MANITOBA HYDRO
DEBT MANAGEMENT STRATEGY

2010/11 - 2011/12

Finance & Administration
December 2010

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1.0 Purpose of this Document

As with most energy utilities, debt is an essential component of Manitoba Hydro's corporate capital structure. As a Crown Corporation owned by the Province of Manitoba, Manitoba Hydro does not have access to share capital as a source of funds. Therefore, in order to adequately provide for the long term energy requirements of the province, Manitoba Hydro must rely on debt as its primary source of external financing.

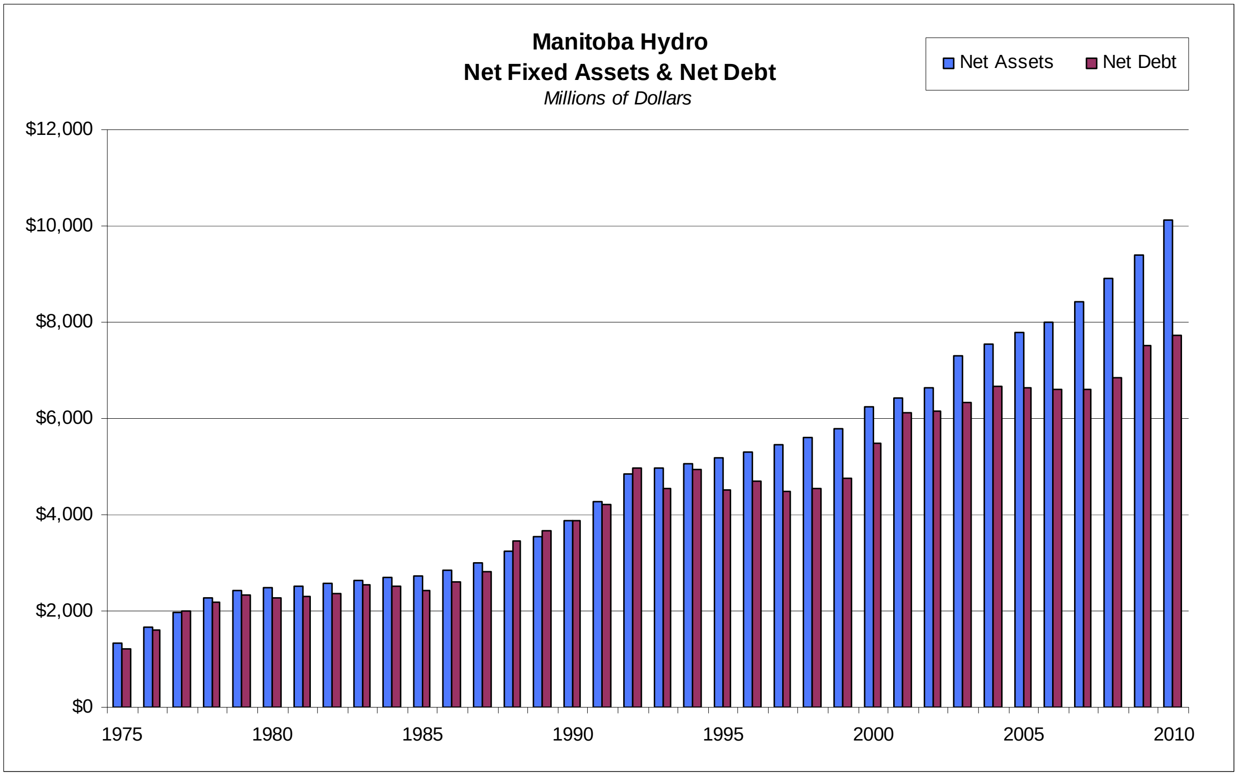
This *Debt Management Strategy* document provides information on the historical growth of the Corporation's investment in fixed assets and the corresponding increase in Manitoba Hydro's long term debt. The document also summarizes the statutes that govern the Corporation's financing programs, and outlines the debt management strategies that will address the Corporation's borrowing requirements for the 2010/11 and 2011/12 fiscal years.

