



2018-21 BUSINESS PLAN HIGHLIGHTS

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Executive Summary

The Ontario Electricity Financial Corporation (OEFEC, or the Corporation) is responsible for the management of the debt and certain other liabilities of the former Ontario Hydro. The OEFEC assumed approximately \$38.1 billion in debt and other liabilities of the former Ontario Hydro when it was restructured on April 1, 1999. A portion of the \$38.1 billion was supported by the value of the assets of Ontario Hydro successor companies, leaving \$20.9 billion of “stranded debt” not supported by those assets (and an initial unfunded liability of \$19.4 billion, when taking into account other OEFEC assets as at April 1, 1999).

As at March 31, 2017, total debt and liabilities amounted to \$21.1 billion, and OEFEC’s unfunded liability was reduced to \$3.2 billion. And, based on the Province’s 2017 Budget projections for OEFEC in 2017-18, the OEFEC projected excess of revenue over expense of about \$1.1 billion would further reduce the unfunded liability by that amount, which would mean 2017-18 would be the fourteenth consecutive year that the stranded debt has been reduced.

Overview of 2017-18 Results

The Ontario Electricity Financial Corporation (OEFEC) accomplished the following key objectives presented in its 2017-20 business plan.

1. Manage debt and other liabilities cost-effectively
 - Continued to manage OEFEC’s debt and other liabilities, with debt outstanding of \$21.0 billion as at September 30, 2017.
 - The Corporation’s projected results are for a continued reduction in the unfunded liability in 2017-18, by an estimated \$1.1 billion. OEFEC has continued to manage with reduced revenues from the Debt Retirement Charge (DRC) as 2017-18 is the second full year of the elimination of the DRC for residential customers, and the last year of the DRC for all other consumers.
2. Manage financial risk within approved policy limits
 - Maintained a zero foreign exchange exposure on outstanding debt principal and maintained net interest rate resetting exposure within policy limits.
3. Manage and administer the OEFEC power supply and demand management contracts
 - In 2017-18, to the end of October, achieved \$5.1 million in cost-savings through curtailments.
 - Continuing to support an IESO initiative, under which the IESO was complying with a direction from the Minister of Energy, OEFEC terminated four and suspended one gas-fired non-utility generator (NUG) power purchase agreements (PPAs). These terminations and suspension allowed those NUGs to enter into curtailment agreements with the IESO that provide an incentive to NUGs to operate in a manner that is better aligned with the integrated power system’s needs, reducing OEFEC costs, costs to ratepayers, and lowering carbon emissions.
 - Continued to manage and implement a contract with the Independent Electricity System Operator (IESO) in support of its Industrial Electricity Incentive (IEI) demand management program.
4. Provide financial assistance, as required, to the Ontario Hydro successor corporations

- Continued to monitor and implement financial assistance from OEFC to Ontario Power Generation (OPG), including a \$700 million credit facility for 2017, for the purpose of financing general corporate purposes, including the Darlington refurbishment project. This credit facility increases to a total amount of up to \$2.35 billion over 2017 and 2018.
 - Continued to monitor and provide analysis and advice on the credit facility between the IESO and the OEFC.
5. Support the implementation of the government's electricity industry policies and determine the impact on the OEFC
- Continuing to support the IEI program.
 - Projections for 2017-18 in *Budget 2017* show an excess of revenue over expense of about \$1.1 billion, which would reduce the Corporation's unfunded liability (or stranded debt) to below \$3 billion. This would be the fourteenth consecutive annual decline in the unfunded liability.
 - Provided support for the implementation of the government's policy on broadening Hydro One ownership, including the Province's final public offering in May 2017, and the sale of Hydro One Brampton, including the dedication of proceeds related to the book value of Hydro One shares sold towards paying down the Province's electricity sector debt and other payables with OEFC and financial benefits provided by the Province to OEFC as per section 50.3 of the *Electricity Act, 1998*.

Key Objectives for for 2018-2021, consistent with its mandate letter from the Minister of Finance, include the following:

- Manage debt and other liabilities cost-effectively.
- Manage financial risk within approved policy limits.
- Manage and administer the non-utility generator (NUG) contracts and demand management contracts.
- Manage and administer a contract with IESO in support of its Industrial Electricity Incentive (IEI) demand management program.
- Provide financial assistance, as required, to the Ontario Hydro successor corporations.
- Support the implementation of the government's electricity industry policies and determine the impact on the OEFC.

