MANITOBA HYDRO

2015/16 & 2016/17 GENERAL RATE APPLICATION

INTEGRATED FINANCIAL FORECAST & ECONOMIC OUTLOOK

INDEX

Appendices

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3.0 OVERVIEW

Tab 3 provides an overview of Manitoba Hydro's Integrated Financial Forecast, Economic Outlook, and Debt Management Strategy. Section 3.1 discusses the 2014 Economic Outlook, Sections 3.2 and 3.3 discuss Manitoba Hydro's 2014 Integrated Financial Forecast (IFF14) and Electric operations forecast (MH14), Section 3.4 discusses Manitoba Hydro's 20 year Financial Outlook and Financial Targets, Section 3.5 discusses Manitoba Hydro's Debt Management Strategy, and Section 3.6 discusses Credit Rating Agency Reports.

The key conclusions with respect to Tab 3 are:

1. The required investments in new and existing infrastructure that are necessary to continue to provide a high level of service to customers are expected to double the asset base and carrying costs of Electric operations in the next 10 years.

2. While a portion of the required investments will be funded by cash flow from operations, the majority will be funded through unprecedented levels of debt financing.

3. Rate stability for customers is dependent on Manitoba Hydro maintaining its financial strength.

4. The required investment in assets will place pressure on Manitoba Hydro's financial strength by deteriorating the financial results and key financial ratios.

5. While Manitoba Hydro is prepared to accept deterioration of its financial ratios in order to mitigate rate increases for customers, the proposed 3.95% rate increases are the minimum that are required to maintain rate stability and

manage the deterioration in the Corporation's financial strength during the period of extensive investments.

6. The proposed 3.95% rate increases will maintain Manitoba Hydro's 2015/16 and 2016/17 net income and financial ratios at acceptable levels and will compensate for lower net extraprovincial revenues that are currently being experienced.

7. The proposed 3.95% rate increases are required notwithstanding more favourable near-term financial results, given Manitoba Hydro's near-term exposure to changes in water flow conditions and the mid-term outlook for less favourable financial results.

8. Inflationary rate increases are not sufficient to maintain rate stability for customers, and will subject customers to increased rate volatility in the future.

9. The key financial risks associated with rate increases lower than 3.95% are:
    i. Increased risk to customers of rate instability and rate shock;
    ii. Increased borrowing requirements and associated financing costs which must be recovered from customers in the future;
    iii. Potential negative implications to the Provincial credit rating and Manitoba Hydro's borrowing costs.

3.1 ECONOMIC OUTLOOK 2014

The Economic Outlook is prepared at the start of the annual forecasting cycle at Manitoba Hydro. The forecasts reported in the Economic Outlook are based on a consensus view of several independent sources including Canada's primary financial institutions in addition to several other independent sources, all of which are well known and respected. The most recent forecasts from each of the sources at the end of March 2014 were used in the spring Economic Outlook. The Economic Outlook provides a forecast of economic and financial variables that are used in business analyses throughout the Corporation and are inputs in other forecasts. Variables such as real gross domestic product and residential customer projections are inputs to the Load Forecast; and, interest, escalation and exchange rates are used in a number of component forecasts that are inputs to the IFF. The 2014 Economic Outlook is provided in Appendix 3.1.

With the weakened outlook for global growth, future forecasts for both interest rates and the Canadian dollar were updated in the fall of 2014, with source forecasts available as of the end of September 2014. Also provided in Appendix 3.1 is an update to Appendix A of the 2014 Economic Outlook to reflect the latest consensus of source forecasts as of September 2014.

As a result of the fall update, the values of certain variables that were used in the IFF have been updated from those in the 2014 Economic Outlook. The economic variables that were revised in the fall update and incorporated into IFF14 are as follows:

Figure 3.1 Updated Economic Variables

	Short-term Interest Rate*	Long-term Interest Rate*	USD/CAD
2014/15	1.95	4.50	1.10**
2015/16	2.30	5.10	1.12
2016/17	3.40	5.50	1.12

*Short-term and long-term interest rates include the provincial guarantee fee
** USD/CAD exchange rate marked with an asterisk was reviewed, but not changed from the spring 2014 Economic Outlook for 2014/15.

Appendix 3.2 provides additional information with respect to the determination of Manitoba Hydro's interest rate forecast.

3.2 INTEGRATED FINANCIAL FORECAST

The Integrated Financial Forecast ("IFF") is Manitoba Hydro's primary planning document for projecting the future financial direction of the Corporation. IFF14 sets forth the projected financial results and financial position of Manitoba Hydro for the 20-year period to 2033/34. Its purpose is to provide an indication of the Corporation's long-term financial direction. The IFF serves as the primary forecast to determine the need for rate increases and the detailed forecasts in years two and three of the IFF form the basis of the revenue requirement portion of the Corporation's electric rate application.

The IFF is based on various component forecasts from across the Corporation including the:

- Economic Outlook
- Energy Price Outlook

- Electricity Export Price Forecast
- Power Smart Plan
- Electric Load Forecast
- Domestic Revenue Forecast
- Power Resource Plan
- Generation Cost & Interchange Revenue Forecast
- Capital Expenditure Forecast
- Operating, Maintenance & Administrative Expense Forecast

IFF14 can be found in Appendix 3.3 and was approved by the Manitoba Hydro-Electric Board ("MHEB") on December 3, 2014. IFF14 includes segment forecasts for electric operations (MH14), natural gas operations (CGM14), and corporate subsidiaries (CS14).

