COST OF CAPITAL

In accordance with Section 2.5 of the OEB Filing Requirements for Electricity Distribution Rate Applications (December 15, 2022), this schedule provides an overview of Toronto Hydro's capital structure and financing plans for 2023, 2024 and 2025. Schedules 2 and 3 provide Appendix 2-OA and Appendix 2-OB for the 2025-2029 period, respectively.

1. CAPITAL STRUCTURE

Toronto Hydro's sets its capital structure for ratemaking purposes in accordance with the OEB's Cost of Capital guidelines issued in EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (December 11, 2009) ("Report of the Board"). For Toronto Hydro, the debt to equity split for the test years is set at 60:40. The debt component in each year includes a deemed 4 percent short-term debt component.

2. FINANCING PLANS

2.1 Equity

Toronto Hydro's forecasted Return on Equity ("ROE") for the 2025 Test Year is based on the OEB's formulaic approach as outlined in the Report of the Board. For 2025, the ROE calculation uses the September 2022 bond yield spread[1] and the Ten-Year Government of Canada Bond Yield Forecast.[2]

Table 1, below, shows the projected ROE for 2025, and details of the derivation based on OEB's formulaic approach.

[1] Difference between the average 30-Year A-Rated Canadian Utility bond yield from Bloomberg L.P. and the average 30-Year Government of Canada bond as published by the Bank of Canada

[2] The average of the forecast Ten-Year Government of Canada bond yield as at December 12, 2022 and September 12, 2023 from Bloomberg L.P.

Table 1: Return on Equity Forecast

Return on Equity (ROE) forecast		
Initial ROE		9.75
Change in LCBF from September 2009		
LCBF (September 2022)	3.231	
Base LCBF	4.250	
Difference	-1.020	
0.5 X Difference		-0.510
Change in A-rated Utility Bond Yield Spread from September 2009		
A-rated Utility Bond Spread (September 2022)	1.653	
Base A-rated Utility Bond Yield Spread	1.415	
Difference	0.238	
0.5 X Difference		0.119
2025 Projected ROE based on September 2022 data		**9.36**

Toronto Hydro used the 2025 ROE forecast for the purpose of calculating the 2025-2029 revenue requirement set out in Exhibit 6, Tab 1. To determine the final revenue requirement for 2025 and the subsequent years (i.e. 2026-2029) Toronto Hydro intends to rely on the ROE set by the OEB in the final quarter of 2024.

Table 2 below provides the 2018 to 2022 Deemed ROE and Achieved ROE.

Table 2: Historical 2018-2022 Deemed and Achieved ROE

	2018	2019	2020	2021	2022
Deemed (included in Rates)	9.30%	9.30%	8.52%	8.52%	8.52%
Achieved	9.33%	8.44%	5.90%	7.08%	7.44%

2.2 Financial Market Overview and Forecast

In 2023 there was a renewed upward march in interest rates, both short-term and long-term rates, as the underlying strength of economies were much firmer than expected at the start of 2023. While headline inflation is decreasing in most major economies, core inflation remains much higher than targets as job markets remain tight, consumer spending is strong, and housing stabilizes. For markets, the combination of a resilient economy and persistent underlying inflation has resulted in additional central bank short-term rate increases and higher long-term rates.

Although Canadian headline inflation declined from its peak of 8.1 percent in June 2022, the declining trend reversed in July 2023 when headline inflation came in at 3.3 percent up from 2.8 percent in June 2023. Furthermore, the core inflation (e.g. food and energy) continues to remain high at 3.6 percent.[3] The Bank of Canada increased interest rates by 25 bps both in June and July 2023 bringing the overnight rate to 5.0 percent, the highest since 2001. The Bank of Canada remains resolute in its commitment to restoring price stability for Canadians by meeting its target to bring down inflation to 2% by mid-2025, but notes progress towards price stability is slow and inflationary risks have increased. Further increases by the Bank of Canada will depend on the upcoming economic data releases.[4]

For corporate issuers looking to tap into the debt capital markets, the 2-year yield is now within reach of the 4.70 percent mark, and up 70 bps from the lows of early May. In a similar vein, the 10 and 30-year yield is around 3.60 percent, up more than 30 bps from the spring. The total Canadian Debt Market year-to-date 2023 issuances as of August 2023, which is comprised of Banks, Corporates and foreign issuers, is down approximately 22 percent

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[3] Statistics Canada, Consumer Price Index, July 2023 (August 15, 2023), https://www150.statcan.gc.ca/n1/daily-quotidien/230815/dq230815a-eng.htm

[4] Bank of Canada, Monetary Policy Report – October 2023 (October 25, 2023) https://www.bankofcanada.ca/2023/10/mpr-2023-10-25/

compared to the same period in 2022. Debt issuances from the Banks and foreign issuers are down 50 percent and 55 percent respectively. However, Corporate issuances were up 59 percent. Corporate issuances were driven mainly by the Power & Utilities sector, which is up 63 percent.[5]

Corporate credit spreads started to tighten in 2022, partially offsetting the rising Government of Canada yields and allowing the absolute all-in yields of issuances to remain relatively stable during the 2022-2023 period. This is evidenced by the all-in coupon rate of 4.95 percent on THC's 30-year issuance on October 13, 2022, compared to an indicative all-in coupon rate of 4.93 percent on THC's 30-year issuance on August 28, 2023.[6] From September 2023 until 2025, the assumption is for THC's 10-year bond spread to be 150 - 170 basis points and 30-year bond spread to be 170 - 190 basis points. These spreads are determined from the weekly indicative quotes provided by designated banks in THC's revolving credit facility.