2.0 Overview of Manitoba Hydro's Capital Financing Program

Debt financing has been very beneficial for Manitoba Hydro and its ratepayers. It has fueled the growth of the Corporation from the early days of farm electrification and the development of the Winnipeg River generation system, through the years of development of the Nelson River generation and transmission system, right up to the current development and construction of the Wuskwatim Generating station in northern Manitoba. None of this would have been possible without debt financing.

While debt financing provides the funding necessary for investment in long term assets (mainly generation and transmission), Manitoba Hydro also funds a significant portion of its capital requirements from cash generated from operations. Utilizing funds from operations reduces the amount that would otherwise need to be borrowed each year by the Corporation. In fact, one of Manitoba Hydro's key financial targets is to fund all of its "base capital" (ie, non-major generation and transmission capital) <u>plus</u> a minimum of 20% above base capital from internally generated funds. Manitoba Hydro refers to this financial target as the capital coverage ratio which is targeted to be greater than 1.20 each year. For the fiscal year ended March 31, 2010, the capital coverage ratio was 1.30 (2009 = 1.77). As indicated in Manitoba Hydro's most recent Integrated Financial Forecast (IFF10), Manitoba Hydro is projecting that the capital coverage ratio target will be met or exceeded in each and every year of the 10-year Forecast.

The following chart illustrates the growth in net fixed assets and net long term debt that has occurred since 1975. While net debt has grown to approximately $7.7 billion as at March 31, 2010, the corresponding investment in generation, transmission, distribution and other assets has grown at a much greater pace to a net book value of approximately $10.1 billion at March 31, 2010. The current market or replacement value of Manitoba Hydro's assets is many multiples of the net book value.



3.0 Borrowing Authority of Manitoba Hydro

Manitoba Hydro's authority to issue debt for new capital borrowing purposes is provided through The Manitoba Hydro Act, The Loan Act, and The Financial Administration Act. The following sections provide a synopsis of the authority received by Manitoba Hydro through this legislation.

3.1 The Manitoba Hydro Act

The Manitoba Hydro Act grants the following powers to the Corporation for issuing debt in the name of the Manitoba Hydro-Electric Board:

1. **Temporary Borrowing Authority**
   The principal amount of short term promissory notes outstanding at any one time shall not exceed in the aggregate the sum of $500 million in Canadian and/or United States, and/or equivalent Canadian funds in other foreign currencies at the time of issue.

2. **Government Guarantee**
   The debt of the Corporation may, subject to the Corporation's request and approval, be unconditionally guaranteed as to principal and interest, if any, by the Government of Manitoba.

3. **Power of the Corporation to Borrow and Issue Securities**

The Corporation may raise money by way of loan, notes, bonds and debentures in the name of The Manitoba Hydro-Electric Board subject to the approval of the Lieutenant Governor in Council for purposes provided in the Manitoba Hydro Act or to refund any loan or advance previously made by the Corporation.

Borrowing authority, under Section 35 of the Manitoba Hydro Act or any other act, will treat Canadian and US borrowings on a one for one par value basis.

Borrowing authority, under Section 35 of the Manitoba Hydro Act, will be abated for the Canadian dollar equivalent using the nominal rate of exchange when the loan is denominated in a currency other than Canadian or US dollars.

3.2 The Loan Act

The Loan Act is approved each year and grants Manitoba Hydro borrowing authority to meet the Corporation's projected financing requirements. Authority granted under the Loan Act is for new investment requirements. Refunding authority to refinance maturing long term debt is provided through the Financial Administration Act.

3.3 The Financial Administration Act

The Financial Administration Act authorizes the Minister of Finance to borrow money for any purpose authorized by any Act of the Legislature or for the payment, refunding, refinancing or renewal, from time to time, of the whole or any part of any loan made or provincial securities issued under any Act.

4.0 Debt Management Objectives

Manitoba Hydro's fundamental debt management objective is to provide stable, low-cost funding to meet the financial obligations and liquidity needs of the Corporation. Manitoba Hydro continually monitors the interest rate environment and acts to secure stable, low-cost financing with terms to maturity that meet investor appetite and fit the Corporation's debt maturity schedule.

Manitoba Hydro manages its level of outstanding debt to achieve a capital structure with the appropriate balance between debt and equity. The Manitoba Hydro-Electric Board has approved a minimum debt to equity ratio of 75:25 as the appropriate balance for the Corporation. This capital structure has also been reviewed and accepted as reasonable by the Public Utilities Board.

