TO: Chair and Members Audit, Finance & Administration  
WARD(S) AFFECTED: CITY WIDE  

COMMITTEE DATE: May 18, 2011

SUBJECT/REPORT NO:  
Hamilton Conservation Authority Pension Deficit Loan (FCS11044) (City Wide)

SUBMITTED BY:  
Roberto Rossini, General Manager Finance & Corporate Services

PREPARED BY:  
Charlie Elliott (905) 546-2424 ext. 2162

SIGNATURE:

RECOMMENDATION:

(a) That a loan to the Hamilton Conservation Authority (HCA), in an amount not to exceed $1,500,000, for the purpose of funding HCA’s Defined Benefit Pension Plan deficit, be approved;

(b) That the loan to the Hamilton Conservation Authority (HCA), to fund HCA’s Defined Benefit Pension Plan deficit and in an amount not to exceed $1,500,000, be for a term of 10 years at a 4.25% rate of interest;

(c) That staff be directed to prepare a Loan Agreement between the City of Hamilton and the Hamilton Conservation Authority, respecting the loan for HCA’s Defined Benefit Pension Plan deficit, in a form satisfactory to the General Manager, Corporate Services and the City Solicitor;

(d) That the Mayor and Clerk be authorized and directed to execute the Loan Agreement, between the City of Hamilton and the Hamilton Conservation Authority, respecting funding for the HCA’s Defined Benefit Pension Plan deficit;
(e) That the Item, respecting the Loan to the Hamilton Conservation Authority, be considered complete and removed from the Audit, Finance and Administration Outstanding Business List.

**EXECUTIVE SUMMARY**

In 2006, the Hamilton Conservation Authority (HCA) deemed their Defined Benefit Pension Plan to be unaffordable, and is in the process of winding it up and replacing it with a Defined Contribution Plan. The Defined Benefit Plan has been closed to new entrants since 2006 and was frozen on March 31, 2010, at which time all participants were moved to a Defined Contribution Plan. In order to wind-up the Defined Benefit Plan the existing plan’s deficit must be funded.

If the Defined Benefit Plan were not to be wound-up, ongoing costs to administer and report to the Pension Commission would continue to be incurred. Should the Plan not be wound up by June 30, 2011, another round of the Plan’s valuation would be required which would incur additional costs as well.

The HCA Defined Benefit Pension Plan has been in a deficit position for the past 5 years. The most recent actuarial estimate of the Pension Plan deficit calculated by Actuarial Solutions Inc. as of June 30, 2010 was $2,708,300. Appendix A to Report FCS11044 is the Executive Summary from the June 30, 2010 actuarial report providing the Financial Position of the Plan. It should be noted HCA is required to make annual payments to fund the Plan’s deficiency over a period not exceeding five years, or until such time the Plan is fully funded, whichever is shorter. HCA made a payment of $581,000 in December 2010, reducing the deficit to approximately $2.1 million.

HCA has sold a property, from which the proceeds of the sale in the amount of $1.061 million will be used to pay a portion of the deficit. Based on the February 28th, 2011 market value of the pension plan assets and the estimate of total wind-up liabilities, it is estimated the total loan required to fund the remaining shortfall would be approximately $1.25 million. The recommended upset loan amount of $1.5 million is to allow for market movement and unanticipated wind-up costs between now and when the pension plan is retired.

The actual amount of the loan would be the minimum amount required to retire the pension plan liability, which will be calculated as of the date the pension plan is wound up.

*Alternatives for Consideration – See Page 4*
FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: HCA currently pays $380,000 annually towards funding the pension deficit. The annual loan payments would amount to $187,245 annually, based on a $1.5 million loan for 10 years at 4.25% interest, and therefore can be accommodated within HCA’s existing operating budget by reallocating the pension deficit funding to paying off the loan. The balance of the $380,000 (approximately $193,000) is required to fund the employer portion of the Defined Contribution Plan which is replacing the Defined Benefit Plan.

