Q&A: OPG OFHP Debt Offering
Ministry of Energy
Key Messages/Questions and Answers
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KEY MESSAGES:

- **The government has been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher bills. Nearly $70 billion[1] has been invested in the electricity system since 2003, including more than $37[2] billion in electricity generation to ensure the system is clean and reliable.**

- **Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the province's history.**

- **OFHP has lowered electricity bills by 25 per cent on average for residential consumers and will hold increases to the rate of inflation for four years. The plan includes the 8 per cent rebate, equivalent to the provincial portion of the HST, introduced in January 2017 and builds on previously announced initiatives to deliver broad-based rate relief on all electricity bills. As many as half a million small businesses and farms are also benefitting from a reduction.**

- **In order to ensure the cost of investments in the electricity system are allocated fairly amongst current and future ratepayers, a portion of Global Adjustment (GA) costs is being refinanced.**

- **Ontario Power Generation (OPG), as the Financial Services Manager for GA refinancing, is responsible for raising funds to finance the deferred costs.~~, and~~ OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.**

- **The government will continue to identify and implement initiatives to take costs out of the electricity system, which would reduce the cost of the GA refinancing program.**

[1] Ministry of Energy, *2017 Long-Term Energy Plan*
[2] Ministry of Energy, *2017 Long-Term Energy Plan*

Qs and As

Q. Is the government pleased with the result of second offering of debt in the capital markets?

OPG's successful second issuance of secured debt in relation to Ontario's Fair Hydro Plan is a positive sign that our plan is working.

Q. What was the result of the first debt offering in February?

On February 6, 2017, OPG announced that it was able to secure an interest rate of 3.357 per cent for the senior debt on the first issuance that has a 15 year term and a value of $500 million.

- According to the Ontario Financing Authority (OFA), this represents a spread of 23 basis points over Ontario long-term debt (per an OFA email from February 2, 2017).

On February 8, 2017, OPG advised that the remainder of the debt is split between $382 million of "subordinated" debt at an interest rate of 3.637 per cent and $98 million of "junior subordinated" debt at 3.957 per cent. The effective interest rate of 3.526 per cent is the weighted average of these three series of debt (i.e., senior, subordinated and junior subordinated).

Q. Why did the government introduce Ontario's Fair Hydro Plan?

The government has been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher bills. Since 2003, nearly $70 billion[3] has been invested in the electricity system, including more than $37[4] billion in electricity generation to ensure the system is clean and reliable.

Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the province's history. OFHP lowered electricity bills by 25 per cent on average for residential consumers and will hold increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting from a reduction.

To address the impact of our electricity system investments on consumers, Ontario's Fair Hydro Plan includes:

- Refinancing the Global Adjustment (GA) over a longer term period for Regulated Price Plan (RPP) eligible consumers, including families, small businesses and farms.

- Helping vulnerable electricity consumers by enhancing electricity support programs and shifting costs off the electricity bill. Eligible consumers will receive additional funding through assistance programs including:
  - Establishing a new Affordability Fund which will support Ontarians who are not eligible for the Home Assistance Program and who have difficulty paying their electricity bills.

~~[3] Ministry of Energy, *2017 Long-Term Energy Plan*~~
~~[4] Ministry of Energy, *2017 Long-Term Energy Plan*~~

- o Broadening Rural or Remote Rate Protection (RRRP) to provide distribution charge relief for the customers of the local distribution companies (LDC's) with the highest distribution charges.
- o Expanding the Ontario Electricity Support Program (OESP) to increase participation and provide further assistance to eligible participants.
- o Establishing a new On-Reserve First Nations Delivery Rate.

- Improving sector efficiency and modernizing Ontario's electricity market, working in collaboration with the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

- Any rate increases over the next four years will be held to the rate of inflation.

In the development of Ontario's Fair Hydro Plan, the government made the decision to provide rate relief to specific residential consumers through the introduction of new and enhanced electricity social programs, such as OESP and RRRP. At the same time, the government also made a policy decision that these new measures would be more appropriately funded from the tax-base, not the rate-base.

If pressed on the cost of these new and enhanced social programs:

On March 2, 2017, the government publicly announced the enhancement of the existing OESP and RRRP program and the new Affordability Fund and on-reserve First Nations delivery credit. At the time, the government indicated that these new measures would cost the government up to $2.5 billion over the next three years.

