MANITOBA HYDRO
DEBT MANAGEMENT STRATEGY

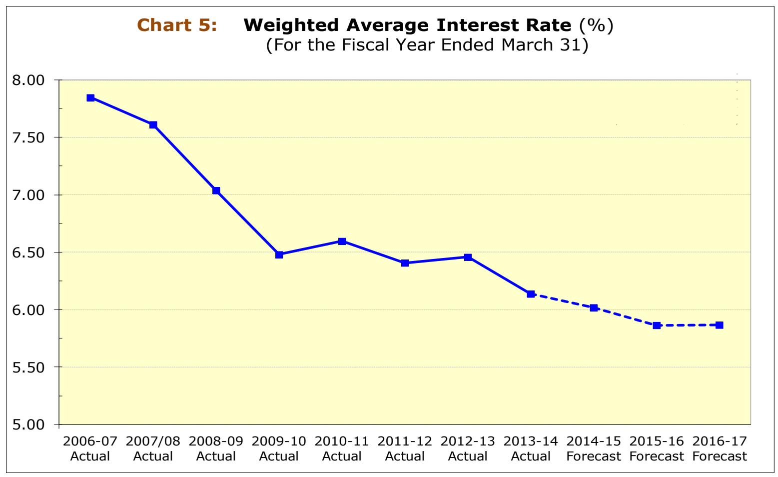
2014/15, 2015/16 AND 2016/17

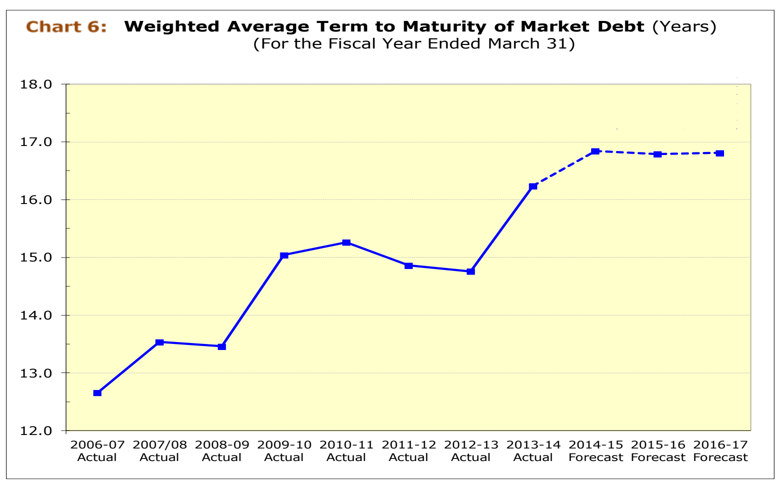
Manitoba Hydro's fundamental debt management objective is to provide **stable, low cost funding** to meet the financial obligations and liquidity needs of the Corporation.

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 its market 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.





Manitoba Hydro

Treasury Division
December 2014

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1.0 Purpose of this Document

The *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 financing requirements for the 2014/15, 2015/16 and 2016/17 fiscal years.

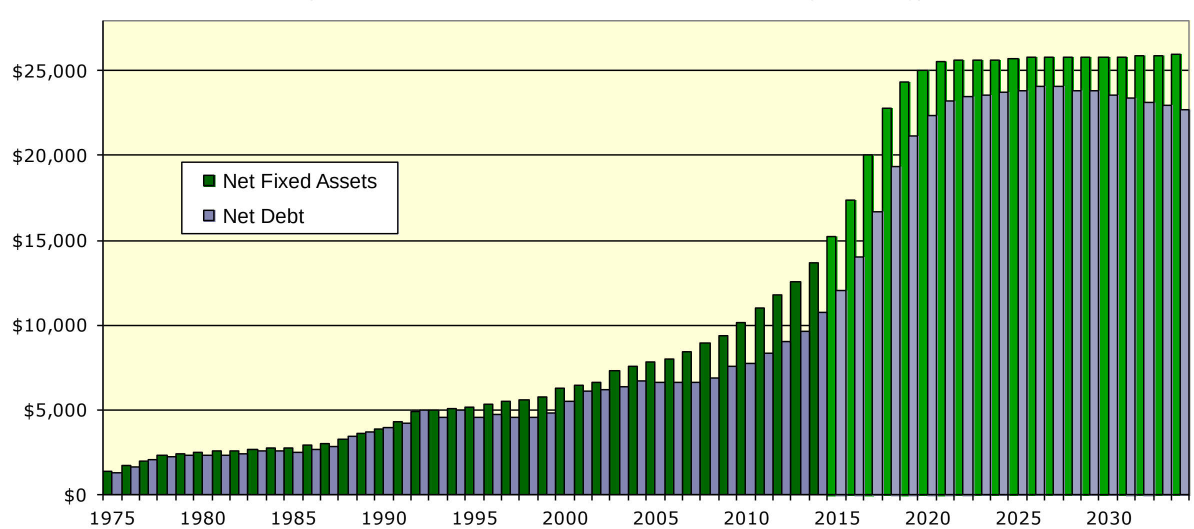
2.0 Overview of Manitoba Hydro's Capital Financing Program

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.

