder as the dividends flowing to the shareholder from BEC are composed of earnings from BHI and BESL.

TEN-YEAR CAPITAL BUDGET AND FORECAST

In keeping with BHI's Asset Management strategy the capital budget and forecast identifies projects that are part of its sustaining capital budget as well as ensuring that Burlington has an adequate supply of electricity. These include:

- Customer demand projects including connecting new customers, building new subdivisions, and relocating system plant for roadway construction work.
- Renewal which focuses on replacement of assets that have reached end of useful life. New assets require less maintenance, deliver better reliability, and reduce safety risks to the public.
- Security which could include adding switching devices or creating a backup feeder supply to reduce the risk to typical restoration times.
- Reliability which supports maintenance of or improvement to the Service Quality indices measured and submitted to the OEB each year.
- Substations which are invested in to improve or maintain reliability to large numbers of customers and to maintain security and safety at the substation sites.

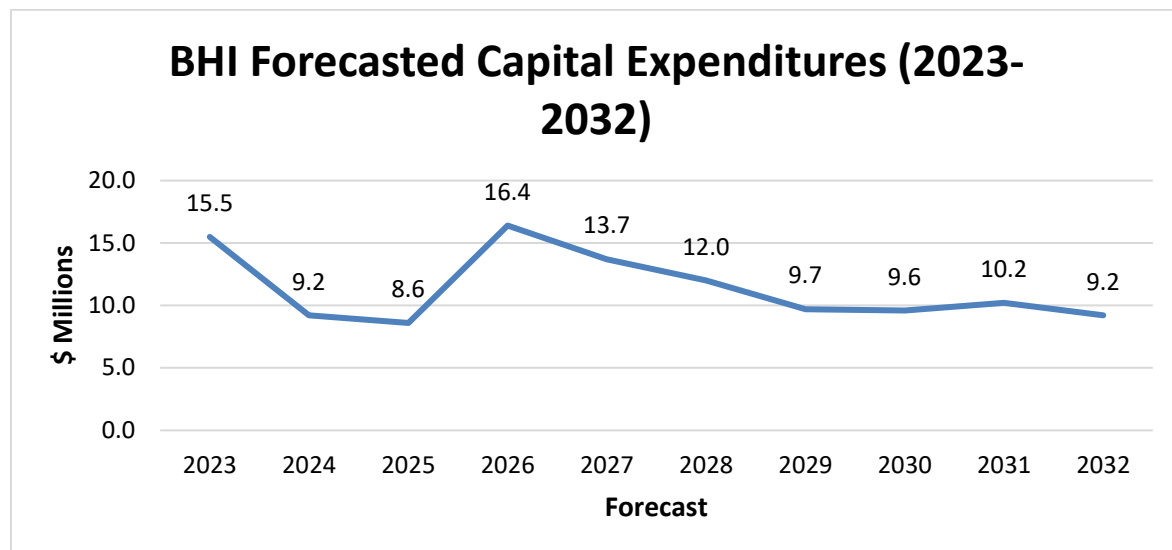
The renewal or retirement of Burlington Hydro's 4.16 kV substations is part of the annual review undertaken as part of the Asset Management strategy.

- Customer Connections and metering include meter installations, meter upgrades and the capital components of wholesale and retail meter verification activities.

There are also special projects which are outside the sustaining capital program. These are:

- Capacity improvements for new customer connections and increased demand of existing customers.
- Developer Buybacks which involve BHI purchasing new subdivision assets as they are put in place by developers.
- Regulatory Requirements which are system capital investments driven by regulatory requirements. These directions may come from the OEB, IESO (Independent Electricity System Operator), the Ministry of Energy or the Ministry of the Environment.
- The Metrolinx Go Transit electrification project is a cost recovery project which will allow BHI to recover costs of staff and resources deployed to the project.