Manitoba Hydro's debt is viewed to be self-supporting as evidenced by the investment grade credit ratings that the Corporation and Province receive on their short and long term debt from the various rating agencies such as Dominion Bond Rating Service, Moody's Investors Service, and Standard & Poors.

In order to maintain the self-supporting nature of the Corporation's debt obligations and the attractive financing rates associated with the Corporation's debt, Manitoba Hydro places significant emphasis on maintaining the following financial targets:

> **Interest Coverage** – Maintain an annual gross interest coverage ratio greater than 1.20. The interest coverage ratio indicates the extent to which net income is sufficient to pay gross interest on debt. It is calculated by dividing net income plus interest on debt by interest on debt.
>
> **Capital Coverage** – Maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio indicates the extent to which cash generated internally is sufficient to fund capital construction expenditures without additional external financing. It is calculated by dividing cash generated from operations by capital construction expenditures (excluding major new generation and transmission projects).
>
> **Debt/Equity** – Maintain a minimum debt/equity ratio of 75:25. The debt to equity ratio indicates the relative percentage of assets financed through debt versus equity. It is calculated by dividing equity by equity plus debt.
>
> Note: Financial targets may not be maintained during years of major investments in the generation and transmission system.

5.0 Analysis and Commentary

The current interest rate environment is marked by exceptionally low rates across the entire spectrum of the yield curve. This is demonstrated on the interest rate chart on page 7 that depicts historical interest rates dating back to January 1948 as well as a range of forecasted interest rates to 2021.

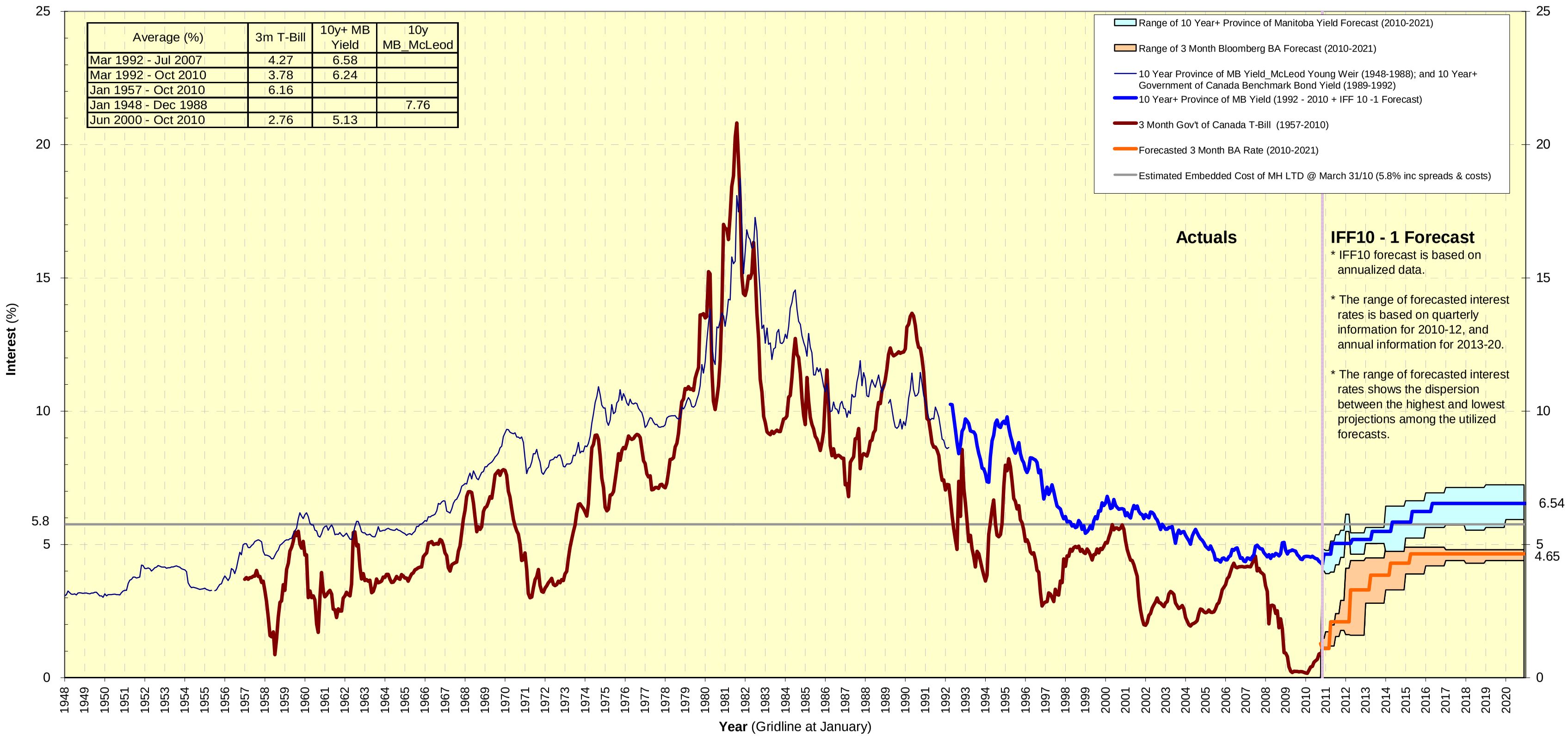
The chart illustrates that for a prolonged period of time from the mid-1970's to the early 1990's, the long term interest rates were in excess of 10%, and in 1981 the long term interest rate exceeded 18%. The average 10 year long term fixed debt rate from 1948 - 1988 was 7.76%, and the average 10 year+ rate from March 1992 - October 2010 was 6.24%. In contrast, the average financing rate for 10 year+ debt from March 2007 to October 2010 was 4.62%. Although long term fixed rate debt costs have been relatively constant since 2005, by 2016/17 the long term fixed interest rates are forecast to return to higher levels approximately in line with the average experience from 1992 - 2007 (6.58%).