Q. Why is the government refinancing the Global Adjustment? It seems like an overly complex way to provide lower electricity rates.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. The majority of the province's electricity generators have 20-year contracts. Many of these generators will be able to operate past their contract term, meaning that generating assets are expected to have ongoing useful life and will benefit future ratepayers by reducing the need to finance the development of new generating assets.

Electricity bills have been reduced for current ratepayers, and future ratepayers will in turn pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Given that the policy objective of OFHP is to more fairly allocate the cost to ratepayers over the useful life, not the contractual term, of electricity generating assets, it was a primary policy objective to ensure that the costs are borne by the beneficiaries of the electricity system – the rate-base – not the tax-base.

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 electricity consumers.

In developing the policy to refinance the GA, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

OFHP operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. What is Global Adjustment (GA)?

Global Adjustment (GA) is a mechanism that recovers certain electricity system costs, such as capital costs incurred by generators. GA is calculated by the Independent Electricity System Operator (IESO) based on the difference between the market price for electricity, which represents the marginal cost of electricity production, and rates paid to regulated and contracted generators to ensure they can recover their fixed costs. It also recovers costs associated with running conservation programs in the province.

GA has been an important factor in providing stable prices while ensuring that sufficient generating capacity is in place to deliver a reliable supply of electricity.

GA pays for the bulk of the recent investments in the electricity system. The majority of the province's electricity generators operate under 20-year contracts. Third-party experts have confirmed that many of these generators will be able to continue to operate beyond the end of their contract. This means that generating assets are expected to have ongoing useful life and benefit future ratepayers by reducing the need to finance the development of new generating assets.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. This more fairly shares the cost of our investments across present and future generations of electricity ratepayers who will benefit from them.

Q. Has the Ministry of Energy's estimate for "peak debt" related to Ontario's Fair Hydro Plan (OFHP) changed? How much is the program expected to cost?

OPG, as the Financial Services Manager for GA refinancing, is responsible for raising funds to finance the deferred costs. While total borrowing costs will not be known until the program is complete, accumulated interest is projected to be considerably less than original estimates.

A number of variables, including interest rates, electricity demand and electricity costs, will vary over the thirty-year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions.

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about $28 billion[5] to approximately $20 billion[6]. These estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manager (FSM) and assume a 5 per cent interest rate.

[5] Ministry of Energy
[6] Ministry of Energy

Q. Why is the government using OPG as a borrowing agent for Ontario's Fair Hydro Plan? Would it be easier to use a traditional government borrowing agent like the Ontario Financing Authority (OFA)?

OPG has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA).

OPG currently manages approximately $20 billion[7] in segregated nuclear funds to manage nuclear liabilities, and, is an electricity sector entity regulated by the Ontario Energy Board (OEB) with extensive experience with regulatory deferral and variance accounts.

OPG also has the breadth and demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization programs and highly 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 structures have resulted in international recognition.

OPG has developed solid investor relationships and has a large investor base in the structured finance space that would be the target market for financing Ontario's Fair Hydro Plan initiative. For example, Lower Mattagami project financing attracted a broad investor base of ~80 institutional investors[8], including major investors in the Canadian power and utility bonds market.

In terms of administration, OPG is currently managing its own Corporate public debt program and three project financing programs totalling more than $2 billion[9] and two commercial paper programs.

Finally, OPG's Treasury functions are well positioned given their management of existing multiple debt programs.

Q. In its role as Financial Services Manager for the Fair Hydro Trust, how much did OPG spend on outside consultants and other third parties to help execute the first tranche of debt? Or did OPG already have the expertise within its organization to complete the transaction?

OPG was identified as the FSM responsible for producing financing plans and for establishing the financing entity (i.e., Fair Hydro Plan Trust) that manages the debt obligations.

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

For example, OPG currently manages approximately $20 billion in segregated nuclear funds to manage nuclear liabilities, and has extensive experience with regulatory deferral and variance accounts. OPG also has a demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization programs and highly successful project debt issuances tied to new hydroelectric developments.

~~OPG~~ OPG has advised costs were incurred for external legal, financial and accounting advisors in order to set up the program and issue the inaugural bond for the Fair Hydro Trust in the most cost-

[7] Ontario Financing Authority
[8] Ontario Power Generation
[9] Ontario Power Generation

effective and efficient way possible, including ensuring an optimal credit rating to reduce the cost of the program.

