Fwd: IESO ability to issue debt and raise capital

From: Kim Marshall <kim.marshall@ieso.ca>
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For discussion....

Sent from my iPad

Begin forwarded message:

> **From:** Pelino Colaiacovo <pcolaiacovo@morrisonpark.com>
> **Date:** February 6, 2017 at 6:51:43 PM EST
> **To:** Kim Marshall <Kim.Marshall@ieso.ca>
> **Subject: IESO ability to issue debt and raise capital**

Kim,

As we discussed, I believe that given appropriate legislative amendments, the IESO would be fully capable of issuing debt under its own name and raising capital in the quantities being considered by the Province.

As you know, the old OPA received a credit rating from a number of credit rating agencies, and that credit rating has carried over to the IESO. The rating was necessary because the IESO/OPA is the counterparty to many contracts, and the lenders to the contracted parties insist on the comfort of an investment grade counterparty to contracts. The IESO's current credit rating is based on its legislated ability to recover its costs from ratepayers. Moody's currently rates the IESO as Aa2 (the same as the it rates the Province of Ontario), and DBRS currently rates the IESO A(high) (which is one notch below the current rating it gives to the Province of Ontario, which is AA).

If the IESO's governing legislation were amended so that it did not have to clear its settlement accounts on a monthly basis, and instead it gained the ability to issue debt in order to defer some of its collections from ratepayers, then its credit rating would be reviewed by the credit rating agencies. They would have to take into account the likelihood of those bonds being paid over time. My opinion is that the credit rating agencies would continue to recognize the IESO's ability to recover its costs, whether on a monthly basis, or on a deferred basis. It may be that one or both of the credit rating agencies choose to adjust the IESO credit rating downwards, but it would be highly unlikely that they would move the rating by more than one notch.

If the IESO were issuing bonds on its own, it is quite likely that there would be a spread between its bonds and those of the province. Depending on the risk curve at the time of issuance, IESO bonds would cost some number of basis points more than bonds of the province. This would make them very attractive to investors, in the same way that Ontario bonds are attractive to investors as compared to Canada bonds (given that Ontario bonds are issued at higher interest rates than Canada bonds with the same terms). Ontario issued approximately $40 billion in bonds in 2014, and $35 billion in 2015 (comprised of both new debt, rollovers and infrastructure debt). There appears to be no reason why capital markets would not be interested in new debt issues from an entity like the IESO, if its legislative ability to recover its costs from ratepayers over time is completely clear and unambiguous.

Prior to making any final decision on this matter, the Province or one of its representatives could get in touch with one or more major bond dealers (such as the big five banks) to gauge the appetite for a new category of bonds coming from the IESO (or some other similar entity). I would expect a positive reception, given the popularity of bonds from such entities as Hydro Quebec, Manitoba Hydro, BC Hydro, and the like. In addition, it is also notable that most of the larger electricity distributors in Ontario either have bond issues of their own (like Hydro One and Toronto Hydro), or have private placement debt at similar rates (like the new Alectra, Ottawa Hydro, etc.). [Note that Hydro One has a DBRS credit rating of A(High), which is the same as the IESO's current credit rating, whereas Moody's rates Hydro One as A3, which is two notches below the IESO]. Given that these entities depend on a regulatory system for their ultimate credibility with the capital markets, and that regulatory system also depends on the same legislation as the IESO, there is no reason to believe that the IESO would be unable to access the debt markets.

Best,

Pelino Colaiacovo

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