With respect to the interest rate environment for Manitoba Hydro's Canadian long term floating rate debt, there has been significant volatility in interest reset rates. The average 3 month T-Bill interest rate (as a proxy for Manitoba Hydro's 3 month Bloomberg BA rate for its floating rate debt interest reset rates) from January 1957 - October 2010 was 6.16% and during 1974 - 1992, the 3 month T-Bill interest rate averaged over 10% with a high of over 20% in 1981.

CHART 1

Historical Short Term and Long Term Interest Rate Comparison

January 1948 - October 2010
(excluding PGF and transaction costs)



Average (%)	3m T-Bill	10y+ MB Yield	10y MB_McLeod
Mar 1992 - Jul 2007	4.27	6.58	
Mar 1992 - Oct 2010	3.78	6.24	
Jan 1957 - Oct 2010	6.16		
Jan 1948 - Dec 1988			7.76
Jun 2000 - Oct 2010	2.76	5.13	

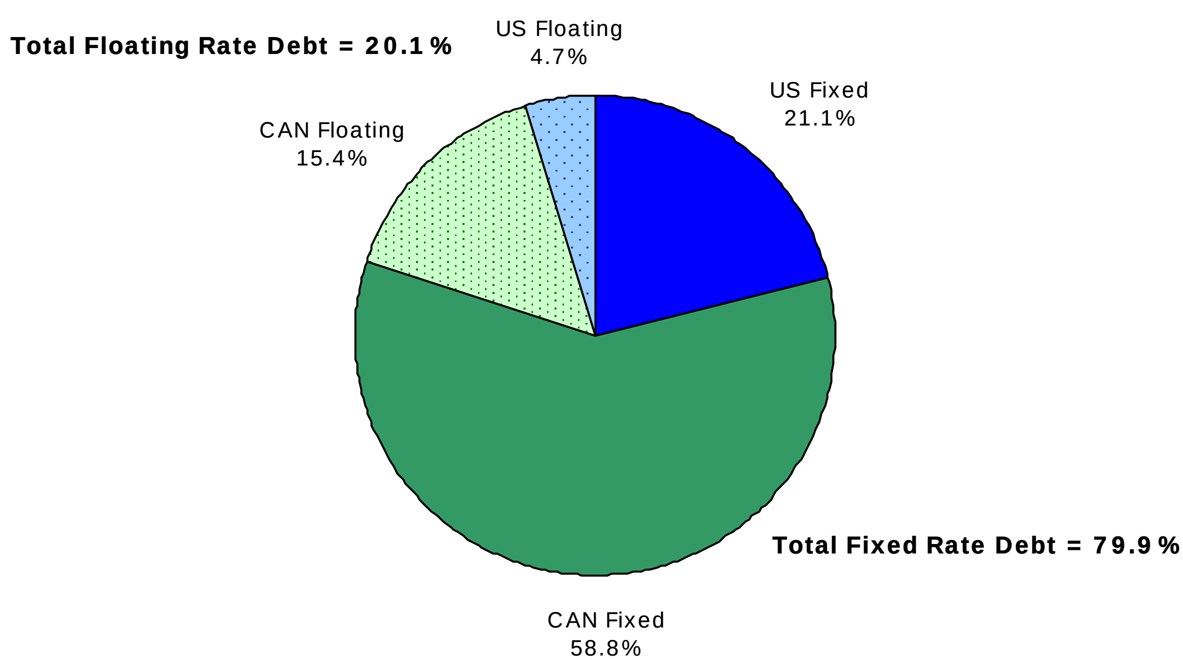
Note 1: The forecasted long term debt credit spread of 54 basis points between the Government of Canada and the Province of Manitoba has been added to each of the forecasters' Government of Canada long term debt forecasts, so that all of the long term debt interest rate projections illustrate Province of Manitoba yields.
Note 2: The forecasted long term interest rates exclude PGF and transaction costs, the estimated transaction cost for Manitoba Hydro's long term borrowing is 6 basis points or 0.06%.
Note 3: The forecasted short term debt credit spread of 20 basis points between the 3 month Government of Canada T-Bill rate and the 3 month Bloomberg BA rate has been added to each of the forecasters' Government of Canada 3 month T-Bill forecasts, so that all of the short term debt interest rate projections illustrate the 3 month BA rate.
Note 4: 10 Year MB Yield_McLeod Young Weir data per Bank of Canada. 3 Month T-Bill data per Bank of Canada. 10 Year+ Province of MB data is calculated as averages of Bloomberg 10 Year MB yield and Bloomberg 30 Year MB yield.
Note 5: 10 Year+ Government of Canada Benchmark Bond Yield has been used as an indicative proxy for the data gap for period Jan 1989 - Feb 1992 where no data was available for Province of Manitoba bond yield.