Forecasted capital expenditures from the Business Plan are presented as follows:

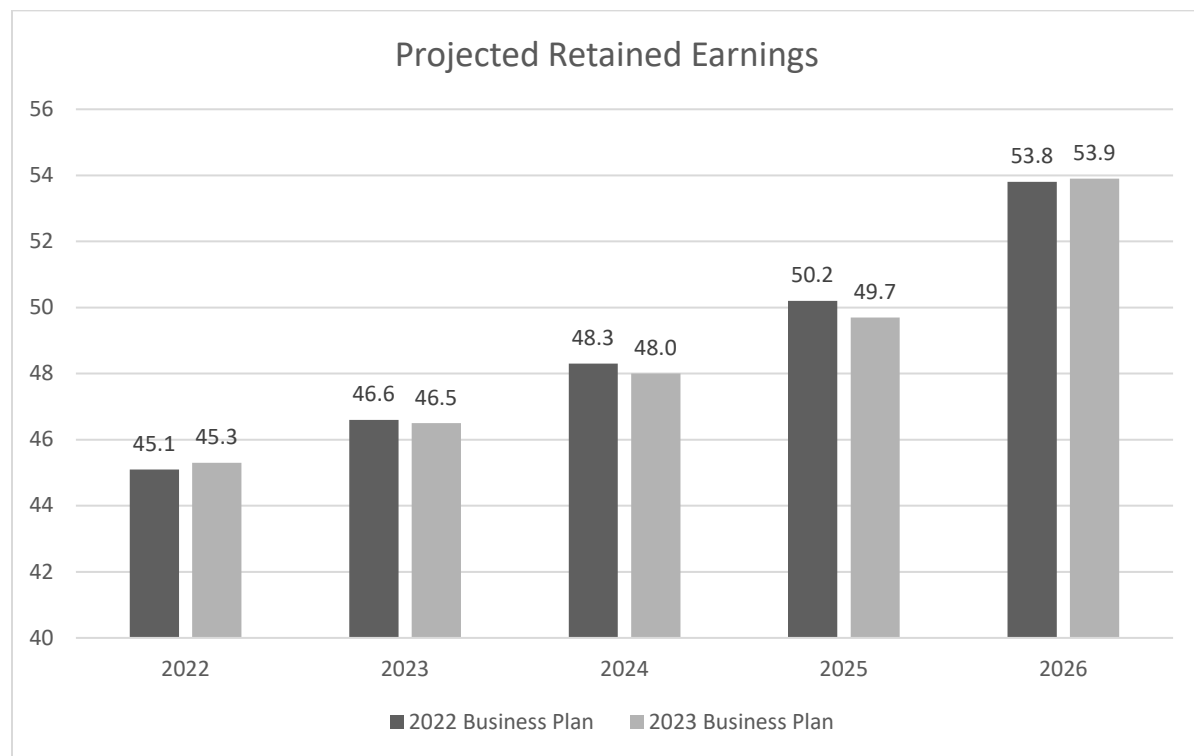


The 2023 capital budget has been developed using data from the asset management plan. The focus on maintaining the distribution system remains.

BALANCE SHEET

(I) Retained Earnings

BHI continues to forecast retained earnings growth that represents value of increased ownership in a larger company. The following chart illustrates retained earnings growth forecast in the first five years of the 2023 business plan:



(II) Long Term Debt

Funding has been in place with Infrastructure Ontario since 2010 for financing the Smart Meter program. This loan has a 15-year amortization period at a fixed rate of 4.51% maturing in 2026. A second loan that assisted with financing the Hydro One Transformer Station capital contributions has a 25-year amortization period at a fixed rate of 4.02% and will mature in 2038.

A third loan has a 15-year amortization period at a fixed rate of 3.63% maturing in 2033. The loan matches long-term funding against BHI capital expenditures including the true-up payment for the Tremaine transformer station and the two Tremaine breakers.

An additional \$10M of long-term debt is planned for 2023. This debt will be used to assist in financing the 2023 capital program.

Total outstanding debt at the end of 2023 is forecast to be \$25.6M.

The 10-year time horizon forecasts additional borrowings of \$20 million until BHI's next rebasing application in 2026 and \$90M over the forecast period. The company's capacity to borrow for capital projects is sound with a debt/capital structure within lender covenants.

The forecast also includes the costs of maintaining a \$20 million operating line of credit for working capital needs and an \$18 million letter of credit facility to cover prudential requirements related to the monthly power bill with the IESO.

