Q/A Response – Estimates

Q. Minister, when we were last here, the Deputy Minister was trying to provide some insight into the $4 billion dollar interest cost estimate from the Financial Accountability Officer's report on Ontario's Fair Hydro Plan.

I was hoping the Deputy Minister could provide the answer that he was attempting to provide last Wednesday and also explain why Ontario Power Generation (OPG) is best qualified to manage the debt obligations?

First, I would like to point out that the $4 billion figure was an estimate made by the Financial Accountability Office (FAO) based on initial Ministry of Energy forecasts of total debt and interest levels for Ontario's Fair Hydro Plan from March 2017.

Subsequent analysis conducted by the Ministry of Energy found that the debt and interest levels are now expected to be substantially lower.

Initial total debt and interest was original forecast at $27.7 billion, but was revised downward substantially to $18.5 billion.

These updated estimates reflect refinements of a number of variables, including the cost of borrowing and electricity system cost forecasts.

I would also note that a number of variables, including interest rates, electricity demand and electricity costs, will vary over the 30-year life of the program and cost estimates will continue to be revised to reflect these changing conditions.

The FAO report itself concludes by saying "the FAO's estimates are subject to many assumptions and uncertainties … Fiscal impact may differ significantly from the FAO's estimates."

While the total cost of the program has already been revised downwards substantially to reflect revised inputs, I would like to take a moment to discuss the methodology behind the FAO's analysis. The FAO simply took an estimated cost of borrowing for the Ontario Financing Authority (OFA) and Ontario Power Generation (OPG) and applied to the difference to debt estimates based on Ministry of Energy data from March.

This analysis ignores the policy intent of Ontario's Fair Hydro Plan, which to ensure that the same group of ratepayers receive the benefit and pay the costs associated with the plan.

Based on this policy decision, it was decided that the debt obligation would be recognized as a regulatory asset that would be sold and securitized. This design appropriately aligns the costs and benefits within the group of eligible consumers.

Ontario Power Generation (OPG) has been identified as the Financial Services Manager (FSM) responsible for the financing plans and the financing entity (known as the Fair Hydro Plan Trust) that will manage the debt obligations.

OPG has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA) and will ensure that it is done in an efficient and cost-effective manner.

I would now like to invite Ken Hartwick from OPG to elaborate on the structure and speak to OPG's qualifications and its plan to keep costs down.

[Deputy passes of to Ken Hartwick to elaborate on the structure and speak to OPG's qualifications and plan to keep costs down]

Let me make a few remarks about OPG's qualifications as the financing manager of the Fair Hydro Plan:

OPG currently manages an $18 billion nuclear fund and as an entity regulated by the Ontario Energy Board (OEB), OPG also has extensive experience with regulatory deferral and variance accounts.

OPG has the breadth and demonstrated track record in the financial markets including the highly successful inaugural public debt offering earlier in October, private placement of insurance linked bonds, participation in securitization programs, and the very successful project debt issuances tied to new hydroelectric developments.

These financing initiatives have been well received by investors at a reasonable cost to OPG. The innovative, cost saving and precedent setting aspects of these financing structures have resulted in international recognition.

OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing the Fair Hydro initiative. For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.

In terms of administration, OPG is currently managing its own Corporate public debt and three project financing programs totaling more than $2 billion, as well as two commercial paper programs.

Q. What is OPG's Role?

OPG will be acting as the Finance Service Manager (FSM) as prescribed under the Ontario Fair Hydro legislation, basically arranging for a variety of debt financing for the deferred costs.

We will be setting up a financing entity in the form of a "Trust", which is ring fenced from the generation activities of OPG in an effort to reflect the unique nature of this business and not co-mingle the operational activities of the two businesses.

The financing requirements are determined by the legislation and the reduction in consumers' bills and will be funded through the Trust.

OPG will arrange for third party debt, supplement this funding with the Province, and OPG will contribute additional funds through increased equity and debt of the OPG operating company that will be lent to the Trust, also at equivalent market rates.

OPG is uniquely positioned to be the financing manager of Ontario's Fair Hydro Plan as we understand the supply and demand characteristics of the market. As previously mentioned, we regularly interact with the Ontario Energy Board (OEB), the Independent Electricity System Operate (IESO) and we have experience in Treasury operations in the marketplace including relationships with credit rating agencies.

Q. What is the difference between the Province Borrowing Program and Fair Hydro Trust (FHT) borrowing program?

A simple comparison between direct borrowing by the Province and OPG's role in Ontario's Fair Hydro Plan is a bit of an "apples to oranges" comparison.

A conventional Provincial borrowing program would raise funds based on the credit worthiness of the Province and the Provincial Guarantee.

Under Ontario's Fair Hydro Plan, lenders will provide funds based on the underlying value of the specific asset. This value is created by the legislated framework rather than through a Provincial Guarantee.

Ontario's Fair Hydro Plan will create a series of deferred assets that will have certain cashflow payment streams going forward. The overall objective of Ontario Fair Hydro Plan is to spread the costs and benefits out. The financing has to be actually linked to the overall payment scheme going forward and aligned with the benefits.

Consequently, the financing actually lends itself toward a "securitization" structure with cash flows matched to specific benefits rather than as a conventional borrowing program.

Q. Why is OPG best placed to minimize the cost of the overall program?

The Ontario Power Generation (OPG) has the expertise and experience to manage this securitization program. The Ontario Financing Authority (OFA), does not, as far as I am aware, have direct experience in setting up or managing a securitization vehicle or program.

This combination and diversity of skills position OPG to ensure an effective funding arrangement is put in place that clearly defines the electricity ratepayer in context of the person receiving the initial benefit of the legislation.

As we work through the financing program for Ontario’s Fair Hydro Plan, OPG is focused on ensuring that financing is optimized to minimize costs to ratepayers.

In particular, attention has been given to achieving a strong credit rating for the Trust, again, with the objective of mitigating the impact to ratepayers through effective market pricing of the funds being borrowed by the Trust.

Finally, OPG’s Treasury function is well positioned given its experience in developing structured financing programs and in managing multiple existing debt platforms.