The loan to the HCA would be reflected as a Loan Receivable on the City’s Balance Sheet.

Staffing: N/A

Legal: N/A

HISTORICAL BACKGROUND (Chronology of events)

At its November 5, 2009 meeting, the HCA Board of Directors approved the following motion: “That the City of Hamilton be requested to provide a loan of up to $1,500,000 to eliminate the deficit for the Defined Benefit Pension Plan”.

HCA’s loan request was considered at the May 19, 2010 Audit and Administration Committee and the following resolution was approved: “That staff be directed to investigate the possibility of entering a loan agreement with the Hamilton Conservation Authority for the purposes of paying off their pension deficit”.

The City’s share of the HCA’s levy requirement is 99.7%.

POLICY IMPLICATIONS

The City’s internal borrowing policy specifies that the internal borrowing interest rate be the equivalent of the City’s external borrowing rate at the time of borrowing. The City’s External Loan Guideline provides for a 0.25% administration fee to be added to the interest rate. Therefore the interest rate on the loan is recommended to be 4.25%, the City’s external borrowing rate for a 10 year term plus 0.25%.

Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.

Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork
The HCA Defined Benefit Plan has been in a deficit position for the past 5 years, requiring annual payments by HCA of $380,000 toward the deficit. Since deeming the Defined Benefit Plan unaffordable, the HCA has moved to a Defined Contribution Plan. In order to wind-up the old Defined Benefit Plan the existing deficit must be paid.

HCA has limited ability to raise funds from other sources and therefore requires a loan from the City to fund the pension deficit.

The most recent actuarial estimate of the plan deficit calculated by Actuarial Solutions Inc. as of June 30, 2010 was $2,708,000. HCA made a payment of $581,000 in December 2010, reducing the deficit to approximately $2.1 million. Interest rate fluctuations and general market conditions impact the valuation of the pension plan, therefore the amount of the deficit will fluctuate until such time as the Plan is wound-up. HCA has sold a property, from which the proceeds of approximately $1.06 million will be used to pay a portion of the deficit; however HCA requires the additional funds in the form of a loan from the City to retire the deficit in its entirety.

HCA will borrow only the amount of funds required to retire the deficit. The actual loan amount required will be calculated as of the date the Defined Benefit Plan is wound-up. Due to market fluctuations it is impossible to calculate what the actual deficit will be at the wind-up date, however it is anticipated the actual loan required from the City will be significantly less than the $1.5 million upset limit on the loan being recommended for approval in this report FCS11044.

Do Not Provide the Loan
Section 3(5) of The Conservation Authorities Act authorizes Conservation Authorities to borrow funds on an interim basis until such funds are levied to and received from a participating municipality. Should HCA borrow from an outside institution to fund the pension deficit, HCA could then levy the full amount of the deficit (up to $1.5 M) to the City of Hamilton. The City would then be required to fund the full amount of the deficit.
SUBJECT: Hamilton Conservation Authority Pension Deficit Loan (FCS11044) (City Wide) - Page 5 of 5

up front, and would not directly recover the funds from HCA, over time. The City’s share of the HCA’s levy is 99.7%.

By loaning the funds to HCA as recommended in Report FCS11044, the funds will be recovered from HCA by way of loan repayments which can be accommodated within HCA’s 2011 operating budget.

Pros
- Avoids administration of a 10 year loan agreement
- HCA reduces interest costs by funding the pension deficit upfront

Cons
- Raises the City’s upfront costs because we would effectively pay for the pension deficit (99.7%) through the levy process
- Reduces the City’s interest revenues

CORPORATE STRATEGIC PLAN (Linkage to Desired End Results)


Financial Sustainability
- Financially Sustainable City by 2020
- Delivery of municipal services and management capital assets/liabilities in a sustainable, innovative and cost effective manner
- Address infrastructure deficiencies and unfunded liabilities

Intergovernmental Relationships
- Maintain effective relationships with other public agencies

APPENDICES / SCHEDULES

Appendix “A” to Report FCS11044
At the request of Hamilton Conservation Authority we have prepared an actuarial valuation of the Pension Plan for Employees of Hamilton Region Conservation Authority reflecting the Wind-up of the Plan as at June 30, 2010. The key results of this valuation are summarized below.