2.3 Medium and Long-Term Debt

Toronto Hydro's issues debt at the THC level via medium term notes in the Canadian public debt market. This requires THC to obtain and maintain credit ratings. As of July 1, 2023, THC's debentures were rated by DBRS and S&P as follows:[7]

Table 3: Rating of THC Debentures

Rating Agency	Commercial Paper	Long-Term Debt
DBRS	R-1 (Low)	A Stable
Standard & Poor's ("S&P")	Not rated	A Developing

[5] CIBC Canadian Corporate Debt Capital Markets (September 1, 2023).
[6] THC's public debt offering information is available at Exhibit 1B, Tab 3, Schedule 6.
[7] The most recent credit rating reports from DBRS and S&P are filed in Exhibit 1C, Tab 3, Schedule 7.

Toronto Hydro is assigned debt through promissory notes between the Toronto Hydro and its parent, THC. The promissory notes are written on the same terms as the parent debt as the borrowing is done on behalf of the corporation's affiliates. A fee of five basis points is charged for administration.

As of July 1, 2023 Toronto, Hydro had outstanding long-term debt in the amount of $2.745 billion, as detailed in Table 4 below.

Table 4: Long-Term Debt

Description	Maturity	Outstanding Principal ($)	Rate (%)
$200M Prom Note	Aug. 25, 2026	200,000,000	2.572
$200M Prom Note	Dec. 11, 2029	200,000,000	2.488
$200M Prom Note	Oct. 15, 2030	200,000,000	1.55
$150M Prom Note	Oct. 20, 2031	150,000,000	2.52
$250M Prom Note	Jun. 14, 2033	250,000,000	4.66
$200M Prom Note	May 21, 2040	200,000,000	5.59
$200M Prom Note	Sept. 16, 2044	200,000,000	4.13
$200M Prom Note	July 28, 2045	200,000,000	3.60
$200M Prom Note	Feb. 28, 2048	200,000,000	3.535
$200M Prom Note	Dec. 10, 2049	200,000,000	3.042
$200M Prom Note	Oct. 18, 2051	200,000,000	3.32
$300M Prom Note	Oct. 13, 2052	300,000,000	5.00
$200M Prom Note	Apr. 9, 2063	200,000,000	4.01
$45M Prom Note	Apr. 9, 2063	45,000,000	3.988
$45M Prom Note	Due on demand	45,000,000	4.16% (using deemed LTD rate)
Total		**2,790,000,000**	**3.65**

Forecasted new debt issuance for 2023-2025 is driven primarily by Toronto Hydro's capital plans and the repayment requirements of the maturing debt. Details of the forecasted debt issues for 2023-2025 are shown in Table 5.

Table 5: Forecasted Long-Term Debt Issues

Description	Issue Date	Term	Principal ($)	Underlying Govt Bond Rate (%)	Corporate Spread Forecast (%)	Forecast Coupon Rate (%)
$200M Prom Note (Series 21)	Oct 15, 2023	10 Years	200,000,000	3.50	1.50	**5.00**
$200M Prom Note (Series 22)	Nov 1, 2024	30 Years	200,000,000	3.95	1.90	**5.85**
$300M Prom Note (Series 23)	July 7, 2025	10 Years	300,000,000	3.75	1.70	**5.45**

Forecasted debt rates are based on the 10-Year and 30-Year Government of Canada Bond Yield Forecast (Bloomberg L.P.), when applicable, plus Toronto Hydro's estimate of corporate spreads at the time of issuance (inclusive of the five-basis points administration fee noted above).

Toronto Hydro applies the weighted average forecasted debt rates in its Cost of Capital, rather than applying the OEB's deemed debt rate, since this debt is based on market rates. Toronto Hydro proposes that the embedded debt rates set for 2025 apply throughout the 2025-2029 rate cycle.

2.4 Preferred Shares

Toronto Hydro has no plans to issue any preferred shares over the 2025-2029 period.

2.5 Short-Term Debt

Over the 2023-2025 period, Toronto Hydro plans to issue short-term debt in order to better match its liquidity needs in an effort to minimize net financing charges. THC maintains a revolving credit facility and also has the ability to issue commercial paper available for Toronto Hydro when short-term funds are required.

One-Month Banker's Acceptance rates (Bloomberg L.P.) are used as a proxy for Toronto Hydro's forecast of its short-term debt rate, plus a five-basis point administration fee. The rates are outlined in Table 6 below. The deemed short-term debt weighting of 4 percent applies to Toronto Hydro's capital structure.

Table 6: Short-Term Rates

Year	Short Term Rates
2023	5.15%
2024	5.40%
2025	5.40%