



**Business Council**  
*of* **Manitoba**

2017/18 & 2018/19 Manitoba Hydro General Rate Application

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Chair of Fiscal Issues Committee

# BUSINESS COUNCIL OF MANITOBA

## MANDATE

- research and advocate innovative positions on selected issues that bear directly on the future health of Manitoba society
- does not seek government funding for its operations
- values independence and the freedom to advocate without regard to partisan politics
- GOAL: make Manitoba a preferred place to live, work and invest

# Academic and Professional Experience

- 1976 – Bachelor of Science (Honours) degree in Actuarial Science from the University of Manitoba and in 1980, became Fellow of Canadian Institute of Actuaries and a Fellow of the Society of Actuaries
- 1976 – 2016 - 15 years with Investors Group following 25 years with Great-West Life
- May 2016 – retired as President and Chief Executive Officer of Investors Group and co-President and co-Chief Executive Officer of IGM Financial Inc.
- Member of the Business Council of Manitoba since 2004, served on its Board since 2006, chaired its Fiscal Issues Committee since 2012 and served as Chair of the Board from 2013 - 2015

# Growing Debt and Future Interest Cost Implications for MB Hydro

- current MB Hydro debt levels (2017) of \$15.4 billion will grow to \$23.3 billion by 2021 to support major projects (Appendix 3.8 – MH16 Update with Interim Forecast)
- Bipole III (\$5 billion) and Keeyask (\$8.7 billion) costs and interest costs for the projects do not yet appear in MB Hydro financial operational costs
- interest costs on the construction debt are currently being capitalized in the project costs until completion, which masks these debt costs being incurred for the rate setting period that is currently under consideration

# Growing Debt and Future Interest Cost Implications for MB Hydro

- MB Hydro needed to borrow > \$200 million in 2016 and 2017 just to pay operating costs and is projected to borrow > \$800 million from 2018 to 2024 for operating costs with a 3.95% increase path (MH-52 – Rebuttal Evidence, Figure 1.10)
- total annual interest costs and depreciation charged in MB Hydro expenses are currently \$969 million (finance expense of \$573 million and depreciation of \$396 million) for 2018 and is projected to be \$2.027 billion by 2024 – more than doubling in just 6 years (MH-64, slide 17)

# MB Hydro Rates Comparatively Low

- why hold rates below operation costs of MB Hydro when Manitoba has one of the lowest costs for electricity of any location in Canada and the United States (MH-64, slide 12)
- to the west: Regina has residential hydro rates that are 77% higher than Winnipeg (MH-64, slide 12)
- to the east: Ottawa has residential hydro rates that are 47% higher than Winnipeg (MH-64, slide 12)

# Forecasted Net Income Levels are Optimistic

- we have not had a drought scenario in the last 14 years
- demand and price of Manitoba energy is under pressure in export markets
- current mega-projects may cost much more than projected
- sheer volume of debt will see interest costs escalate
- potential for higher interest rates and/or credit spreads will amplify the growing interest costs

# Interest Cost Risk Needs Serious Consideration

- interest rates are at record low levels and can change quickly
- as MB Hydro borrows for increases in debt levels and refinances existing debt, the potential for higher interest costs is the most likely scenario given the recent sustained low interest levels
- currently, the economies in Manitoba, Canada and globally are quite strong - but if any of them begin to struggle, access to issuing debt will become more limited and interest rates on lower rated debt will increase



# Increased Borrowing Costs will be borne by MB Hydro Customers

- excessive debt in Manitoba, arising in large measure from MB Hydro, combined with potential unfavourable economic environments could lead to increases in credit spreads of up to 0.50% on top of potentially higher levels of interest rates of 1.0% or more
- if MB Hydro is exposed to a 1.5% higher interest rate on their estimated \$23.3 billion debt in 2021, MB Hydro will be incurring an additional annual interest cost of \$350 million
- for perspective, the difference between a rate increase of 7.9% and 3.95% next year is about \$70 million of incremental income

# Credit Rating Agencies Influence the Bond Market

- exposure to such increases at a time of rapidly growing debt will pose huge costs for MB Hydro customers in the future
- credit rating agencies have become more rigorous since the financial crisis 10 years ago
- credit rating agencies have identified rate increases as a distinct opportunity for MB Hydro to maintain financial responsibility
- appropriate rate increases when needed will be an important signal to the credit rating agencies (and the bond investors they serve) that Manitoba will use this tool of rate adjustment responsibly
- showing leadership to increase rates substantially for the next two years will be important

# In My Past Experience

- best time to acquire good terms and rates for debt is when you can show you do not need the debt
- when financial affairs are built on needing significant levels of increasing debt, the terms and costs become very unattractive
- increasing debt at a time when the local or global financial outlook is distressed becomes very expensive or even unmanageable
- recall markets of 2008 where there was virtually no bond issue being funded into the market for several weeks and months, excepting the very strongest of Federal Government debt advanced to add liquidity in the markets
- when markets turn, it often happens quickly and more severely than anticipated

# On Reflection

- MB Hydro rates could have been increased gradually over the years and still be substantially lower than retail rates of our neighbours
- such increases would have put MB Hydro on a stronger economic footing to help absorb the costs of building and financing Bipole III, which creates no revenue, and Keeyask, where short term revenue generation does not cover building and financing costs
- rates were not increased because, technically, MB Hydro has no “actual expense” for their multi-billion dollar projects until they are completed
- pinning our rate setting to this accounting rule, that defers reality, is hardly wise stewardship

# Relevant Analogy

- consider if your child had built up \$100,000 of student debt
- would you tell your child to ignore the \$100,000 debt while they are studying to gain their credentials as it is “not really an expense” until they graduate?
- or, would you encourage your child to work all summer and take on part time jobs to limit the amount of debt cost they must bear in future years?

The Business Council of Manitoba appeals to the Public Utilities Board to:

- consider a decision for rates in the next two years to improve financial stability and the lowest costs over future years
- not be so focused on rates in the near term at the expense of overall future costs for Manitobans in years to come