According to OPG, costs for external advisors are expected to decrease moving forward.

OPG has committed to ensuring the Fair Hydro Trust is managed transparently, and reports publicly on the Trust through its quarterly financial statements. OPG's financial reports are also filed with the Ontario Securities Commission (OSC) and are subject to OSC oversight.

Further questions on OPG spending should be directed to OPG.

Q. Does OPG make money running the Fair Hydro Trust?

OPG was identified as the Financial Services Manager that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

Under the *Ontario Fair Hydro Plan Act, 2017* (the "Act") and associated regulations*,* OPG is permitted to charge fees as Financial Services Manager. This ensures OPG is able to recover costs incurred in relation to its activities as FSM. The methodology for the calculation of fees is set out in regulation and includes performance-based components. The regulation also sets out the role of the Ontario Energy Board (OEB) in reviewing and approving the fees.

In accordance with OPG's Financing Plan, 49 per cent of the debt obligations are purchased by OPG, funded by periodic equity injections from the Province and OPG's own corporate borrowing program.

OPG earns a return on its investment in the Trust, which ensures the transactions are commercial and meets accounting requirements. The remaining 51 per cent of the debt obligations are funded through the capital markets.

Q. Some say you are unfairly placing the burden of debt on future generations through things like Ontario's Fair Hydro Plan, how do you respond?

To reduce pressure on today's electricity consumers, a portion of Global Adjustment (GA) costs is being refinanced. In later years, the cost of financing will be recovered from consumers.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. The majority of the province's electricity generators have 20-year contracts. Many of these generators will be able to operate past their contract term, meaning that generating assets are expected to have ongoing useful life and will benefit future ratepayers by reducing the need to finance the development of new generating assets.

Electricity bills have been reduced for current ratepayers, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Moving forward, Ontario's 2017 Long-Term Energy Plan (2017 LTEP) focuses on continuing to put downward pressure on electricity bills over the long term. Our robust electricity supply puts us in a good position to improve efficiency, increase transparency and enhance opportunities for innovation and competition to further reduce system costs. That is why Ontario's Fair Hydro Plan includes a commitment to improving sector efficiency and modernizing Ontario's electricity market, building on the collaboration of the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

For example, IESO's Market Renewal initiative will result in a more efficient marketplace with competitive and transparent mechanisms that meet future system needs at the lowest cost. The initiative is expected to save up to $5.2 billion[10] over a 10-year period and forms a key component of Ontario's plan to ensure the affordability of electricity in the longer term.

Q. When will the next tranche of debt be sold?

OPG was identified as the Financial Services Manager that will manage the debt obligations. OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

OPG is expected to regularly purchase IESO's regulatory asset and to issue longer term debt in the capital markets on a periodic basis.

Q. There is an election in June. Can Ontario's Fair Hydro Plan be undone? What will that mean for the refinancing of the GA and Ontario ratepayers?

Ontario's Fair Hydro Plan is governed by legislation and regulations, and its implementation is ongoing. GA Refinancing is implemented through ongoing financings that OPG, as the Financial Services Manager, takes to market.

The *Ontario Fair Hydro Plan Act, 2017* and associated regulations provide the legislative framework for the GA refinancing program and its policy goals, allowing certain electricity system costs to be fairly allocated across generations of electricity ratepayers. Current ratepayers are paying less now, and future ratepayers will in turn help to pay for their fair share of the significant investments that we've made to build a clean and reliable electricity system.

In accordance with the legislation and associated regulations, Ontario's Fair Hydro Plan has lowered electricity bills by 25 per cent on average across the province for residential customers. The plan includes the 8 per cent rebate, equivalent to the provincial portion of the HST, introduced in January 2017 and builds on previously announced initiatives to deliver broad-based rate relief on all electricity bills. As many as half a million small businesses and farms are also benefitting. Increases will be held to the rate of inflation for four years.

Commented [DN(1]: Consistent with an LSB-approved reponse provided for the last issuance

Q. Who was involved in the policy and implementation process to meet the mandate?

Senior officials and staff from several departments and agencies, led by the Ministry of Energy, collaborated to plan a structure, identify risks, make decisions and take other actions to meet the mandate.

