

PROMISSORY NOTE

Recommendation

The Commissioner of Finance & Corporate Services in consultation with the City Manager and the Commissioner of Legal & Administrative Services & City Solicitor recommends:

- 1) That the City of Vaughan agree to defer eight quarterly interest payments on the existing promissory note for an initial period of 5 years, subject to the Board of PowerStream being satisfied with respect to any regulatory or other concerns; and
- 2) That the Mayor and City Clerk be authorized to execute the necessary documents; and
- 3) That PowerStream Inc., the Town of Markham and Vaughan Holdings Inc. be advised.

Economic Impact

Increasing the City's investment in PowerStream would increase investment returns to the City. Based on the current rate for Ontario Bonds, the increase in investment returns is estimated to be \$93,000 annually for a total of \$482,000 over five (5) years.

Purpose

To increase investment returns to the City and assist PowerStream in the funding of their new head office located in the City of Vaughan.

Background - Analysis and Options

PowerStream is building a new corporate head office in Vaughan. PowerStream advises that they prefer to fund no more than 35% of the cost of the land and building internally, and would require external financing to cover the balance. In February, 2006, the Board of PowerStream resolved that "management be directed to work with the Shareholders' staff to investigate financing options, including issuance of Shareholder mortgages, and that the Shareholder advise of their decision to proceed ...". For analysis purposes staff have assumed that the two (2) shareholders would finance 75% to 80% of the costs of the land and building.

The City of Vaughan currently holds \$78 million in the form of a promissory note issued by PowerStream at an annual interest rate of 5.58%. This equates to approximately \$4.3 million of annual interest to the City (paid in quarterly installments). The terms of this note are provided in Attachment 1.

The initial financing option that was proposed by PowerStream, was to issue an additional promissory note to the respective Holding Companies (i.e. the shareholder). The proposed promissory note would have a 5.58% annual rate of return, the same rate of interest as the current note with renewal periods every five years. At each renewal period, the interest rate would be subject to change in order to reflect current market conditions and the deemed interest rate as prescribed by the Ontario Energy Board (OEB).

Based on this proposal the promissory note would be between Vaughan Holdings Inc. (VHI) and PowerStream. VHI is taxable and therefore the interest would be treated as taxable income. The pre-tax interest of 5.58% would net to approximately 3.63% after-tax.

VHI has advised that they have limited funds available to invest. PowerStream is actively examining a number of new business opportunities while also continuing to examine the potential and economics of further growth in their core business. Equity investments in PowerStream currently earn a 9% after-tax rate of return. As such there may be a better utilization of VHI's funds than investing in PowerStream's new building and earning only 3.63%.

Ultimately rates of interest on promissory notes and other aspects of PowerStream's cost structure are subject to regulatory scrutiny. Creating a second note with a related party may raise issues. The following is an extract from the OEB's decision with respect to Toronto Hydro. On page 37 of its decision OEB ruled "the Board's responsibility is to ensure that rates are just and reasonable. That does not include ratepayers paying an additional \$16 million here in order that the City of Toronto can receive interest income from the utility at above market rates. The Board will accordingly, as of the effective date of this Decision, disallow as a regulatory expense any interest charges above the current market level".

Section 7.2 of the current promissory note between PowerStream and the City of Vaughan states that "in the event that payment of Principal or interest thereon is delayed, whether due to the above mentioned conditions of subordination or not, all outstanding amounts (including interest on unpaid interest) will continue to accrue interest at the rate set out in section 2.1 (5.58%) hereof until such time that the payments are remedied".

Alternatively under the structure of the current note the City can assist in the funding of the new building and earn the current rate of 5.58%. This could be achieved if the City agrees to permit PowerStream to defer the interest payments (on the \$78 million promissory note) payable to the City for 8 consecutive quarters (approx. July 2006 to April 2008). This would equate to approximately \$8.6 million that, if deferred would provide PowerStream with funds for the new building. Based on the wording of the current note, these deferred payments would be subject to a 5.58% interest "penalty". The City would be able to earn this interest tax-free since the City is not taxable and VHI would not be involved as an intermediary.

In order for PowerStream to effectively manage cash flows, it is recommended that the interest be deferred for an initial period of five years (i.e. from April 2008 to April 2013). During this period, the City would only be receiving the 5.58% interest on the deferred \$8.6 million. After this initial five year period, the City can decide to call the \$8.6 million or the City and PowerStream can decide to renew the arrangement depending on the terms and conditions of the existing promissory note.

FINANCIAL CONSIDERATIONS

The 5.58% annual return is approximately 108 basis points higher than a five year Ontario bond (as at May 16, 2006). Therefore, for every \$1 million invested in a promissory note, an additional \$10,800 in interest will be earned each year. After 2 years worth of interest payments are fully retained by PowerStream (i.e. \$8.6 million), the additional interest earned by the City (vs. a 5-year Ontario Bond) would be \$482,000 over a five year period.

It is important to note that allowing PowerStream to defer 8 quarters of scheduled interest payments (\$8.6 million) would not negatively affect the City. The City has funds it invests on an ongoing basis. Whether the City actually receives the payment each quarter or in five years, the recognition of interest revenue would be accounted for in a consistent manner. As such, the outstanding interest payments would simply be recorded as an interest receivable rather than cash.