BURLINGTON ELECTRICITY SERVICES INC. (BESI)

BESI is the sister company to the distribution company BHI. Unlike BHI, which is closely regulated by the OEB, BESI operates as an unregulated business. Its divisions include:

Festival of Lights Division: This division contains the annual costs of operating the Festival of Lights net of any sponsor donations.

Region Billing Division: Provides water billing services for the Region of Halton. The contract continues to contribute net income to the company.

Solar Array Division: Its revenues are derived from a solar array which was connected in 2012 to the City's Fire Hall 8. General maintenance of the array is the division's operating costs.

Electric Vehicle (EV) Charging Station Division: Installs charging stations for electric vehicles. Revenue is rental revenue from the stations. The program paves the way for key information on homeowner interaction with EV's and the electricity grid.

Mobile Turbine Co-Generator Division: This division holds the Mobile Turbine Co-Generator situated in the South Parking Lot of the Brant Street Office.

Control Room Division: This division provides control room monitoring for Milton Hydro.

Suite Metering Division: Provides suite metering services.

1328 Brant Street Building Rental: Leased office space to the City.

Operating expenses for BESI cover salaries and benefits, consulting services, legal services, promotion, and marketing costs. These are forecast to be unfavourable by \$44K.

Overall net income after tax is forecast to have a positive variance of \$10K. Unfavourable variances in the Electrical Vehicle Charging Stations and Suite Metering are offset by favourable variances in the other divisions.

Dividends

Annual dividends paid to the shareholder are composed of dividends from BHI operations, BHI working capital and BESI net income.

(in \$ Millions)	2023 Budget	2024 FCST	2025 FCST	2026 FCST	2027 FCST	2028 FCST	2029 FCST	2030 FCST	2031 FCST	2032 FCST
Dividends - BHI	2.3	2.1	2.1	2.1	3.2	3.2	3.3	3.4	3.7	4.0
Dividends - BESI	0.6	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6
Total Dividends declared to Shareholder	2.9*	2.5*	2.5*	2.5*	3.6	3.6	3.7	3.9	4.2	4.6

*Dividends declared are inclusion of special dividends not paid to the City. The 2023 budget includes a special dividend of \$288K for the Sustainability Plan Study to be conducted by BESI for the City. Included in the budget for 2023-2026 is a special dividend equivalent to the property lease with BEC for 1340 Brant as approved in report CM-27-22.

The increase in dividends starting in 2027 reflect expected revenues based on a cost of service application. The increase is not guaranteed and will be adjusted based on actual approval.

Shareholder Risks and Opportunities

(I) Regulatory/Political Risk

As a regulated business, BHI is subject to the direction of Government legislated boards and committees. The 2018 provincial change in government has impacted the utilities particularly in conservation demand management programs which have been centralized under the IESO. Incentives related to the demand management program are no longer paid to the local utilities. Issues related to electricity are expected to remain in the public view.

(II) Cost of Service Review

The OEB has established a five-year cycle in which the local distribution companies must undergo a full "cost of service" review. As a result of the 2014 cost of service review, the City was impacted by having the interest rate on the promissory note dropped from 5.87% to 4.88%. With the most recent rate application, the interest rate on the promissory note has reduced from 4.88% to 2.85% effective May 1, 2021. The original interest rate on the note

was 7.25%. The following outlines actual cash flow received by the City from BEC:

(in \$ Millions)	2015	2016	2017	2018	2019	2020	2021	2022
Dividends	2.5	3.6	2.6	3.4	2.6	2.6	2.4	2.4
Interest	2.3	2.3	2.3	2.3	2.3	2.3	1.6	1.4
Interest on RESF	0.7	0.7	0.6	0.5	0.4	0.3	0.2	0.1
Total	5.5	6.6	5.6	6.2	5.4	5.2	4.2	3.9

(III) Opportunities

It is through BESI, the unregulated company that the shareholder has opportunities for strategic initiatives. BESI has set out as part of its overall business strategy to pursue in-scope services and new business ventures. Services that might be pursued would be intended to minimize risk to the taxpayers while representing an opportunity to establish and/or enhance existing common or shared services. Working strategically with Hydro management presents the City with an opportunity to find creative solutions that will ensure fiscal sustainability.