Governing Legislation and Mandate

Under the *Electricity Act, 1998* (the "Act"), Ontario Hydro was restructured into five corporations (excluding subsidiaries): Ontario Power Generation Inc. (OPG), Hydro One Inc. (now a subsidiary of Hydro One Ltd., or Hydro One), the Independent Electricity System Operator (IESO), the Electrical Safety Authority (ESA) and the OEFC.

Pursuant to the Act, the OEFC's mandate includes the following:

- Managing its debt, financial risks and liabilities, including the debt of the former Ontario Hydro.
- Managing the former Ontario Hydro's NUG contracts.
- Receiving all payments and administering other assets, liabilities, rights and obligations of the former Ontario Hydro that were not transferred to another of the Hydro successor corporations and disposing of any of these items as it deems appropriate or as directed by the Minister of Finance.

- Providing financial assistance to the successor corporations of Ontario Hydro and a distributor owned or controlled, directly or indirectly, by Her Majesty the Queen in Right of Ontario and licensed by the Ontario Energy Board.
- Entering into financial and other agreements relating to electricity supply or management of electricity demand, in Ontario.
- Performing any additional objects as specified by the Lieutenant Governor in Council.

Strategic Directions and Performance Measures

1. Manage Debt and Other Liabilities Cost-Effectively

- The OEFC has existing long-term debt maturities totalling, \$0.7 billion, \$1.4 billion and \$1.4 billion in 2018-19, 2019-20 and 2020-21 respectively.

2. Manage Financial Risk within Approved Policy Limits

- Maintain unhedged exposure to foreign currencies below five per cent of outstanding debt.
- Maintain net interest rate resetting exposure below 35 per cent of outstanding debt.
- Maintain credit exposures within policy limits which are based on credit ratings and capitalization as set out in Table 2 of the OEFC Credit Risk Policy.

3. Manage and Administer the OEFC Power Supply Contracts and IESO Agreement in support of its IEI Program

- Produce cost savings through curtailment and other arrangements with the NUGs while protecting the interests of the ratepayers.
- Maintain and improve operational systems, applications and infrastructure as required.
- Calculate, settle and report energy payments to the NUGs and other relevant parties, accurately and on a timely basis, according to contract terms.
- Monitor and work with the meter service provider to ensure that maintenance, upgrade and reseal of meter installations are cost-effective and in line with the IESO's market rules and timelines.
- Provide operational and market settlement information and advice in support of legal proceedings, renegotiation of contracts and energy curtailments as required.
- Administer the OEFC's obligations to provide the IESO support for its DRC offset payments made under the IEI demand management program.

4. Provide Financial Assistance as Required to the Ontario Hydro Successor Corporations

- Provide and monitor credit facilities to OPG and IESO, as needed, for general corporate purposes, refinancing maturities, specific projects and/or provide other financial assistance as directed or required.

5. Support the Implementation of the Government's Electricity Industry Policies and Determine the Impact on the OEFC

- Monitor the financial performance of the successor electricity corporations.
- Meet operational requirements on a timely basis to implement the government's policy initiatives.
- Provide analysis and advice on the financial impacts on OEFC from broadening ownership of Hydro One.
- Provide quarterly and annual financial statements and projections of revenues and expenses to the audit committee and Board for approval.
- Timely and responsive implementation of Directives as required.

Environmental Scan: Assessment of Issues Facing the OEFC

Factors that could affect OEFC meeting financial projections or core corporate objectives are described below.

