

An Assessment of the Financial Impact of the Partial Sale of Hydro One

Presentation to the ICEAA Canada Workshop
Ottawa - February 23, 2016

Presentation Outline

- Introduction
- Key Questions and Scope
- Methods and Findings
- Questions and Discussion

Introduction

Who we are: Financial Accountability Office of Ontario

- Financial Accountability Officer is an officer of the Legislative Assembly of Ontario.
- Mandate: to provide the Legislative Assembly of Ontario with independent analysis on the state of the Province's finances and trends in the provincial economy, and on bills and other proposals to support the Assembly's performance of its constitutional responsibility.
- The first officer, Stephen LeClair, was appointed in spring of 2015.

Project team and other participants

- Two analysts
- Myself as project manager
- Financial Accountability Officer and Chief Economist in a review capacity
- Peer reviewers
 - Independent
 - Within government

Background I: The Sale

- Hydro One is an electricity transmission and distribution company that was wholly owned by the Province of Ontario.
- In 2014, the company operated 97 per cent of Ontario's transmission capacity and the largest distribution system in Ontario, spanning 75 per cent of the province.
- In its 2015 Budget the Province announced its intention to sell up to 60 per cent of Hydro One, 15 per cent in 2015–16 and the balance in subsequent sales for which no specific timeline has been announced.

Background II:

- The 2015 Budget also noted that uniquely attractive conditions enable the government to maximize value and obtain greater net proceeds. ... these would be available to be credited to the Trillium Trust and directed into building transit, transportation, and other priority infrastructure...
- The partial sale could also have had important direct implications for non-residential electricity customers. They pay a Debt Retirement Charge (DRC) levied on electricity consumption to help pay down the debt of the former Ontario Hydro, the predecessor to Hydro One.
- The DRC is not only an additional charge for electricity consumers, but also a significant source of revenue for the Province.

Key Questions and Scope

Purpose of the Report: Key Questions

- How much can the Province expect in proceeds from the partial sale of Hydro One?
- What is the impact of the partial sale on the DRC?
- What is the impact on the Province's budget balance (surplus/deficit)?
- What is the impact on the Province's net debt?
- What is the impact on the Trillium Trust?

Scope

The report did not seek to:

- Assess the merits of the decision to sell Hydro One
- Forecast the impact of the partial sale of Hydro One on electricity rates in Ontario
- Assess the prospects for performance improvements at Hydro One that might result from the partial sale or any future changes at Hydro One
- Assess the financial impact of any government spending financed by the sale of Hydro One, i.e. transportation projects financed by the Trillium Trust.

Methods and Findings

Uncertainty was a key factor in our analysis

- Uncertainty around the proceeds to be obtained
- Uncertainty around how the debt retirement charge (DRC) would be affected (unknown calculation methodology)
- Solution was to develop four scenarios to cover all possibilities:

Financial Impact Scenarios	DRC Retained	DRC Eliminated
Low Proceeds	Low-DRC	Low-No DRC
High Proceeds	High-DRC	High-No DRC

Estimating Proceeds

- Used a comparable trading multiples approach.
 - Reviewed similar companies currently trading in North America to determine likely multiples.
 - Balance of Canadian and US companies.
- FAO estimated market value of Hydro One at \$11.0-14.3 billion, comparable to the government's public estimates ranging from \$11.3-15.0 billion.