3.3 ELECTRIC OPERATIONS FORECAST (MH14)

The MH14 forecast contains the projected financial results for electric operations and can be found in Appendix 3.4. Manitoba Hydro's financial targets have been set for consolidated operations. As requested in past proceedings, Manitoba Hydro has also provided financial ratio calculations for electric operations in Appendix 3.4. Given the dominate size of electric operations in relation to consolidated operations, these calculations usually differ only slightly from consolidated ratio calculations.

In this Application, 2015/16 and 2016/17 are the two years for which rate increases are sought. Manitoba Hydro is also seeking final approval of the 2.75% rate increase granted effective May 1, 2014 in Order 49/14. The forecast period for MH14 extends for 20 years, in order to provide an indication of the longer-term financial outlook for electric operations. For the purposes of the requested rate increases, the focus of this Application is centered on the three year period under review in this proceeding (2014/15 to 2016/17) and the first 10 years of MH14 (2014/15 to 2023/24). This follows the Manitoba Hydro approach of determining near-term rate proposals in the context of the 10 year financial outlook and the financial challenges in this period that result from the extensive investment requirements.

The rate increases proposed for 2015/16 and 2016/17 have been approved by the MHEB for submission to the PUB. The indicative rate increases subsequent to 2016/17 may be changed in future forecasts and are presented for illustrative purposes only. Each year's revision to the Integrated Financial Forecast is based on the current year's assumptions including energy supply and demand, projected interest and escalation rates, projected prices for exported energy, operating and capital forecasts and other factors. Actual rate applications made in future years will depend upon the circumstances and outlook at that time and will be subject to the review and approval of the MHEB.

3.3.1 10 Year Electric Operations Financial Outlook

Figure 3.2 below summarizes the changes in net income between MH14 and MH13 (2013 forecast for electric operations). In comparison to MH13, Electric operations net income including the proposed and indicative rate increases is projected to be approximately $0.5 billion lower over the 10-year period to 2023/24.

Figure 3.2 - Comparison of Electrical Operations MH14 to MH13
Increase/(Decrease)
(millions of $)

	2015-2017			2015-2024		
	MH14	MH13	Variance	MH14	MH13	Variance
General Consumers at projected rates	4 430	4 550	(119)	17 755	18 460	(705)
Extraprovincial	1 293	1 134	159	6 449	5 892	557
Other	43	40	3	149	158	(9)
Total Revenues	5 766	5 724	43	24 353	24 495	(142)
Operating and Administrative	1 579	1 584	(5)	5 751	5 821	(71)
Finance Expense	1 553	1 579	(26)	8 975	8 564	411
Depreciation and Amortization	1 228	1 325	(97)	5 486	5 451	36
Water Rentals and Assessments	359	345	14	1 213	1 186	28
Fuel and Power Purchased	456	504	(49)	2 091	2 209	(118)
Capital and Other Taxes	327	331	(4)	1 355	1 350	5
Corporate Allocation	25	27	(1)	83	88	(5)
Other Expenses	7	0	7	25	0	25
	5 534	5 695	(161)	24 980	24 668	311
Non-controlling Interest	45	57	(12)	68	88	(21)
Net Income	277	86	191	(559)	(85)	(474)

The decrease in General Consumers Revenue in the first ten years of MH14 is primarily due to increased energy and capacity savings as a result of more aggressive Residential and Commercial incentive based DSM programs, alternative approaches to the market, and additional new energy efficiency programs.

The increase in Extraprovincial Revenue in the first ten years of MH14 is primarily due to a projected weakening of the Canadian dollar compared to MH13, as well as increased DSM energy and capacity savings, which increase export sales. These increases in Extraprovincial Revenue are partially offset by lower projected export prices compared to MH13.

The decrease in OM&A in the first ten years of MH14 is mainly due to the reclassification of Great Northern Transmission Line costs to fuel and power purchases, as well as the nine month deferral of Bipole III Reliability Project.

The increase in Finance Expense in the first ten years of MH14 is primarily due to an increase in interest expense associated the revised capital spending for the Bipole III Reliability Project and the Keeyask Generating Station when these projects are placed into service and the interest is no longer capitalized. This increase is partially offset by lower projected interest rates compared to MH13.

The increase in Depreciation and Amortization Expense in the first ten years of MH14 is primarily due to the revised capital spending noted above, and is almost fully offset by the reduction in depreciation rates as a result of the 2014 Depreciation Study and changes to depreciation methodologies.

The decrease in Fuel and Power Purchased in the first ten years of MH14 is primarily a result of the following: a reduction in import purchases and thermal generation requirements due to increased DSM energy and capacity savings, lower import and fuel prices, and lower transmission charges. Decreases in Fuel & Power Purchased are partially offset by a projected weakening of the Canadian dollar compared to MH13.

Tab 5 of the Application provides detailed explanations of the actual and forecast revenues and expense related to Electric operations for 2012/13 to 2016/17.