(IV) ERM (Enterprise Risk Management)

In 2015 the Hydro Board gained an appreciation of ERM. A high-level risk management review identified the wide range of risks to which the BHI organization may be exposed. These were narrowed down to a list which was analyzed in more detail. They were examined for the risk profile, current state, and future considerations. This list; show below provides the framework for a Risk Management Plan. The 2023 business plan includes a full analysis of each of the identified risk areas.

- Safety
- Public Safety
- Aging Infrastructure
- Reliability-Systems issues
- Head Office Building
- Workforce Sustainability
- Reputational
- Financial
- Regulatory/Political

Execution of the plan will be important to the City as shareholder as it allows the Hydro Board and Management to manage risk for the organization.

Financial Matters:

As per the Hydro Business Plan as presented above the following are notable areas that will have an impact to the City's Hydro reserve fund.

First, is the decline in the dividend by \$200,000 annually which began in 2021. The City previously received an annual dividend of \$2.6 million and this has been reduced to \$2.4 million. Staff have been working with Burlington Hydro to put together a dividend policy to provide some stability to the annual amount received. The policy is expected to come forward for approval in Q1. It should also be noted that BEC has declared special dividends to the City when circumstances allow.

Secondly, is the interest that the City receives on its promissory note. Since 2014 the City has received an annual rate of 4.88% equating to an annual cash flow of \$2.3 million. The rate on the promissory note was reduced to 2.85% in 2021. This equates to an annual reduction of \$970,000 going forward. This rate is set by the OEB.

The City's Hydro reserve fund is an integral part of the City's capital infrastructure program. It provides \$2.1 million annually to support the annual capital renewal program. Furthermore, it is anticipated over the next five years to be providing for the annual average repayment of approximately \$2.0 million in debt charges on special circumstances debt towards major capital projects of varying types throughout the City. As well the reserve fund was relied on for City's storm allocation program until 2022 and is still relied on for direct cash contributions towards capital projects.

The Hydro reserve fund is closely monitored, and adjustments are made as required to ensure a sustainable reserve fund balance.

Total Financial Impact

Not applicable.

Source of Funding

Not applicable.

Other Resource Impacts

Not applicable.

Climate Implications

To prepare for the transition from the use of fossil fuels to electrification in the community to mitigate greenhouse gas emissions, City Council approved a direction (EICS-11-22) requesting Burlington Hydro complete a Climate Sustainability report to prepare for increased demand. The study will assess the impacts on the local grid of the growth in electric vehicles and charging requirements, the greening of corporate fleets, bi-directional charging, thermal energy (heat for buildings), energy storage, renewable energy and, increasing use of battery electric equipment (i.e., lawn mowers, leaf blowers, etc.). Also included in the request is an assessment of climate projections and the forecasted impacts of a changing climate on the local grid and to prepare for grid resiliency. City staff are liaising with and supporting Burlington Hydro on this initiative; the report is targeted for completion by the second quarter of 2024.

Burlington Hydro is an active member of the community stakeholder advisory committee for the City's Climate Action Plan and provides regular updates to the committee on activities related to becoming a net zero carbon community.

Engagement Matters:

Burlington Hydro has engaged in a Customer Value Proposition Campaign over the period of 2017-2020. The goals of the campaign are to deliver on four priorities:

1. Bring together various elements the company makes with customers/stakeholders to ensure a consistent "value proposition" message
 2. Engender trust and confidence across all stakeholder and customer audiences
 3. Extol the virtues of the value of electricity in our everyday lives.
 4. Engage all classes of customers and provide practical examples and success stories of how they deliver value back to the customer and through to the community.
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Conclusion:

As shareholder, the City has noted the commitment to risk management evidenced in this business plan. The City is appreciative of the efforts of the Board of Directors and Hydro Staff in continuing to manage this valuable City asset in a highly effective manner as reflected by the continued strong results forecast in the business plan and realized in the current year. The City's 10-year Capital Financing Strategy is heavily dependent on both annual dividends and interest on the note receivable.

Respectfully submitted,

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Notifications:

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Report Approval:

All reports are reviewed and/or approved by Department Director, the Chief Financial Officer and the Executive Director of Legal Services & Corporation Counsel.