Short term interest rates have begun to rise from their recent historical lows. As illustrated on the interest rate chart, by 2014/15, these short term interest rates are forecast to return to the interest rate levels that existed prior to the financial crisis, and in line with the average experience from 1992 - 2007. Short term debt currently carries an asymmetrical risk profile as short term interest rates are more likely to rise than to fall. As short term interest rates are projected to rise faster than the long term interest rates, a financing strategy favouring fixed long term debt versus floating rate debt or shorter dated debt maturities will reduce the risk that the Corporation's future gross interest expense will be higher upon refinancing the debt stream.

Short term borrowings are considered to have terms to maturity of less than one year. Manitoba Hydro has a $500 million limit for temporary short term borrowings which includes all lines of credit and the Corporation's Commercial Paper Program. This $500 million short term borrowing program is a credit facility to safeguard Manitoba Hydro from liquidity risk, to provide sufficient liquidity for the Corporation's temporary cash requirements and to bridge the timing between long term debt issues. As Manitoba Hydro can issue promissory notes payable within its Commercial Paper Program at rates less than the Prime or Base Rates, Manitoba Hydro typically issues promissory notes instead of relying on bank overdrafts to meet its temporary cash requirements.

Manitoba Hydro's floating rate debt policy for interest reset risk is to limit the percentage of total short term and floating rate long term debt to a maximum of 30% of the total debt portfolio, and to maintain a target range between 15 - 25%. Note that Manitoba Hydro considers short term debt to be floating rate debt. Since 2003/04, Manitoba Hydro's actual quarter-end range of floating rate debt has been between 16.6% - 21.9%. A graphical depiction of Manitoba Hydro's debt structure as at September 30, 2010 is as follows:

Summary of Debt Structure
As at September 30, 2010



During the past number of years, Manitoba Hydro's actual long term financing has included issuance in various terms throughout the curve, including the issuance of floating rate notes. However, careful consideration is given to the debt maturity schedule and the total level of annual borrowings. In order to mitigate refinancing risk, to maintain financing flexibility during the upcoming decade, and in keeping with the concept of matching the Corporation's long-lived assets with long term debt, Manitoba Hydro will continue to favour long term financings with maturities of 10 years+, while maintaining floating rate debt within policy limits.