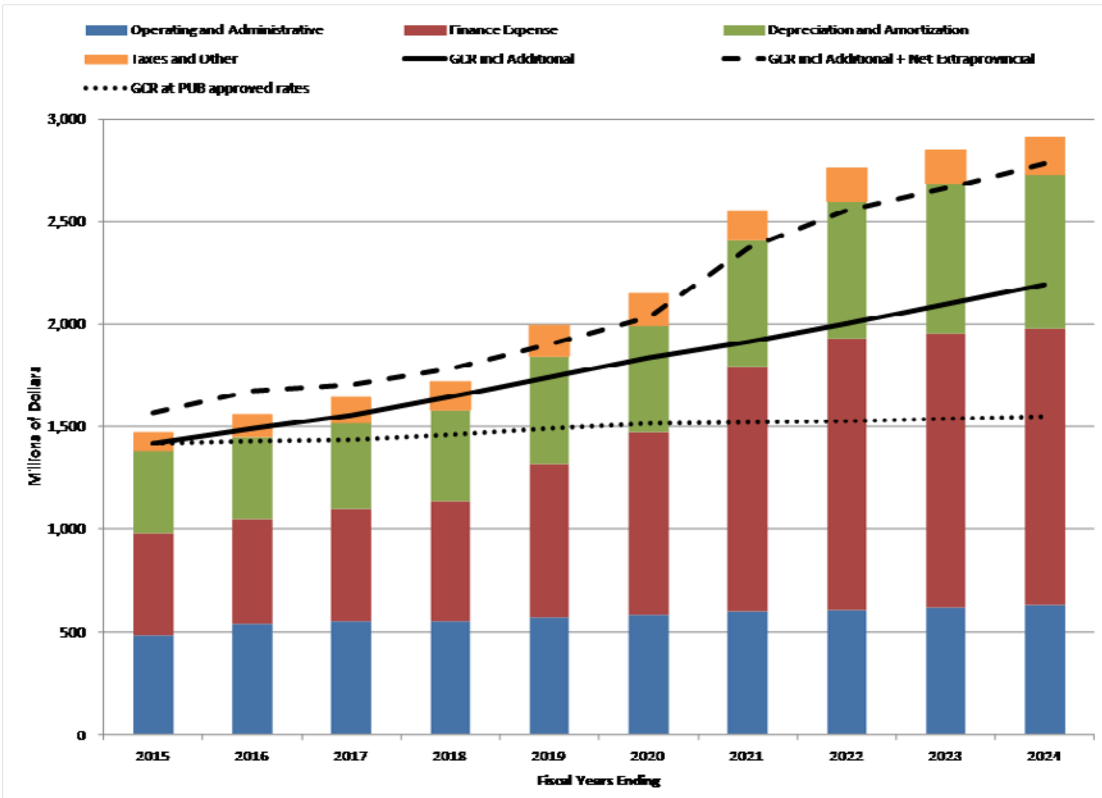
3.3.2 10 Year Comparison of Expenses Versus Revenues—Electric Operations

The following Figure 3.3 compares Manitoba Hydro’s electric operations projected non-flow related expenses (OM&A, finance expense, depreciation expense, and taxes and other expenses), which are more fixed in nature, to the Corporation’s projected domestic and net export revenues (extraprovincial revenues less fuel & power purchases and water rentals & assessments). Manitoba Hydro's costs rise sharply to approximately $3.0 billion over the 10 year period to 2023/24, essentially doubling from their current level of $1.5 billion. This increase in costs is primarily driven by Manitoba Hydro's required capital investments.

General Consumers Revenue is insufficient to fully cover the $1.5 billion total cost increase. Over the 10 year period, General Consumers Revenue, including the proposed and projected indicative annual rate increases, rises by only about half the cost increase ($0.7 billion and $1.5 billion respectively). Even with net extraprovincial revenues, Manitoba Hydro is projecting losses on electric operations in 2018/19 to 2023/24 totaling approximately $0.9 billion, which reduces projected retained earnings from approximately $2.7 billion in 2014/15 to $2.0 billion by 2023/24.

Manitoba Hydro is relaxing its adherence to financial targets over this period in order to alleviate rate increases in excess of 3.95% to the extent possible. Due to the deterioration in Manitoba Hydro's financial ratios (discussed in Section 3.4), any further increases to costs or reductions to revenues increases the risk of significantly higher rate increases to customers.

Figure 3.3 Electric Expenses Compared to Revenues



In the next 10 years there is significant financial risk and potential for rate volatility as Manitoba Hydro's financial position deteriorates due to the large capital investment requirements. In the longer term, the indicative 3.95% rate increases and the additional export revenues from Keeyask are forecast to accumulate to a sufficient level to cover the increased costs and Manitoba Hydro is projected to begin to rebuild its financial reserves.

3.3.3 Sensitivity Analysis

Manitoba Hydro's earnings and financial reserves are highly sensitive to fluctuations in water flows, interest rates, export prices, and domestic rates changes. The Sensitivity Analysis discussion on pages 22-25 in Appendix 3.3 and provided in Appendix 3.6 show the following impacts to retained earnings associated with changes to these assumptions (assuming there are no compensating changes to the projected rate increases reflected in MH14):

- A 5 year drought would result in a significant detrimental impact to Manitoba Hydro's financial stability causing a decrease in retained earnings of $1.7 billion by 2020/21 (the end of the 5 year drought period).

- A change in interest rates by +/- 1% would cause retained earnings to change by approximately +/- $1 billion by 2023/24.
- A low or high export price change would cause retained earnings to change by approximately +/- $700 million by 2023/24.

Although MH14 shows a strengthening of earnings in the first four years of the forecast to 2017/18, Manitoba Hydro's projected financial results and ratios (discussed in detail in Section 3.4) show a projected decline over this period and continuing through to the in-service of the Keeyask Generating Station. It is imperative for Manitoba Hydro to be granted the proposed rate increases, as well as regular and reasonable rate increases over the long term to maintain Manitoba Hydro's financial integrity and self-sufficiency, ensure rate stability for its customers, to maintain its infrastructure and to accommodate capital development to provide adequate supply, transmission and distribution into the future.

By receiving regular and reasonable rate increases, as forecast in MH14, Manitoba Hydro will continue to effectively manage the growing electricity requirements of the Province, strive to maintain system reliability and the financial strength of the Corporation on behalf of its customer base.