External Factors

- The financial performances of OPG and Hydro One affect OEFC revenues relating to
 - i) the continuation of the discretionary electricity sector dedicated income from the Province, which is calculated as the Province's combined net income from OPG and Hydro One in excess of the Province's interest costs of its investment in its electricity subsidiaries; and
 - ii) OPG payments in lieu of taxes (PILs) to the OEFC, and payments to OEFC in respect of Hydro One Inc. provincial corporate income taxes.
- The financial performance of municipal electricity utilities (MEUs) also affects OEFC revenues through MEU PILs to the OEFC.
- The Ontario Energy Board's (OEB) decisions on regulated rates, including the allowed return on equity, may affect projected OPG and Hydro One's financial performance and MEU PILs.
- Additional financial assistance to OPG may be required in the future, including debt maturity refinancing and new loans.
- The Province's initiative to broaden Hydro One ownership, which has had its final public offering of shares in May 2017, has an impact on the OEFC's dedicated income from the Province related to Hydro One. The dedication of certain proceeds from Hydro One share offerings affects OEFC's cash flows, refinancing requirements and debt interest costs.
- The financial performance of Hydro One can be affected by acquisition activity, affecting Hydro One Limited's net income, which may affect the amount of Electricity Sector Dedicated Income transfer from the Province to OEFC, and may affect Hydro One Inc.'s provincial corporate taxes and the amounts transferred to OEFC.
 - On July 19, 2017, Hydro One announced an offer to acquire Avista Corporation (Avista), for \$6.7 billion Canadian (USD \$5.3 billion). On November 21, 2017, the proposed acquisition received Avista shareholder approval and Hydro One expects the transaction to close in the second half of 2018, subject to certain U.S. state and federal regulatory and government approvals and clearances. The potential acquisition would affect Hydro One's net income and would also dilute the Province's ownership in Hydro One by approximately 5 percentage points.
- Acquisitions in the local distribution sector by non-PIL-paying entities of municipally-owned local distribution companies would affect transfer tax, departure tax and future PILs paid to OEFC.

Economic conditions and electricity demand:

- Economic conditions, industrial activity, and higher/lower electricity demand have an impact on the OEFC through net incomes of OPG, Hydro One, Hydro One provincial CIT, OPG and MEU PILs, and

Debt Retirement Charge (DRC) revenue (up to March 31, 2018). An economic downturn/recovery would tend to decrease/increase electricity demand.

- Electricity demand lower than projections in regulatory filings could result in lower revenues for OPG, Hydro One and MEUs in the absence of recovery through variance accounts. In addition, lower demand could trigger curtailments for hydroelectric and nuclear production, potentially resulting in a negative financial impact to OPG if these costs are non-recoverable in rates.
- Lower electricity consumption also results in lower DRC revenues, prior to the end of the DRC on April 1, 2018.
- Economic conditions may affect pension costs for OPG and Hydro One. Any pension costs not recovered through electricity rates or deviating from forecasts without recovery through variance accounts would lead to reductions in earnings of OPG and Hydro One.

Financial markets:

- The Bank of Canada has raised the overnight rate target since last summer, first to 3/4 per cent in July 2017, to 1 per cent in September 2017 and again to 1¼ per cent in January 2018. The decision was largely driven by a strong Canadian economy in 2017 fuelled by stronger-than-expected consumption and residential investment, reflecting solid employment growth. The Bank of Canada also noted stronger-than-expected global growth but cautioned the uncertainty surrounding the future of NAFTA. On average, private-sector economists expect further rate hikes in 2018.
- In the United States, the Federal Reserve raised rates three times throughout 2017, citing a continuously strengthening labour market and solid economic growth. It is expected that the Fed will continue to raise rates, though at a gradual pace. On the other hand, monetary policy in the European Union continues to remain accommodative. In December 2017, the European Central Bank (ECB) announced that interest rates will remain unchanged and are expected to stay "at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases." The ECB also plans to continue its asset purchase program until at least September of 2018, albeit at a lower monthly pace than in 2017.
- In Canada, long-term interest rates have remained at historically low levels for several years but have risen in recent months. Long-term interest rates are projected to gradually rise over the next few years but still remain low compared to the long-term historical average.
- According to private-sector forecasters, the Canadian three-month Treasury bill rate is expected to rise gradually from an average of 0.7 per cent in 2017 to 1.4 per cent in 2018, and 2.1 per cent in 2019. According to the January 2018 Blue Chip consensus outlook, the three-month U.S. Treasury bill rate is expected to average 1.8 per cent in 2018, before rising to 2.4 per cent in 2019.
- The 10-year Government of Canada bond rate averaged 1.8 per cent in 2017. According to private-sector forecasters, the 10-year Government of Canada bond rate is projected to rise, averaging 2.4 per cent in 2018 and 3.0 per cent in 2019. According to the Blue Chip consensus outlook, the yield on 10-year U.S. government notes is expected to average 2.7 per cent in 2018 and 3.2 per cent in 2019, up from 2.4 per cent in 2017.

