

Policy

Title: DISTRIBUTABLE FUNDS/DIVIDEND POLICY			Number: 0169
Reference: Administrative Committee - August 14, 2024 Corporate Services Committee - August 22, 2024	Adopted by City Council: October 7, 2024		Supersedes: Dividend Policy #0139 Land and Properties Dividend Policy #0153
	City Clerk/	Chief Administrative Officer	
Prepared by: FINANCE DEPARTMENT, CORPORATE SERVICES DIVISION			

STATEMENT

THE CITY OF MEDICINE HAT EXPECTS A FAIR AND REASONABLE RETURN FROM ITS INVESTMENT IN BUSINESS UNITS INCLUDING RATE-BASED UTILITIES, ENERGY PRODUCTION AND LAND DEVELOPMENT & REAL ESTATE.

THE DISTRIBUTABLE FUNDS/DIVIDEND POLICY ESTABLISHES A BALANCE BETWEEN TWO OBJECTIVES:

- (1) LONG TERM SUSTAINABILITY OF BUSINESS UNITS BY REINVESTMENT OF EARNINGS FOR SUSTAINING CAPITAL, MAINTENANCE OF EXISTING EQUIPMENT AND DEBT SERVICE AS WELL AS FINANCIAL RESERVES (OPERATING AND CAPITAL) TO FUND FUTURE GROWTH CAPITAL WHILE CONTINUING TO OPTIMIZE APPROPRIATE DEBT / EQUITY LEVELS FOR BUSINESS UNITS AND THE CITY,**
- (2) RETURN A REASONABLE AMOUNT OF EARNINGS TO THE CITY TREASURY TOWARDS FINANCIAL RESERVES (ENDOWMENT) AS WELL AS A DIRECT MUNICIPAL DIVIDEND TO THE CITY.**

PRINCIPLES

1. **Adherence to Statutory Requirements:** This Policy shall be governed by the Municipal Government Act and related City Bylaws.
2. **Ethical Conduct:** Business Units are committed to preserving and evolving the confidence and trust of the residents.
3. **Return on Investment:** Dividends provide fair and reasonable compensation to the City for capital committed and the associated risk of the investment.
4. **Sustainable Business Units:** Earnings to be retained at a level to account for all administration, operation, sustaining capital and maintenance costs of existing equipment required to provide the current level of service in each Business Unit.
5. **Long-Term Sustainability of the City Enterprise Business Units:** Distributable Funds to fund prudent Financial Reserves for financing of Operating, Capital, Abandonment Obligations, and Energy Transition, as well as Dividend support of City's tax supported operations in the form of a direct relatively sustainable dividend to the City.

ROLE OF COUNCIL

1. To receive, review and adopt this policy and any recommended amendments thereto.

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1. DEFINITIONS

- 1.01 Asset Retirement Obligation (ARO) - a legal obligation associated with the retirement of a tangible capital asset.
- 1.02 Business Units - includes the operations of Tax Supported, Rate-Based Utilities, Energy Production and Land Development & Real Estate.
- 1.03 Energy Production - Business Unit representing the integrated commodity-based operations (power generation and natural gas resources).
- 1.04 Cost of Land Sold - costs incurred to develop lots that were sold in the current year. These development costs would have occurred in a prior year.
- 1.05 Current Year Development Costs - costs incurred in the current year to develop lots for future land sales.
- 1.06 Free Cash Flow (FCF) - the cash generated after taking into consideration cash outflows that support operations and maintains capital assets.
- 1.07 Dividends - the amount of cash that the City receives as partial compensation for investments. For the City, not all earnings are paid in dividends; some are reinvested in the Business Unit(s), with the intention of producing additional future cash flow.
- 1.08 Fiscal Year - January 1 through to and including December 31.
- 1.09 Rate Based Utilities - Business Unit representing utility distribution systems (gas and electric including retail), and environmental utilities (water, sewer, and solid waste).
- 1.10 Land Development & Real Estate - Business Unit representing land development and real estate.
- 1.11 Tax Supported Operations - the activities of the City that are substantially supported by property tax revenues including Corporate Services Division, Public Services Division, Development and Infrastructure Division, Police Services, and General Government.
- 1.12 Working Capital - the amount of cash and other current assets a business has available after all its current liabilities are accounted for.

2. RESPONSIBILITIES

- 2.01 Administrative Committee
 - (a) Review and recommend changes to this policy.
 - (b) Review and approve the procedures related to this policy.