3.4 20 YEAR FINANCIAL OUTLOOK & FINANCIAL TARGETS

Over the 20-year period to 2033/34, electric operations net income in MH14 is projected to be approximately $1.8 billion lower than MH13. General Consumers Revenue is $3.3 billion lower compared to MH13 mainly due to increased demand side management savings, a lower approved rate increase for 2014/15 and lower projected indicative rate increases from 2031/32 to 2033/34. Over the 20 year forecast period, net extraprovincial revenues are projected to be $2.0 billion lower compared to MH13 mainly due to the suspension of Conawapa, as well as lower projected export prices, partially offset by increased energy available for export as a result of increased demand side management (DSM) energy and capacity savings.

The reduction in General Consumers Revenue and extraprovincial revenues is partially offset by reductions in finance expense ($2.6 billion), capital and other taxes ($0.4 billion), and depreciation expense ($0.2 billion) compared to MH13 that result from lower projected interest and depreciation rates and projected capital expenditures that are

$7.5 billion lower over the 20 year period to 2033/34 mainly due to the suspension of Conawapa. OM&A expenses are reduced by $0.4 billion mainly due to the reclassification of Great Northern Transmission line costs.

3.4.1 Consolidated Financial Targets

Manitoba Hydro has three primary financial targets for consolidated operations which are used to assess the financial strength of the Corporation.

1. Debt/Equity: Maintain a minimum debt/equity ratio of 75:25.
2. Interest Coverage: Maintain a minimum annual gross interest coverage ratio of greater than 1.20.
3. Capital Coverage: Maintain a capital coverage ratio of greater than 1.20 (excepting new major generation and transmission).

The Corporation has commenced construction on the Bipole III Reliability and Keeyask generating station projects. It is recognized that it may not be possible to maintain financial targets during this period of major investment in the generation and transmission system and that financial ratios will deteriorate during this investment period, even with the proposed and indicative rate increases of 3.95%.

Manitoba Hydro recognizes that the rate increases that would be necessary to maintain its financial ratios at or above targets in the near to medium term, would be financially challenging for its customers. Further, this would be inconsistent with Manitoba Hydro's approach of smoothing rate increases over time in order to promote rate stability. Consequently in MH14, financial results and ratios are projected to be significantly below target for an extended period of time. Notwithstanding Manitoba Hydro's desire to smooth rate increases to customers over time, the Corporation recognizes that the 3.95% rate increases are the minimum that are required to maintain rate stability and financial integrity.

The PUB expressed concern with respect to the adequacy of Manitoba Hydro's financial reserves when it found in Order 43/13, page 23:

> *"Manitoba Hydro currently has achieved its debt-to-equity target of 75:25. However, the Board is concerned about the contemplated deterioration in the utility's financial targets, particularly the fact that by 2021, the debt-to-equity ratio is projected to be*

90:10. Any further escalations in the capital cost for Manitoba Hydro's major new capital projects will cause the financial structure to deteriorate further.

…

The Board is concerned that, by moving towards a 90:10 debt-to-equity ratio by the end of the decade, there will be an insufficient retained earnings reserve to deal with droughts and other risks such as infrastructure failure or rising interest rates. The Board sees a need to further examine and quantify the other risks that Manitoba Hydro faces at the next General Rate Application and determine whether these should be subject to separate reserve provisions. The Board will require Manitoba Hydro to provide an analysis of risks on a quantitative and probabilistic basis at the next General Rate Application.

The Board notes that Manitoba Hydro shares the benefit of the flow-through credit rating of the Province, which affords it preferential interest rates on its debt and access to funds to meet its major capital spending program. However, as its debt grows, there is a potential for Manitoba Hydro's financial condition to affect the credit rating of the Province. It is important that Manitoba Hydro remains a financially strong and viable organization."

Manitoba Hydro has recently commenced a review of its financial targets and KPMG has been selected as the consultant to provide recommendations to Manitoba Hydro on the appropriate financial targets which align with the mandate of the Corporation and the interests of its stakeholders considering its operating and business outlook and associated risks. The review will consider the objectives of maintaining rate stability for customers and Manitoba Hydro's self-supporting status for credit rating proposes. It is expected that this review will be completed in time for the approval of IFF15 by the MHEB in late fall of 2015.

As part of this review, analysis will also be provided to satisfy PUB Directive 10 from Order 43/13 to review Manitoba Hydro's operating and financial risks in order to assess the adequacy of financial reserves, including, as appropriate, the use of quantitative and probabilistic analysis. It is expected that this information would be available for review by the PUB at the next GRA proceeding.

Manitoba Hydro has filed extensive information in Appendices 3.5 and 3.6 of the Application with respect to the financial impacts of the key risks of the Corporation, as well as the financial implications of various alternative rate scenarios. Manitoba Hydro is of the view that this information provides adequate support for the PUB to approve Manitoba Hydro's Application for 2015/16 and 2016/17.

The 3.95% proposed and indicative rate increases are the minimum necessary to manage the significant deterioration in Manitoba Hydro's projected financial results and ratios in the next 10 year period. Should the PUB defer the proposed rate increases, there is greater risk that future rate increases will be significantly higher than 3.95%.