Changes to the government policy environment can affect OEFC revenues and expenses:

- Changes in corporate tax rates would affect OEFC's current and projected future payments-in-lieu of tax revenues to OEFC from OPG and MEUs and current and projected future payments of Hydro One provincial corporate income tax allocated by the Province.

- The government has concluded its final public share offering in its initiative to broaden Hydro One ownership. Following an initial public offering of Hydro One common shares in November 2015, and a subsequent secondary offering in April 2016, the Province completed its final public offering in May 2017.
- The government completed its sale of Hydro One Brampton to Alectra Utilities on February 27, 2017. The sale will contribute to and encourage consolidation in the local distribution sector.
- Government policy and implementation, and business strategy in moving forward with these plans could affect OEFC's current and projected revenue streams from the Province, Hydro One and MEUs, and affect OEFC's expenses.
- The Province's concluded initiative to broaden Hydro One ownership affects OEFC revenues and expenses relating to
 - i) the electricity sector dedicated income from the Province, as
 - a) a decrease in Provincial ownership has reduced the Province's share of Hydro One net income; and
 - b) the Province's commitment to using proceeds related to the book value of the shares sold to pay down payables to OEFC has reduced the Province's interest payments to OEFC related to its investment in Hydro One.
 - ii) the financial benefit as per section 50.3 of the *Electricity Act, 1998* related to the sale of Hydro One shares.
 - iii) interest on debt, as the Province's commitment to using proceeds related to the book value of the shares sold to pay down payables to OEFC has provided OEFC with cash inflows that help reduce borrowing requirements.
- Potential local acquisitions by Hydro One would move the income related to those entities out of the PILs regime, reducing OEFC PILs. Such acquisitions may also increase Hydro One net income, which could increase ESDI to OEFC.
- Government policy that would affect electricity load, up or down, with an increase or decrease in DRC revenue, up to the legislated end date of April 1, 2018, from commercial, industrial and other electricity users, offset by any expense to support load management.

Resources

OEFC has no employees. Since April 1, 1999, pursuant to a directive from the Minister of Finance, the OFA has conducted borrowing and related debt and risk management activities, cash management, banking, accounting, financial reporting, forecasting and other related activities on a cost-recovery basis for the OEFC.

Many OFA staff perform OEFC-related functions; for efficiency reasons, these staff are integrated with OFA business units. The costs of twenty full-time equivalents (FTEs) and associated overhead are fully recovered from the OEFC. OFA positions are generally excluded from collective bargaining as the OFA performs borrowing and investing on behalf of the Province, including the OEFC.

The Ministry of Finance was not assigned or allocated FTEs for OEFC. Rather it was agreed that FTEs within the Ministry of Finance be allocated to provide revenue collection and reporting services. Costs of these positions are fully recoverable from the OEFC.

The OFA works closely with the Ministry of Finance's human resources branch to implement and maintain the government's human resource strategies, policies and practices.

Financial Statements

The OEFC is an operational enterprise agency of the Province. It has a legislated requirement to issue audited financial statements for the fiscal year, which are approved by its Board of Directors and to submit these to the Minister of Finance within 90 days after the end of every fiscal year. The financial statements summarize the OEFC's revenues and expenditures and are tabled in the Legislature once approved by the Minister of Finance. The statements are also included in the Public Accounts of Ontario. The financial results of the OEFC are consolidated with those of the Province for Public Accounts and Budget purposes.

Implementation Plan

For 2018–21, the OEFC intends to implement its business plan using existing resources.

Communications Plan

OEFC updates, including annual reports, bulletins, information for Ontario Hydro bondholders and electricity sector updates can be found on www.oefc.on.ca. Annual financial statements are also available in Volume 2 of the Public Accounts of Ontario. Financial and borrowing updates can be found in the Provincial Budget, the Economic Outlook and Fiscal Review, Ontario's Quarterly Finances and the OFA Bulletin.