2.1 FINANCIAL POSITION

The financial position of the Plan as at June 30, 2010 (the Wind-up Date) is shown below:

<table>
<thead>
<tr>
<th></th>
<th>June 30, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Market Value of Assets</td>
<td>$8,530,100</td>
</tr>
<tr>
<td>Prepaid Benefit Payments</td>
<td>29,500</td>
</tr>
<tr>
<td>Expense Provision</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$8,559,600</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Commuted Value Elections</td>
<td></td>
</tr>
<tr>
<td>Active Wind-up Members</td>
<td>$2,202,900</td>
</tr>
<tr>
<td>Disabled Wind-up Members</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Commuted Value Liab.</strong></td>
<td>$2,202,900</td>
</tr>
<tr>
<td>Annuity Purchase Elections</td>
<td></td>
</tr>
<tr>
<td>Active Wind-up Members</td>
<td>$4,128,700</td>
</tr>
<tr>
<td>Disabled Wind-up Members</td>
<td>263,700</td>
</tr>
<tr>
<td>Deferred Vested Members</td>
<td>233,900</td>
</tr>
<tr>
<td>Retirees Members and Beneficiaries</td>
<td>4,438,700</td>
</tr>
<tr>
<td><strong>Total Annuity Liab.</strong></td>
<td>$9,065,000</td>
</tr>
<tr>
<td>Total Wind-up Liabilities</td>
<td>$11,267,900</td>
</tr>
<tr>
<td>Wind-up Excess (Deficiency)</td>
<td>($2,708,300)</td>
</tr>
<tr>
<td>Wind-up Funded Ratio</td>
<td>0.76</td>
</tr>
</tbody>
</table>

The Wind-up Deficiency will change as a result of changes in long-term interest rates and investment performance from the Wind-up Date to the ultimate settlement date. The Wind-up Deficiency will also change as a result of member elections of commuted values or annuities different than those assumed. The Wind-up Liabilities for Plan members who are assumed to elect a lump-sum settlement are credited with interest between the Wind-up Date (or their termination date) and the first day of the month of the settlement date based on the prescribed interest rates. Final Wind-up Liabilities for Plan members who will have annuities purchased on their behalf will be determined when the annuities are purchased.

Based upon the above and the current asset mix of the Plan, we note that the Wind-up Deficiency may change materially after the Wind-up Date.
2.2 REQUIRED CONTRIBUTIONS

Pursuant to Section 75 of the Pension Benefits Act, the Wind-up Deficiency as at June 30, 2010 must be funded by equal payments, payable annually in advance, over a period not exceeding five years. The amount of the annual payment in a particular year cannot be less than the minimum special payment required in 2010 (i.e. $220,908 as specified in the December 31, 2009 valuation report).

As of the Wind-up Date, the minimum annual special payment required to fund the Wind-up Deficiency is $587,979 payable annually in advance for up to five years or until such earlier time as the Plan is fully funded. This minimum annual special payment amount will be recalculated on an annual basis.

No payment of commuted values or purchase of annuities can occur before the Wind-up report is approved by the Financial Services Commission of Ontario and the Wind-up Deficiency is funded.

It is our understanding that the Company intends to fully fund and settle the benefits in the Plan after receiving approval from the Financial Services Commission of Ontario. However, until the Wind-up Deficiency has been fully funded annual updates of the Wind-up position must be filed with the Financial Services Commission of Ontario in accordance with the Pension Benefits Act. These annual updates may adjust the minimum annual special payment required to fund the remaining Wind-up Deficiency.