3.4.2 Equity Ratio

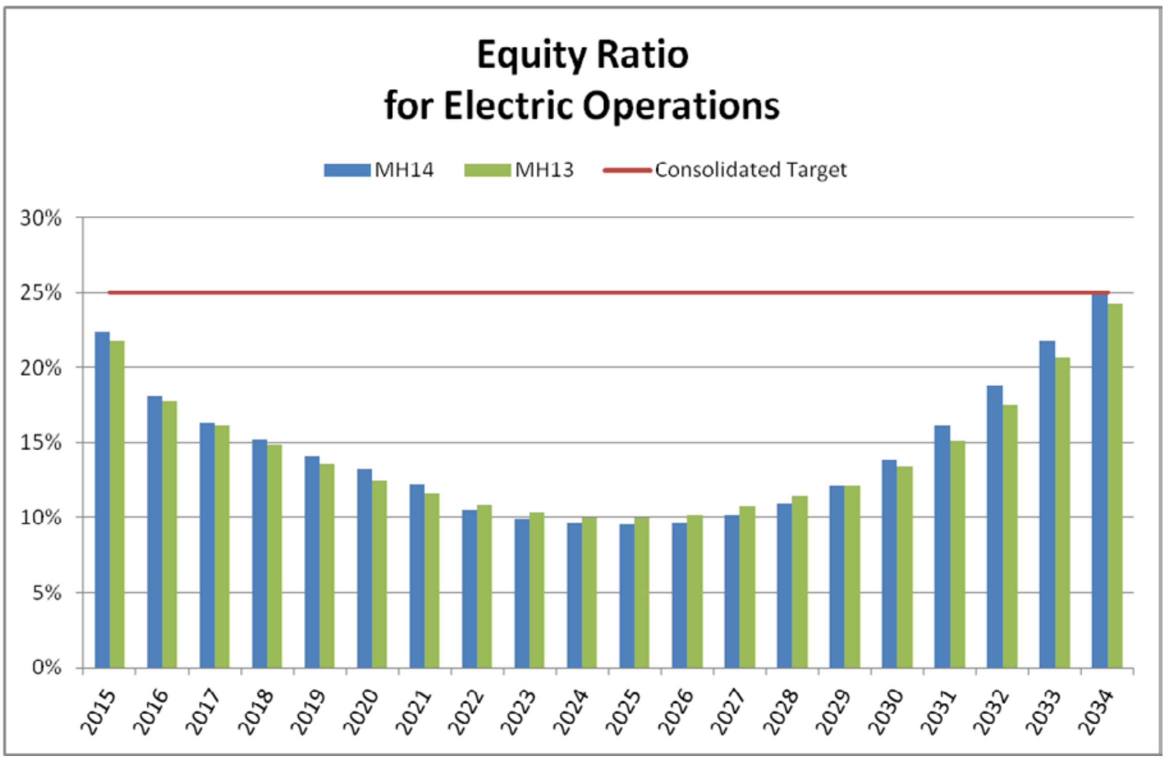
Manitoba Hydro's consolidated debt/equity target is to maintain a minimum debt to equity ratio of 75:25 (i.e. 75% debt and 25% equity). The equity ratio measures the portion of assets that have been financed by internally generated funds (equity) rather than debt. Manitoba Hydro's equity is not a cash reserve but is primarily represented by the internally generated funds accumulated since its inception that have been reinvested in the assets of the Corporation.

It is beneficial for customers when assets are funded through internally generated funds rather than debt in that Manitoba Hydro must collect the carrying costs on debt through rates. The ability to fund a portion of assets through internally generated funds is also beneficial in that it preserves borrowing capacity in the event of any adverse financial impact. It is very important that Manitoba Hydro achieve an appropriate balance of debt and equity such that the Corporation can continue to invest in its system without driving its debt to unacceptable levels or dramatically impacting customers' rates.

Should the capital markets perceive Manitoba Hydro's debt levels to be too high, there may be negative implications to the Province's credit ratings, which could result in higher borrowing costs. An appropriate debt/equity target, assists Manitoba Hydro to maintain reasonable levels of debt and equity in proportion to the assets the Corporation has invested in, in order to keep debt and borrowing costs at manageable levels. As a result of the significance of the size of Manitoba Hydro's debt in relation to the Province of Manitoba's debt as a whole, the debt/equity ratio is a key indicator in the review of Manitoba Hydro for the Province's credit rating.

Figure 3.4 below provides the projected electric operations equity ratio for MH14 compared to MH13. Manitoba Hydro's electric operations equity ratio was 23% at March 31, 2014. The debt/equity ratio is projected to weaken substantially over the next several years to 10% by 2022/23 (the same level as MH13) mainly due to the significant capital investment in major new generation and transmission and expenditures to renew and replace aging infrastructure. The equity ratio is projected to return to the 25% target by 2033/34 (the same year as in MH13) due to the regular and reasonable rate increases that are included in the forecast, as well as export revenues resulting from the Keeyask Generating Station.

Figure 3.4 Projected Equity Ratio



In Manitoba Hydro's judgment, the projected deterioration in the equity ratio in MH14 is at the minimum acceptable financial operating level even with the proposed and indicative rate increases. Any further deterioration in the equity ratio significantly increases the risk of large rate increases to customers in the longer term and any reduction to the rate increases proposed in this Application only intensifies this risk to customers. As an example, the impact of the reoccurrence of the historic 5-year drought would result in significant further deterioration in the equity ratio from MH14 and essentially deplete Manitoba Hydro's financial reserves. In this circumstance, there would not be sufficient reserves to mitigate the potential financial impacts of the considerable array of the risks the Corporation faces in fulfilling its mandate.