The senior officials and staff were from:

- Ministry of Energy;
- Ministry of Finance;
- Treasury Board Secretariat;

[10] Independent Electricity System Operator, *Assessment of the Benefits of Market Renewal (Brattle Group)*

- Office of the Provincial Controller;
- Cabinet Office;
- Ontario Financing Authority (OFA);
- Independent Electricity System Operator (IESO); and
- Ontario Power Generation Inc. (OPG).

In development and implementation of Global Adjustment (GA) refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

Auditor General and Financial Accountability Office reports

Q. The Auditor General and the Financial Accountability Office both suggest that the cost of borrowing will be more expensive than traditional government borrowing? Is this true?

In the development of Ontario's Fair Hydro Plan (OFHP), the government made the policy decision that deferred electricity system costs should be borne by the rate-base and not the tax-base.

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.

The $4 billion[11] figure referenced by the Financial Accountability Office (FAO) in its May 2017 report, was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

A number of variables (i.e., including interest rates, electricity demand and electricity costs) will vary over the thirty-year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions.

The government will continue to identify and implement initiatives to take costs out of the electricity system, which would reduce the cost of the GA refinancing program

OPG~~)~~ was identified as the Financial Services Manager responsible for the financing plans and the financing entity (i.e., Fair Hydro 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.

If pressed on FAO analysis on interest costs:

The FAO's analysis of the interest cost associated with 55 per cent of debt being financed by OPG through capital markets assumed a 90 basis point spread above the rate for Government of Ontario debt. This is based on an average Government of Ontario interest rate assumption of 4.5 per cent and an average OPG interest rate assumption of 5.4 per cent.

[11] Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*

As noted above, Ontario's revised analysis assumes an average interest rate for all debt of 5 per cent over the life of the plan. For reference, OPG Trust's initial offering of senior debt (comprising 51 per cent of the total offering) came in at 3.357 per cent.

If pressed on the details of the revised peak debt number:

Peak debt for OFHP has been revised down substantially from March 2017, from about $28 billion[12] to approximately $20 billion[13]. The higher March 2017 estimate was used by the FAO in its May 2017 report.

Updated estimates are consistent with 2017 Long-Term Energy Plan (LTEP) projections, include fees charged by OPG in its role as financial service manage (FSM) and assume a 5 per cent interest rate.

If pressed on interest costs:

The government estimates of total interest cost also decreased from $25 billion[14] to less than $19 billion[15].

Q. In the development of Ontario's Fair Hydro Plan, did the government set up the financing structure intentionally to keep it off government books?

No. GA refinancing is designed so that deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base. We believe it is appropriate for ratepayers to pay for the financing of electricity assets.

In addition, the rate-base has a different risk profile than the tax-base, which is reflected in different financing costs. Having the rate-base pay for financing of electricity system assets is not a new policy; for example Hydro One has borrowed in the capital markets since the early 2000s.

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 electricity consumers.

GA refinancing operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. How do you respond to the Auditor General's claim that the government ignored warnings regarding a potential adverse audit opinion of Ontario's public accounts?

The government's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS), and will continue to follow these standards for the transactions resulting from Ontario's Fair Hydro Plan (OFHP) in 2017-18 and in future years.

[12] Ministry of Energy
[13] Ministry of Energy
[14] Ministry of Energy
[15] Ministry of Energy

Ontario's Fair Hydro Plan (OFHP) operates under a financial and accounting framework that is appropriate for the intended purpose and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

The Independent Electricity System Operator (IESO) chose to begin recognizing its market accounts' assets (i.e., amounts due from power distributors) and liabilities (i.e., amounts due to power producers) in its financial results. The IESO chose to recognize these markets accounts on its books for transparency reasons, as it better reflects its net financial position on behalf of the IESO-administered markets at year-end.

The government supports the enhanced reporting and greater transparency for the economic activities of IESO resulting from the recognition of the market accounts.

In addition, IESO made the decision to adopt rate-regulated accounting because it better reflects the economic substance of certain types of expenses that may not be directly recovered through the normal revenue requirement model.

Both accounting changes were accepted by IESO's independent external auditor, which issued an unqualified, or "clean," audit opinion and were highlighted in IESO's annual report which was published online in March 2017.

In the development of OFHP, the government consulted with several third party advisors in the application of accounting standards. This is normal course of business governments take for complex transactions.