Conclusion

It is recommended that the City of Vaughan assist in the funding of PowerStream's new head office by permitting PowerStream to defer eight quarterly interest payments (approx. July 2006 to April 2008) on the existing promissory note that are scheduled to be paid to the City of Vaughan for an initial period of 5 years, subject to the Board of PowerStream being satisfied with respect to any regulatory or other concerns.

Under the Shareholder Agreement this would be considered a related party transaction and requires the approval of both shareholders.

Attachments

Attachment 1 – Promissory Note

Respectfully submitted,

Clayton D. Harris, CA
Commissioner of Finance & Corporate Services

AMENDED AND RESTATED PROMISSORY NOTE

FOR VALUE RECEIVED, Amalco Hydro Distribution Inc. ("Amalco") hereby promises to pay to the order of The Corporation of the City of Vaughan (the "City"), the principal sum of Seventy-Eight Million. Two Hundred and Thirty-Six Thousand, Two Hundred and Eighty-Five dollars (\$78,236,285.00) (the "Principal"), together with interest on any and all amounts remaining unpaid thereon from time to time as specified herein.

SECTION 1: TERM

1.1 This Note has a term of 20 years, due May 31st 2024.

SECTION 2: INTEREST

2.1 This Note shall bear interest, from the date hereof, on the outstanding Principal amount at a rate per annum equal to 5.58%.

2.2 Interest is calculated daily, on the basis of a 365 day year, not compounding, and payable quarterly in arrears on the last business day of the month immediately following each of Amalco's fiscal quarters.

2.3 Interest payments are subject to the conditions of subordination described in section 4 hereof.

2.4 The interest rate may be adjusted from time to time as agreeable between the City and Amalco, in order to reflect current market conditions and the deemed interest rate as prescribed by the Ontario Energy Board.

SECTION 3: ACCELERATION

3.1 The City may at any time after January 01 2005 accelerate payment of all or part of the outstanding Principal, together with all interest accrued and unpaid thereon, without penalty, by way of written notice to Amalco no less than ninety (90) days in advance.

3.2 Any demand for accelerated payment is subject to and conditional on receiving confirmation from the Dominion Bond Rating Service Limited and from Standard & Poor's credit rating service (or their respective successors), that such repayment will not negatively affect the credit rating of Amalco.

3.3 Any demand for accelerated payment is subject to the conditions of subordination outlined herein.

SECTION 4: SUBORDINATION

4.1 The payment of the Principal and all interest on this Note is subordinated to the indebtedness issued by Amalco (or any predecessor of Amalco) to the Electricity Distributors Finance Corporation ("EDFIN") insofar as no such payment shall be made if and for so long as an Event of Default (as defined in the relevant series supplement to the Master Custodial Agreement) has occurred and remains outstanding.

4.2 The City further agrees to subordinate the indebtedness owed it hereunder to debt issued by Amalco from time to time to a financial institution or other third party for the purposes of Amalco or its subsidiaries on such terms as the lender may reasonably request

4.3 The City shall execute such documents as may be reasonably required by Amalco to evidence such subordination.

SECTION 5: ADJUSTMENTS

5.1 Adjustments, revisions, changes or restatements to this Note, including changes to the interest rate, may only be made if confirmation is received from Dominion Bond Rating Service Limited and Standard & Poor's credit rating service (or their respective successors), that such adjustments, revisions, changes or restatements will not negatively affect Amalco's credit rating.

SECTION 6: ASSIGNMENT

6.1 This Note is not assignable by the City without the consent of Amalco, which will not unreasonably withhold such consent.

SECTION 7: DEFAULT

7.1 An event of default will be deemed to have occurred at any time that Amalco fails to make payment of Principal or interest thereon when the same shall become due as herein provided, unless such failure is a result of the conditions of subordination set out in section 4 hereof, or is remedied by the applicable payment of Principal or interest within 30 days of the due date. In such an event of default, the holder of this Note may declare the entire Principal sum, together with all accrued and unpaid interest thereon, immediately due and payable.

7.2 In the event that payment of Principal or interest thereon is delayed, whether due to the abovementioned conditions of subordination or not, all outstanding amounts (including interest on unpaid interest) will continue to accrue interest at the rate set out in section 2.1 hereof until such time that the payments are remedied.

SECTION 8: DEFINITIONS

8.1 For the purposes of this Note:

- (a) "business day" means any day other than a Saturday, Sunday or any other day that is a statutory holiday in the Province of Ontario; and
- (b) "Master Custodial Agreement" means the master custodial agreement dated August 15, 2002 between Electricity Distributors Finance Corporation and Canada Trust Company.

SECTION 9: AMENDMENT AND RESTATEMENT

9.1 This Amended and Restated Promissory Note amends and restates the Promissory Note dated as of the 18th day of July, 2002 made by Hydro Vaughan Distribution Inc., a predecessor of Amalco, in favour of the City.

DATED as of the 1st day of June, 2004.

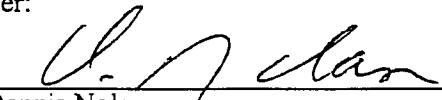
AMALCO HYDRO DISTRIBUTION INC.

Per:



Brian Bentz
President and Chief Executive Officer

Per:



Dennis Nolan
Executive Vice-President, Corporate
Services and Secretary