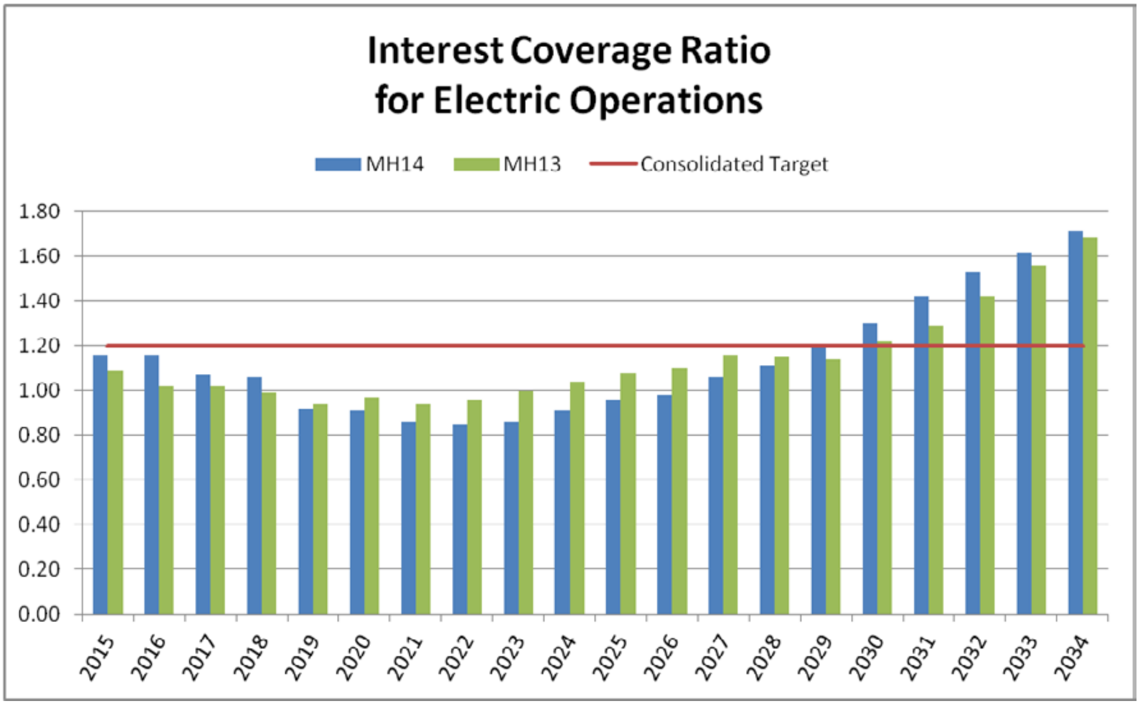
3.4.3 Interest Coverage Ratio

Manitoba Hydro's consolidated target is to maintain a minimum annual gross interest coverage ratio of greater than 1.20. The interest coverage ratio provides an indication of the ability of the Corporation to meet interest payment obligations with the net income generated by the Corporation. Annual interest coverage at or greater than 1.20 ensures that there is a sufficient margin of earnings in excess of that which is required to cover interest payments to bondholders.

Manitoba Hydro's interest coverage ratio is also forecast to be well below target for several years of the forecast. In eight years of the forecast, Manitoba Hydro's interest coverage ratio is below 1.0, which indicates that the utility would experience elevated operational liquidity risk and may have difficulty generating sufficient revenues and cash flow from operations to pay its interest obligations.

Figure 3.5 below provides the projected electric operations interest coverage ratio for MH14 compared to MH13. Manitoba Hydro's electric operations interest coverage ratio was 1.25 at March 31, 2014. Lower net earnings and higher finance expenses associated with the higher capital costs of Bipole III, DSM, Keeyask and aging infrastructure renewal and replacement results in projected interest coverage ratios lower than target for a period of fourteen years, and below 1.00 for eight of those years, before returning to target in 2028/29.

Figure 3.5 Projected Interest Coverage Ratio



4.4.4 Capital Coverage Ratio

Manitoba Hydro's consolidated target is to maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio measures the ability of current period internally generated funds to finance sustaining capital expenditures (excluding major new generation and transmission capital expenditures). A capital coverage ratio of greater than 1.20 provides sufficient cash flow from operations to fund sustaining capital expenditures and further reduces the need for debt financing.

Similar to the interest coverage ratio, a lower capital coverage ratio indicates that the utility has less revenues or more operating or finance expenses resulting in less cash flow from operations to fund sustaining capital expenditures. A capital coverage ratio of less than 1.0 indicates that the utility is having difficulty generating sufficient revenues required to fund its sustaining capital expenditures and must borrow more debt in order maintain the same level of expenditures and customer service. The capital coverage ratio is a measure that assists in keeping Manitoba Hydro's debt and finance expense at manageable levels.

Figure 3.6 below provides the projected electric operations capital coverage ratio for MH14 compared to MH13. Manitoba Hydro's electric operations capital coverage ratio was 1.39 at March 31, 2014. Capital coverage is projected to be below target for nine years of the forecast, and below 1.00 for six of those nine years, due to the reduction in net income and increasing capital requirements to replace aging infrastructure. The capital coverage ratio is projected to return to target by 2023/24 and then projected cash flows are sufficient to enable this target to be met in the remaining years of the forecast.