Investor appetite within the capital markets will also have a significant effect on the cost, availability and timing of Manitoba Hydro's financing. This was especially the case during the past few years as investors increasingly sought safety in liquid, high quality, government debt instruments. The impact of the recent financial credit crisis also had a significant effect on the short and long term spreads required by investors on Manitoba Hydro's borrowings. Although the benchmark Government of Canada rates dropped to exceptionally low levels during this time, this was counterbalanced by a sharp elevation in the credit spread between benchmark Government of Canada bonds and the all-in cost to the Province of Manitoba. Consequently, the all-in cost for Manitoba Hydro's long bonds remained at historically low levels in spite of the steep increase in the borrowing spread. By 2009 the spreads had decreased sharply and have since showed preliminary signs of stabilization, although still remaining elevated above the pre-crisis levels.

Manitoba Hydro has significant export revenues denominated in USD. As part of the Corporation's foreign exchange exposure management program, in order to mitigate the foreign currency exchange risk on these revenues, Manitoba Hydro maintains a natural foreign exchange hedge with US denominated debt. In addition to the mitigation of foreign exchange risk, Manitoba Hydro considers a number of factors when determining whether it will seek US dollar versus Canadian dollar debt, including the cost effectiveness of executing a US dollar versus a Canadian dollar issuance for available terms, and the liquidity and interest rate benefits associated with broadened access to capital within a diversified investor base.

6.0 Debt Management Activities for 2010/11 and 2011/12

The following section outlines the actual long term debt financings undertaken during the current fiscal year and provides an overview of Manitoba Hydro's forecasted financing requirements for the remainder of 2010/11, as well as for 2011/12.

Actual financings will vary from forecast. Actual financings will consider the timing, dollar value, denomination, and fixed versus floating nature of the issue depending on a number of factors including: the cash and liquidity requirements in existence at the time of financing; refinancing requirements on forward interest rate swaps; the term dependent on the current maturity schedule, interest rate expectations and the mitigation of refinancing risk; the management of foreign exchange risk; and the market appetite and economic environment.

2010/11

The actual long term debt financings undertaken during this fiscal year, along with the forecasted financings for the remainder of 2010/11 are as follows:

Quarter 1 On May 4, 2010, Manitoba Hydro secured long term debt series C115 for CAD $50 million and a May 4, 2015 maturity date. C115 bears a floating coupon rate of 3 month BAs + 23 basis points, and has a yield rate of 3 month BAs + 25 basis points including commissions. Debt series C115 was used for new cash requirements.

On June 4, 2010, Manitoba Hydro secured long term debt series C116 for CAD $100 million and a March 5, 2031 maturity date. C116 was issued at a premium with proceeds of $121,802,000 (net of accrued interest), bears a fixed coupon rate of 6.30%, and has an all-in cost to Manitoba Hydro of 4.65%. Debt series C116 was used for new cash requirements.

Quarter 2 On July 23, 2010, Manitoba Hydro secured long term debt series C117 for CAD $100 million and an October 14, 2011 maturity date. C117 was issued at par with proceeds of $99,975,760 (net of commissions), bears a floating coupon rate of 3 month BAs, and has a yield rate of 3 month BAs + 2 basis points including commissions. Debt series C117 was used to refinance debt series C102 which matured July 15, 2010.

On August 4, 2010, new long term debt series C119 was issued for CAD $250 million and a September 5, 2025 maturity date. The fixed rate issue was immediately swapped to floating at a rate of 3 month BAs + 42.5 basis points to accommodate $100 million of the cash flow structure of the forward interest rate swap from maturing debt series C108, and $150 million to rebalance the fixed/ floating portfolio mix. Debt series C119-1 was advanced to Manitoba Hydro to refinance debt series C108 in the amount of $100 million which matured September 1, 2010 and debt series C119-2 for $150 million was advanced to Manitoba Hydro for new cash requirements.