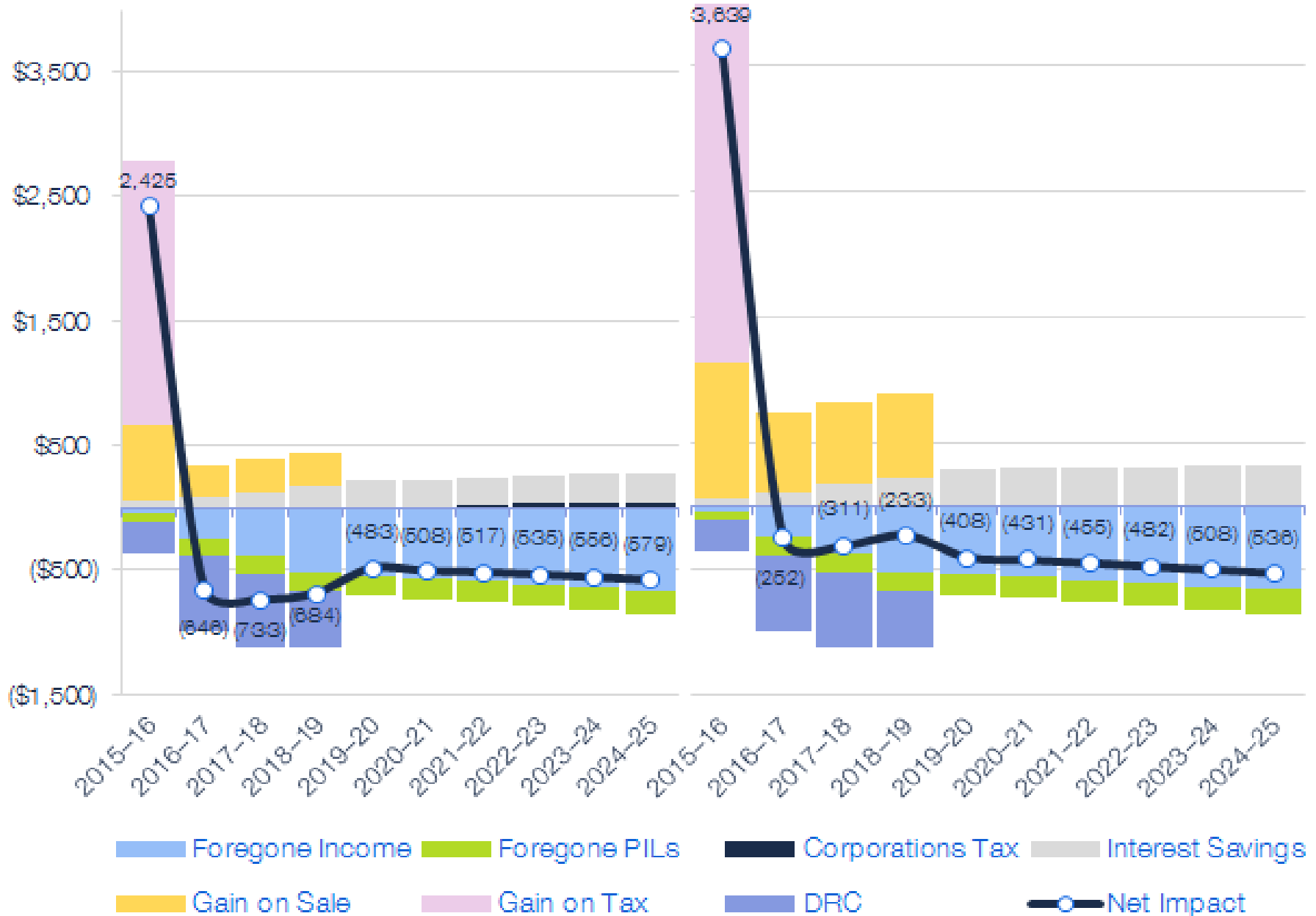
Translating proceeds into financial impact

Key drivers of financial impact on the government's income statement:

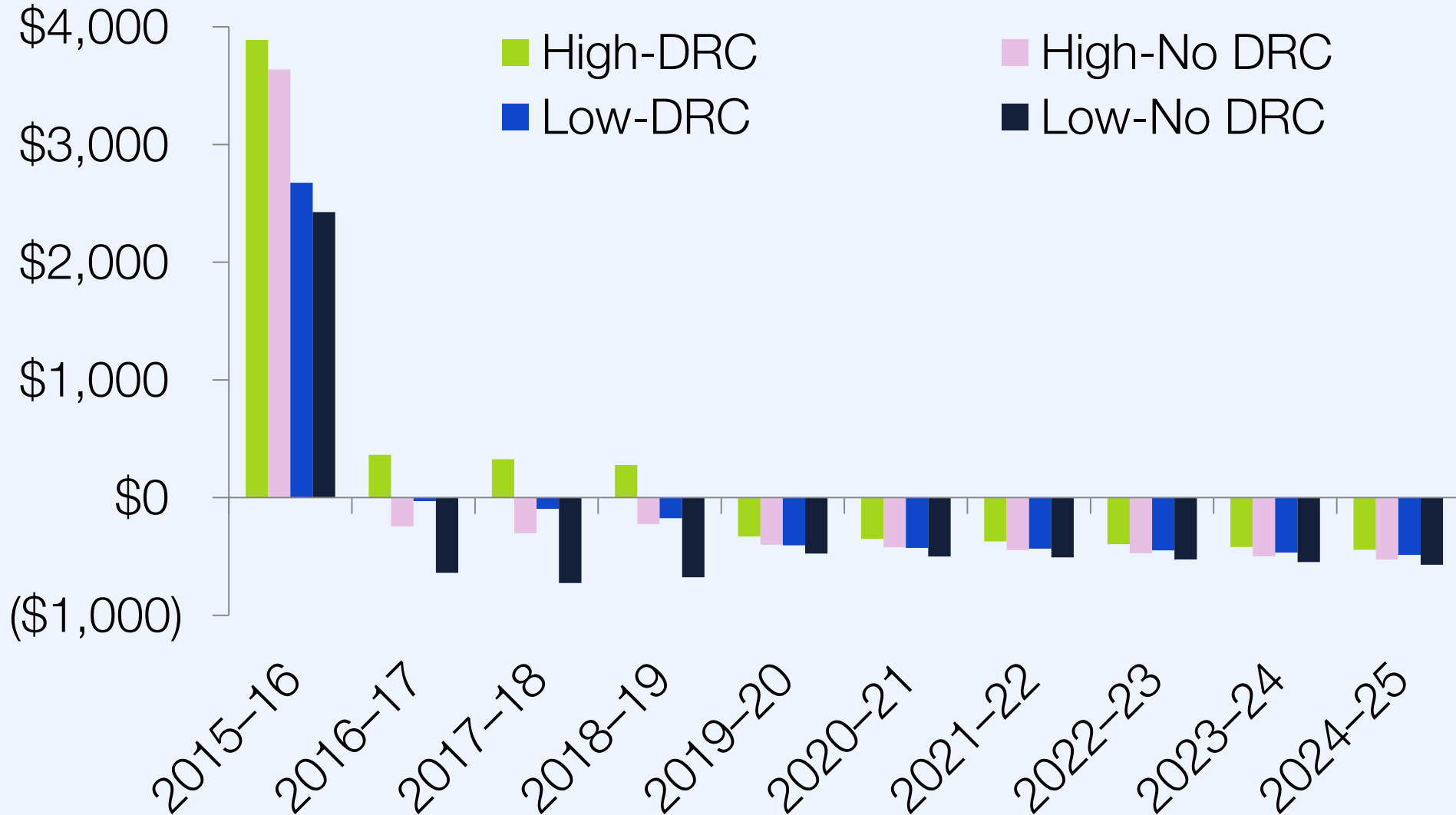
- Positive:
 - Gain on sale
 - Gain on tax (recognition of tax asset)
 - Interest savings (from foregone borrowing)
 - Increased corporations tax
- Negative:
 - Foregone income from Hydro One
 - Foregone payments in lieu of taxes
 - Foregone debt retirement charge

Low Valuation/DRC Eliminated

High Valuation/DRC Eliminated



Impact on budget balance (\$ millions)



Impact on net debt (\$ billions)

Low-DRC High-DRC Low-No DRC High-No DRC



Key output: questions for legislators to ask the government

- Does the Province expect the partial sale of Hydro One to affect the date that the debt retirement charge would be eliminated?
- When does the Province plan future sales of Hydro One shares beyond the initial 15 per cent committed in 2015–16?
- What is the Province's estimate of the fiscal impact of the sale of 60 per cent of Hydro One specifically over the next 10 years in terms of annual deficit/surpluses and net debt?

Outcomes

- Significant interest by legislators, who asked many questions of the Government in the legislature
- Significant interest by the media
- Positive reception overall, with only criticism around scope and not content, i.e. we could have looked at other issues.

Questions and Discussion

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Financial Accountability Office of Ontario

Established by the *Financial Accountability Officer Act, 2013* (the act), the Financial Accountability Office (FAO) provides independent analysis on the state of the Province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario.

The FAO produces independent analysis on the initiative of the Financial Accountability Officer. Upon request from a member or committee of the Assembly, the officer may also direct the FAO to undertake research to estimate the financial costs or financial benefits to the Province of any bill or proposal under the jurisdiction of the legislature.

Stephen LeClair was appointed as Ontario's first Financial Accountability Officer in February 2015. A career civil servant, he was most recently the Deputy Minister of Finance with the Government of Yukon and had previously held the position of Assistant Deputy Minister, Economics and Fiscal Policy with the Government of Alberta.