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DBRS Finalizes Provisional Ratings on Fair Hydro Trust Series 2018-1 Notes

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 February 09, 2018

DBRS Limited (DBRS) finalized its provisional ratings on the following notes issued by Fair Hydro Trust (the Trust):

- 3.357% Senior Notes due May 15, 2033, Series 2018-1 (the 2018-1 Senior Notes) rated AAA (sf)
- 3.637% Subordinated Notes due May 15, 2033, Series 2018-1 (the 2018-1 Subordinated Notes) rated AA (sf)
- 3.957% Junior Subordinated Notes due May 15, 2033, Series 2018-1 (together with the 2018-1 Senior Notes and the 2018-1 Subordinated Notes, the 2018-1 Notes) rated A (sf)

The 2018-1 Notes are supported by an Investment Interest that is an irrevocable property right consisting of the right to impose, invoice, collect, receive and recover the Clean Energy Adjustment (the CEA) from Specified Consumers in accordance with the Ontario Fair Hydro Plan Act, 2017 (the FHPA) and the regulations promulgated under the FHPA (the Regulations).

The 2018-1 Notes accrue fixed rates of interest payable on a semi-annual basis until the Expected Maturity Date and monthly thereafter. A portion of collections will be accumulated monthly beginning January 15, 2030, to repay principal on the 2018-1 Notes in full on the Expected Maturity. Until July 31, 2021, all Carrying Costs of the Trust will be paid by the Independent Electricity System Operator (the IESO; rated A (high) with a Stable trend by DBRS) as mandated under the FHPA. Carrying Costs paid by the IESO will be recorded in its Regulatory Asset variance account and could be recovered by transferring the variance balance to the Trust. After the Moratorium Period, interest payments and repayment of the 2018-1 Notes will be made from CEAs collected from Specified Consumers.

Issuers

Fair Hydro Trust

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The ratings incorporate the following considerations:

(1) Repayment by a Large and Diversified Ratepayer Base

The Specified Consumers from which CEA amounts will be collected represent a large and diversified group of ratepayers in the Province of Ontario (Ontario or the Province; rated AA (low) with a Stable trend by DBRS). Specified Consumers – which generally include residential consumers, small businesses and farms – total approximately 5.05 million as at the end of 2016. Ontario is the largest province by population and is one of the main hubs of economic activity in Canada. The Province is an attractive place for Canadians to live, increasing the likelihood of the ratepayer base growing in the future. Ratepayer representation from the entire Province helps mitigate potential shortfalls in collections because of unanticipated events (such as weather or economic downturns) occurring in regional areas. Ratepayers in Ontario have also demonstrated a strong track record of paying their hydro bills on time despite having the highest electricity rates in Canada.

(2) Non-Bypassability

The CEA invoiced under the FHPA will be irrevocable and may not be set off or bypassed by Specified Consumers. The non-bypassability of the charge ensures that the repayment of the 2018-1 Notes will be shared among nearly all residential consumers as well as small businesses and farms in Ontario. Currently, there are approximately 5.05 million electricity consumers that are classified as Specified Consumers. All Specified Consumers would be required to make payment on the CEA amount invoiced, and such amount would be listed as a separate line item on their monthly utility bills.

(3) Regulated Electricity Market in Ontario

All participants in the Ontario electricity market – including generation, transmission and distribution companies – operate under the guidance or regulations set out by the Ministry of Energy, the IESO and the Ontario Energy Board (the OEB). Industry participants are required to operate with licences granted by the OEB, and such licences could be revoked if certain performance standards are not met. The regulated nature of the industry increases operational consistency and efficiency among all participants and improves the coordination of industry initiatives. More importantly, it ensures full participation from all market participants in carrying out their respective roles and responsibilities as set out in the FHPA.

(4) True-Up Mechanism

True-up amounts are permitted under the FHPA to recover any shortfall in collections from prior periods. As the amount of CEAs collected could be affected by factors such as energy consumption and delinquency rates, there would likely be deviations between actual collections and expected collections in each Reference Period (each six-month period from November 1, 2017, to April 30, 2047, or a later date prescribed by the Regulations). The true-up amount allows shortfalls from prior periods to be recovered in a subsequent period. As long as there are 2018-1 Notes outstanding, the true-up amount is

determined for each Reference Period (or more frequently, if necessary) and is factored into the CEA invoiced to Specified Consumers. The calculation for each true-up amount includes amounts that were not received from prior periods and other anticipated shortfalls going forward. If there were over-collections from prior periods, the true-up amount could result in a reduction in CEA amounts that would otherwise be invoiced.

(5) Low Historical Charge-Off Rates

As electricity is a basic necessity, the historical charge-off rates from customers are very low. For instance, charge-off rates from Toronto Hydro Corporation (rated “A” with a Stable trend by DBRS) customers have been in the range of 0.19% to 0.35% from 2010 to 2016. Write-offs may not result in a shortfall in overall collections, as anticipated delinquencies/charge-offs are incorporated in the electricity rate-setting process. Electricity rates are grossed up by the amount of delinquencies/charge-offs that are expected such that, on a net basis, actual collections received are sufficient to repay all providers in the electricity market. Shortfalls arising because of higher-than-projected delinquencies/charge-offs are included in the next period’s true-up amount, thereby limiting the cumulative effect of delinquency and loss rates typical in other consumer-backed securitizations.

Notes:

The principal methodologies are Rating Canadian Structured Finance Transactions (Appendix: Legislated Utility Collections) and Legal Criteria for Canadian Structured Finance, which can be found on dbrs.com under Methodologies.

The related regulatory disclosures pursuant to the National Instrument 25-101 Designated Rating Organizations are hereby incorporated by reference and can be found by clicking on the link under Related Documents or by contacting us at info@dbrs.com.

The rated entity or its related entities did participate in the rating process for this rating action. DBRS had access to relevant internal documents of the rated entity or its related entities in connection with this rating action.

Please see the related appendix for additional information regarding the sensitivity of assumptions used in the rating process.

The full report providing additional analytical detail is available by clicking on the link under Related Documents below or by contacting us at info@dbrs.com.

Ratings

Date Issued	Debt Rated	Action	Rating	Trend	Issued
2/9/18		Provis.-Final		—	CA

Date Issued	Debt Rated	Action	Rating	Trend	Issued
	3.357% Senior Notes due May 15, 2033, Series 2018-1		AAA (sf)		
2/9/18	3.637% Subordinated Notes due May 15, 2033, Series 2018-1	Provis.-Final	AA (sf)	--	CA
2/9/18	3.957% Junior Subordinated Notes due May 15, 2033, Series 2018-1	Provis.-Final	A (sf)	---	CA

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Related Documents

Methodology Used:

Legal Criteria for Canadian Structured Finance / July 7, 2017

Rating Canadian Structured Finance Transactions / December 6, 2017

Rating Report:

Fair Hydro Trust: Rating Report

Other:

Fair Hydro Trust - DBRS Limited Regulatory Disclosure

Fair Hydro Trust - DBRS Risk Sensitivity Analysis

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Commentary - null

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Commentary - null

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