Figure 3.6 Projected Capital Coverage Ratio

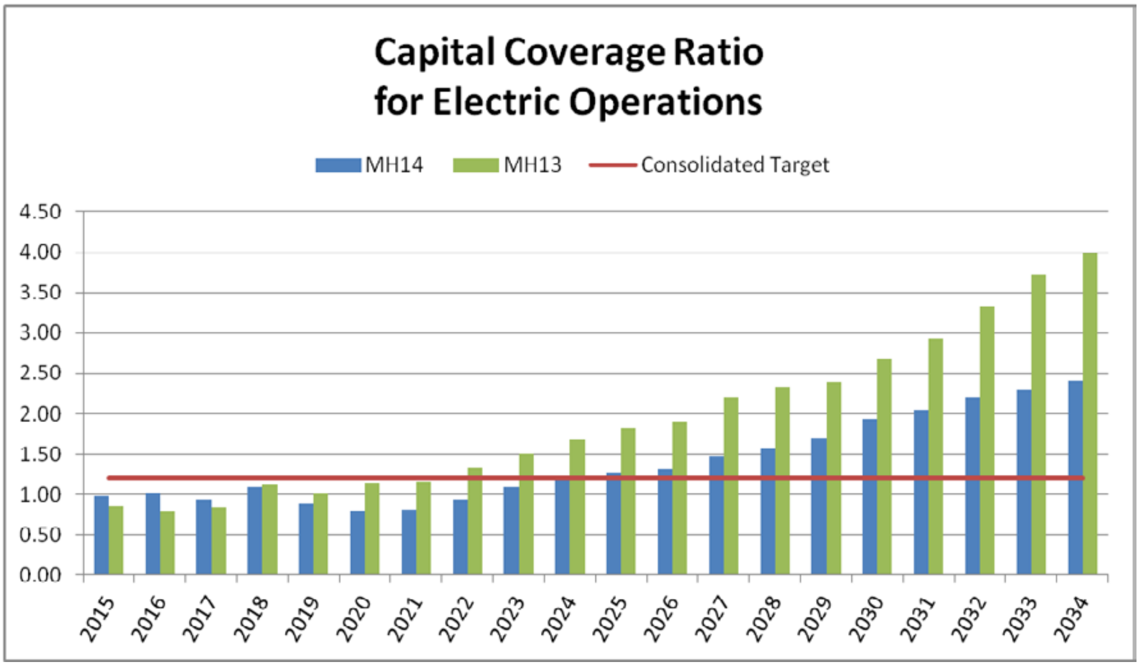
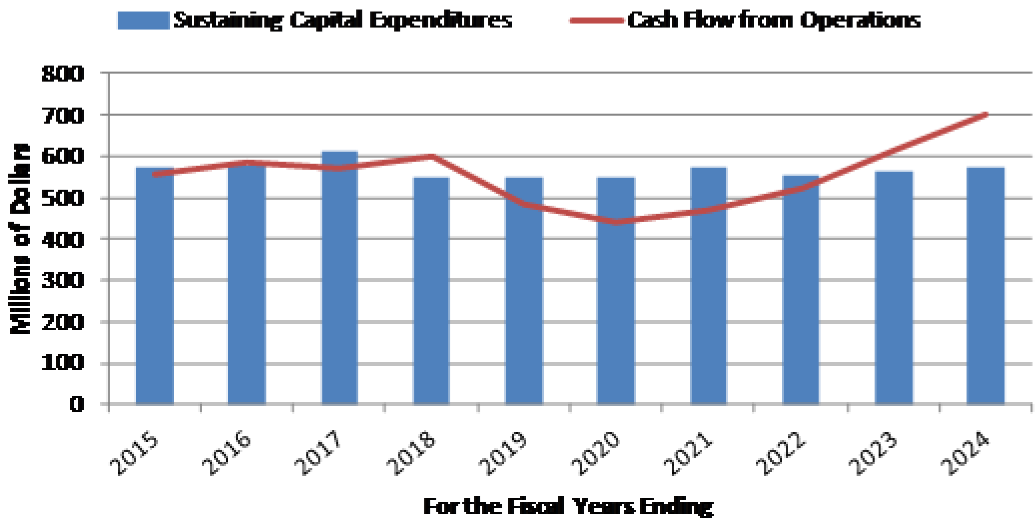


Figure 3.7 below shows the relationship between sustaining capital expenditures and cash flow from operations for MH14. Although revenues (Manitoba and extraprovincial) are increasing gradually over MH14, cash flow from operations is relatively flat over the first four years and then declines for a short period to 2019/20.

Until such time as there are sufficient internally generated funds in 2022/23, there is a cumulative sustaining capital expenditure funding deficit of $300 million which results in incremental borrowing for Manitoba Hydro. Following the in-service of the Keeyask Generating Station, revenues are projected to be sufficient to generate a surplus of cash flow from operations in excess of sustaining capital expenditures. In the interim, until the Keeyask Generating Station is generating revenue, any further reduction in revenues or increases in capital expenditures will result in further capital coverage ratio deterioration which increases the risk of significant rate increases to customers in the future.

Figure 3.7 Sustaining Capital Expenditures and Cash Flow from Operations



3.5 DEBT MANAGEMENT STRATEGY

The Debt Management Strategy document (see Appendix 3.7) 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 financing requirements for the 2014/15, 2015/16 and 2016/17 fiscal years.

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.

The low interest rate environment over the past few years has provided the opportunity for Manitoba Hydro to secure stable, low cost funding. Since 2006/07, the debt portfolio's net weighted average interest rate has decreased by nearly 2.0%. To enhance the debt portfolio stability, the weighted average term to maturity of the Corporation's debt portfolio has increased by over three years.

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 fixed rate financings with maturities of 10 years and longer.

3.6 CREDIT RATING AGENCY REPORTS

Manitoba Hydro uses debt advanced and guaranteed by the Province of Manitoba to finance its investment in assets. Manitoba Hydro's long and short term credit ratings are a flow-through of the Province of Manitoba's credit ratings (as highlighted in green in Figure 3.8 below):

Figure 3.8: Province of Manitoba Credit Ratings

S&P		Moody's		DBRS	
Long Term	Short Term	Long Term	Short Term	Long Term	Short Term
AAA	**A-1+**	Aaa	**P-1**	AAA	R-1 high
AA+		**Aa1**		AA high	
AA		Aa2		AA	**R-1 middle**
AA-		Aa3		AA low	
A+	A-1	A1		**A high**	R-1 low
A		A2		A	
A-	A-1/ A-2	A3	P-1/ P-2	A low	
BBB+	A-2	Baa1	P-2	BBB high	R-2 high
BBB	A-2/ A-3	Baa2	P-2/ P-3	BBB	R-2 middle
BBB-	A-3	Baa3	P-3	BBB low	R-2 low/ R-3

The Province of Manitoba has a high credit rating as can been seen in the following chart that shows the long term credit ratings for each of the Canadian provinces. This high credit rating benefits Manitoba Hydro's customers by reducing the cost of borrowing that the Corporation must recover in its rates.