The OFA also responds to inquiries from investors about bonds issued by the former Ontario Hydro, as well as inquiries from the public regarding the OEFC and its responsibilities.

Appendix A – Corporate Structure and Accountability

Governing Legislation

Pursuant to the *Electricity Act, 1998* (the Act), OEFC is the legal continuation of Ontario Hydro and is a corporation without share capital. Its legislative mandate is set out in the Act. The Act provides for the appointment by the Lieutenant Governor in Council of a Board of Directors to supervise the management of the OEFC. The Act provides that the CEO is appointed by the Lieutenant Governor in Council, on the recommendation of the Minister of Finance. The CEO is responsible for managing the day to day operations of the OEFC.

Agency Classification

The Act provides that the OEFC is an agent of the Crown. It is classified as a “Board Governed Agency” agency pursuant to Management Board’s Agencies and Appointments Directive.

Minister of Finance

The Minister of Finance is responsible to the Legislature for the fulfilment of the OEFC’s mandate and reporting on the affairs of the OEFC, including tabling of the annual report in the Legislature. The Minister approves the OEFC’s annual business plan, which may also be reviewed at any time at the request of the Minister or Management Board of Cabinet (MBC).

In accordance with MBC requirements, the Minister enters into or affirms a Memorandum of Understanding (MOU) with the OEFC which sets out the OEFC’s mandate and the roles and responsibilities of senior management, including the Chair, Board of Directors and CEO. The MOU also sets out financial and other reporting responsibilities of the OEFC to the Minister. The Minister recommends the approval of the MOU by MBC.

Deputy Minister and Chair

The Deputy Minister of Finance advises the Minister of major issues or developments involving OEFC. Generally, the Deputy Minister is also appointed as Chair of the OEFC. As Chair, he or she provides leadership and direction to the OEFC Board and is responsible for developing the MOU with the Minister and for submitting the annual business plan, including budget, to the Minister.

Corporate Governance

Board of Directors

The Board of Directors is appointed by the Lieutenant Governor in Council on the recommendation of the Minister of Finance. In accordance with the OEFC's MOU with the Minister of Finance, the OEFC Board performs a supervisory role. It oversees the management of the OEFC and helps to ensure that the OEFC's mandate, as determined by the Province, is implemented. The Board is currently comprised of current and former public servants.

The Board fulfills its responsibilities through regular meetings of its Audit Committee and meetings of the full Board, receipt of regular reports from management and approval of the OEFC's financial risk policies as well as its internal audit plan, annual business plan and annual report. The Board receives quarterly reports from management regarding OEFC's compliance with applicable laws, directives and policies. The Board may enact by-laws for the OEFC, which must be approved by the Minister of Finance. The Board meets at least once quarterly.

OEFC is required to provide its annual report to the Minister of Finance within 90 days of the fiscal year end, or, if extended by the Minister, by the day on which the Public Accounts of Ontario are released. The annual report is tabled in the Legislature. The OEFC financial statements are included in the Public Accounts of Ontario.

Audit Committee

The Audit Committee supports the Board of Directors. It reviews the OEFC's financial statements and recommends them to the Board of Directors. It also approves the annual internal audit plan and reviews the findings of the internal auditors regarding the adequacy of internal controls. Another function of the Audit Committee is to receive regular reports regarding OEFC's compliance with legal and regulatory requirements and applicable government directives and policies.

Chief Executive Officer (CEO)

The CEO is accountable to the Board for managing the day to day operations of the OEFC in accordance with its annual business plan, the OEFC's by-laws, Board-approved policies, and applicable ministerial and government directives. The CEO reports at each quarterly board meeting regarding the operations of the OEFC. The CEO also reports to the Chair concerning the OEFC.

Employees

The OEFC does not have any employees, although some OFA staff members are designated as officers of the OEFC for the purpose of executing agreements and other documents on its behalf. The OFA and staff in the Ministry of Finance carry out the OEFC's day to day operations under the supervision of the CEO and the OEFC Board.

Ontario Electricity Financial Corporation (OEFC) Organization Chart