On August 9, 2010, a swap transaction was executed on Manitoba Hydro's dual currency bond EZ-3 in order to simplify the hedge accounting associated with the floating LIBOR rate component. This transaction converted the semi-annual floating USD interest payments on dual currency bond EZ-3 (6 month LIBOR - 0.0645% on $150 million USD notional principal) to semi-annual fixed USD interest payments at a fixed rate of 1.257% on $150 million USD notional principal to its December 2013 maturity.

Q3 & Q4 On October 27, 2010, debt series FP was reopened and new long term debt series FP-3 was issued for CAD $250 million and a June 3, 2020 maturity date. FP-3 was issued at a premium with proceeds of $263,805,000 (net of accrued interest), bears a fixed coupon rate of 4.15%, and has an all-in cost to Manitoba Hydro of 3.469%. Debt series FP-3 will be used for new cash requirements.

On December 10, 2010, long term debt series C119 was reopened for CAD $115 million of additional principal and a September 5, 2025 maturity date. The fixed rate issue was immediately swapped to floating at a rate of 3 month BAs

+ 48.45 basis points, and debt series C119-3A, C119-3B and C119-3C were advanced to Manitoba Hydro to accommodate the cash flow structure of the $115 million forward interest rate swaps from maturing debt series C099-1, C099-2, C099-3A, and C099-3B.

The forecasted long term debt balance remaining to be financed for 2010/11 includes $200 million for new cash requirements.

Sinking fund contributions for the 2010/11 fiscal year will be equal to the legislated minimum requirement of 1% of the long term debt outstanding at the end of the previous year plus 4% of the balance in the sinking fund at that date. For 2010/11, this will amount will be approximately $118.5 million. Manitoba Hydro has the equivalent of $217 million CAD maturities during 2010/11 that are forecast to be fully retired through sinking fund withdrawals as follows:

Debt Series	**Principal**	**Maturity Date**
Hydro Bond, Series 10	CAD $ 13.0 million	June 15, 2010
CO94	USD $200.0 million	February 22, 2011

2011/12

During 2011/12, the forecasted long term debt financing requirement is $1,085 million, made up of $485 million of refinancings and $600 million of new cash requirements. Short term financing will be utilized as required to provide temporary bridge financing. The long term debt financings forecasted for this fiscal year are as follows:

Quarter 1 A $200 million refinancing of CO97-1 and CO97-2 (maturing June 1, 2011) is forecasted to occur this quarter. In addition, it is forecasted that $200 million of long term debt will be issued during this quarter for new cash requirements.

Quarter 2 It is forecasted that $200 million of long term debt will be issued during this quarter for new cash requirements.

Q3 & Q4 A $100 million refinancing of C117 (maturing October 14, 2011) and a $185 million refinancing of C100-1 and C100-2 (maturing November 1, 2011) is forecasted to occur in Q3. In addition, it is forecasted that $200 million of long term debt will be issued during this time period for new cash requirements.

Sinking fund contributions for the 2011/12 fiscal year will be equal to the legislated minimum requirement of 1% of the long term debt outstanding at the end of the previous year plus 4% of the balance in the sinking fund at that date. For 2011/12, this amount is forecasted to be $98.9 million. Manitoba Hydro has the equivalent of $24.6 million CAD maturities during 2011/12 that are forecast to be fully retired through sinking fund withdrawals as follows:

Debt Series	**Principal**	**Maturity Date**
Hydro Bond, Series 9	CAD $23.4 million	June 15, 2011
Series 5B	CAD $ 1.2 million	June and December, 2011

7.0 2011 Loan Act Authority

The Loan Act is approved each year and grants Manitoba Hydro borrowing authority to meet the Corporation's projected financing requirements. Authority granted under the Loan Act is for new investment requirements. New Incremental Loan Act Authority of $595 million to December 31, 2012 is as follows:

		(millions)
2010 Loan Act Authority Available at March 31, 2011 (net)		$527
Add:	Projected Internally Generated Funds in 2011/12	554
		$1,081
Deduct:	Projected Capital Expenditures in 2011/12	$1,069
	Sinking Fund Requirement in 2011/12	99
	Capital Bridging Requirements to December 31, 2012	508
		$1,676
New Incremental Loan Act Authority Required		**$595**