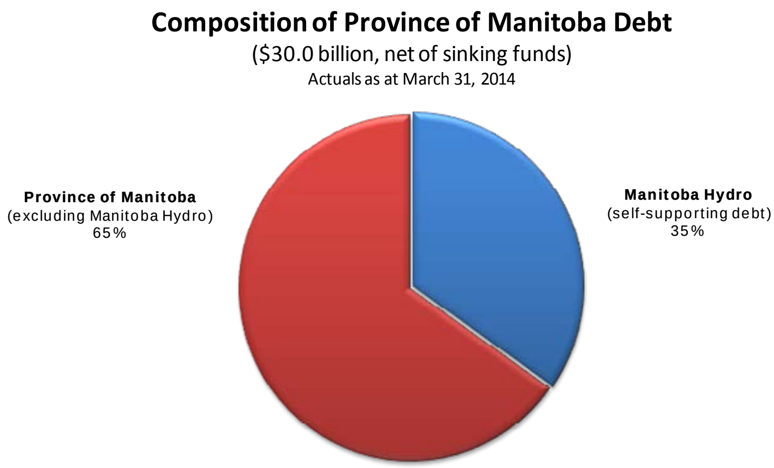
Figure 3.9: Provincial Long Term Credit Ratings Comparison

Province	Standard & Poors	DBRS	Moody's Investors Service
British Columbia	AAA	AA (high)	Aaa
Saskatchewan	AAA	AA	Aaa
Alberta	AAA	AAA	Aaa
Manitoba	AA	A (high)	Aa1
Ontario	AA-	AA (low)	Aa2
Nova Scotia	A+	A (high)	Aa2
Newfoundland & Labrador	A+	A	Aa2
Québec	A+	A (high)	Aa2
New Brunswick	A+	A (high)	Aa2
Prince Edward Island	A	A (low)	Aa2

Rating reports are issued to individual provinces and not necessarily at the same time.

As demonstrated in Figure 3.10, debt advances to Manitoba Hydro form a significant portion of the total provincial debt and the Corporation's financial performance is therefore a contributing factor toward the financial strength and stability of the Province's credit rating.

Figure 3.10 Composition of Province of Manitoba Debt



The credit rating agencies view Manitoba Hydro to be financially self-supporting in that the Corporation is able to meet its financial obligations based on its own revenues without being supported by the tax-base of the Province. As noted by Moody's Investors Service ("Moody's") in a credit analysis on the Province of Manitoba (September 5, 2012):

> "Roughly one third of the province's total direct and indirect debt is attributed to Manitoba Hydro (issued and on-lent by the province) and is considered to be self-supporting. This Crown Corporation's ability to meet its own financial obligations, without recourse to provincial subsidies is a positive credit attribute for the province."

Credit rating agencies view Manitoba Hydro's current low rates and reasonable regulatory framework as positive ratings considerations. According to Moody's (reports dated October 17, 2014 and November 6, 2014):

> "The province issues debt on behalf of its wholly-owned utility company Manitoba Hydro, which we view as a self-supporting entity and therefore,

> exclude the related net debt from the Province of Manitoba's debt metrics. … The anticipated increase in debt at Manitoba Hydro could increase the contingent liability for the province of Manitoba in the next few years. … We will monitor the increase in Manitoba Hydro's debt ratios and the progress of construction of these projects. … We note positively, that Manitoba Hydro has flexibility to increase utility rates given fairly low rates compared to other provinces and that it has already negotiated future long-term export contracts with customers in the US."
>
> "Manitoba Hydro operates in a stable regulatory framework with steady yearly rate increases. It forecasts annual rate increases of 3.95% until FY2033 to contribute to replacing aging generation, transmission and distribution facilities. The rates are set on a cost-of-service basis. The MPUB independently overseas the rate setting process and has a supportive environment for cost recovery. Residents of Manitoba continue to pay rates that are among the lowest in North America. Revenues from exports to the US and other Canadian provinces accounts for over 20% of electric revenue, alleviating pressure of rate hikes and contributing to the current low rates in the Province."

Attached for information as Appendix 3.8, are the following credit reports that have recently been issued by DBRS and Moody's for Manitoba Hydro and the Province of Manitoba:

- DBRS Province of Manitoba October 17, 2014
- DBRS Manitoba Hydro October 23, 2014
- Moody's Province of Manitoba October 17, 2014
- Moody's Manitoba Hydro November 6, 2014

Manitoba Hydro is awaiting permission from Standard & Poor's to provide copies of the most current credit rating reports.

While Moody's reaffirmed the Province of Manitoba's credit ratings, they revised the outlook on the Province of Manitoba's Aa1 long term debt ratings from stable to negative. Moody's P-1 short term rating on the Manitoba Hydro-Electric Board's commercial paper program was not affected. Credit ratings and outlooks from S&P and DBRS remained unchanged.

It is important that credit rating agencies continue to view Manitoba Hydro's debt as self-supporting and that weakened financial ratios as a result of major capital investments and reinvestments do not negatively impact the credit rating of the Province.

The proposed rate increases are necessary to continue to demonstrate to the credit rating agencies that the regulatory framework in Manitoba is supportive of Manitoba Hydro's self-supporting financial status.