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2.02 City Manager/Chief Administrative Officer (CAO)

- (a) Notifies City Council of any market impacts that may adversely affect the asset value or profitability of the Business Units.
- (b) Provides regular updates to Council throughout the year of the actual total Distributable Funds/Dividend calculation and the estimated payment at year-end from the Business Units.
- (c) Review the calculation of Distributable Funds/Dividend payable from the Business Units.
- (d) Approve the Distributable Funds/Dividend allocation to Financial Reserves in accordance with Financial Reserves Policy #0168.

2.03 Business Unit Managing Directors

- (a) Review Business Unit financial information, sensitivity analysis and Free Cash Flow calculations from Finance Department to manage current level of service.
- (b) Provide relevant information on market impacts that may affect the asset value or profitability of the Business Unit.
- (c) Manage:
 - RateBased Utilities - Electric & Gas Distribution: management of the electrical and gas distribution, transmission and substation infrastructure providing long-term reliable and sustainable services. Environmental Utilities: provide safe, reliable and cost-effective services in a fiscal and environmentally responsible manner.
 - Energy Production- Gas Production: maximize the City's value through controlling costs, abandonments, optimizing production, and divestment. Electric Generation: provide safe, efficient, reliable electrical power at cost competitive rates.
 - Land Development & Real Estate - Maximize the cash flow generated by managing the Land & Properties portfolio as efficiently as possible while maximizing the future tax base.

2.04 Managing Director, Corporate Services/CFO

- (a) Review the calculation of Distributable Funds/Dividend payable from the Business Units.
- (b) Recommend the amount of Distributable Funds/Dividend transfer from each Business Unit.

2.05 Finance Department

- (a) Maintain a 10-year forecast of Free Cash Flow for each Business Unit and a consolidated forecast for the City.
- (b) At the end of the year, calculate the Free Cash Flow and make a recommendation to the Managing Director, Corporate Services/CFO on the allocation of the Distributable Funds/Dividend.
- (c) At the end of the year, distribute the Free Cash Flow amounts to the City Financial Reserves in accordance with Financial Reserves Policy 0168.
- (d) Provide analysis on the sustainability of the Free Cash Flow.
- (e) Provide sensitivity analysis on pro-forma income and cash flows for the Business Units.

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3. PROCEDURES

- 3.01 The annual Distributable Funds/Dividend shall be determined by the Free Cash Flow generated by Business Units. The Free Cash Flow will be allocated to City Financial Reserves in a tiered priority to ensure stability in operations and sufficient equity to meet capital requirements and long-term liabilities while also providing a relatively sustainable Dividend to the City.

Calculation of annual dividend from Business Units as follows:

Business Unit	Calculation	Recipient
Rate-Based Utilities	Free Cash Flow	Reserves in Tiered Priority
Energy Production	Free Cash Flow	Reserves in Tiered Priority
Land Development & Real Estate	Free Cash Flow	Reserves in Tiered Priority

- 3.02 Free Cash Flow framework - the Free Cash Flow will be calculated from each Business Unit's Statement of Cash Flows as follows:

	Net income
Plus	Non-Cash Expenses (depreciation, amortization, accretion, impairments etc.)
Plus/Minus	Change in current assets and current liabilities
Minus	Capital expenditures and ARO funded through the business unit's operations/working capital
Minus	Debenture principal payments
Minus	Gas production capacity (if applicable)
Equals	Free Cash Flow

- 3.03 The Free Cash Flow from each Business Unit will be allocated in a tiered priority in accordance with Financial Reserves Policy #0168 as follows:
1. Municipal Operations: Free Cash Flow will be allocated to the Tax Supported Business Unit as required to provide a source of sustainable Dividend funding for municipal operations.
 2. Capital Reserve Fund: Free Cash Flow allocated from Business Units to maintain adequate capital to support the funding of the City's capital requirements.
Debt-to-Equity Ratio: The funding of Capital will be based on continuing to optimize appropriate Debt-to-Equity levels for each business unit and the organization based on regulatory framework and industry peer information, notwithstanding the requirement to meet the legislated and City policy debt limits.
 3. Operating Reserve Fund: Free Cash Flow allocated from Business Units to maintain a Minimum level -10% of annual municipal expenditures (excluding non-cash items) and/or a Target/Optimum level - 30% of annual municipal expenditures (excluding non-cash items).
 4. Medicine Hat Endowment Fund: Free Cash Flow allocated from Business Units to maintain a target balance of \$200 million.

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5. Abandonment Obligations Reserve: Free Cash Flow allocated from Business Units to maintain adequate funds over time to support funding of the City's asset retirement obligations.
6. Energy Transition Reserve: Free Cash Flow allocated from Business Units to maintain adequate funds over time to support funding to achieve a net-zero emissions target as prescribed by the provincial and federal government.

4. APPENDICES

None