Debt financing has been 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 recent construction of the Wuskwatim Generating station in northern Manitoba. None of this would have been possible without debt financing.

Chart 1 illustrates the growth in net fixed assets and net long term debt since 1975. While net debt has grown to approximately $10.8 billion as at March 31, 2014, the corresponding investment in generation, transmission, distribution and other assets has grown at a much greater pace to a net book value of approximately $13.6 billion at March 31, 2014. Moving forward, both the level of net fixed assets and net debt are forecasted to grow until the 2020s before the projected level of net debt begins to decline after 2025.

Chart 1: **Manitoba Hydro**
Net Fixed Assets & Net Debt
(Actuals to March 31, 2014 in millions of dollars at fiscal year ending)



The *Capital Expenditure Forecast* (CEF14) is a projection of Manitoba Hydro's capital expenditures for new and replacement facilities to meet the electricity and natural gas service requirements in the Province of Manitoba, as well as expenditures required to meet firm sale commitments outside the province. The CEF14 totals $17.8 billion for the ten year period from 2014/15 to 2023/24. Expenditures for Major New Generation & Transmission total $11.7 billion, with the balance of $6.1 billion comprised of expenditures for infrastructure renewal, system safety and security, new and increasing load requirements, and ongoing efficiency improvements.

While debt financing provides the majority of funding necessary for investment in long term assets, 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. The net cash flow from operations for the next 10 years is forecast to be nearly $6.2 billion, with an average during this timeframe of nearly $620 million per fiscal year.

3.0 Borrowing Authority of Manitoba Hydro

Manitoba Hydro's authority to issue debt 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 of principal outstanding at any one time, upon such terms, for such periods, and upon such other conditions, as the Corporation may determine.

2. **Government Guarantee**
   The Government may, on such terms as may be approved by the Lieutenant Governor in Council, guarantee the payment of the principal and interest on any borrowings of the Corporation under this section.

3. **Power of the Corporation to Borrow and Issue Securities**
   The Corporation may raise money by way of loan, notes, bonds, debentures or other securities 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, will treat Canadian and US borrowings on a one for one par value basis. The borrowing authority 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 purposes other than to refinance debt, including 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 fit the Corporation's debt maturity schedule and meet investor appetite.

Manitoba Hydro's debt is viewed to be self-supporting by credit rating agencies (Dominion Bond Rating Service, Moody's Investors Service, and Standard & Poor's). 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 the following financial targets:

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 debt by debt plus equity.

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 gross interest on debt by gross interest on debt.

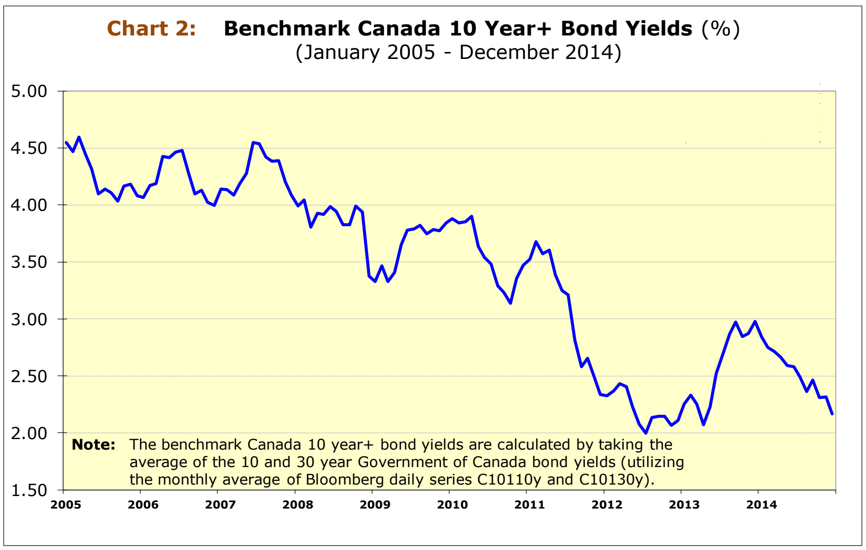
Capital Coverage – Maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio indicates the extent to which cash generated internally is sufficient to fund capital construction expenditures without additional external financing. It is calculated by dividing cash generated from operations by capital construction expenditures (excluding major new generation & transmission projects).

Note: Financial targets may not be achieved during years of major investment in the generation and transmission system.

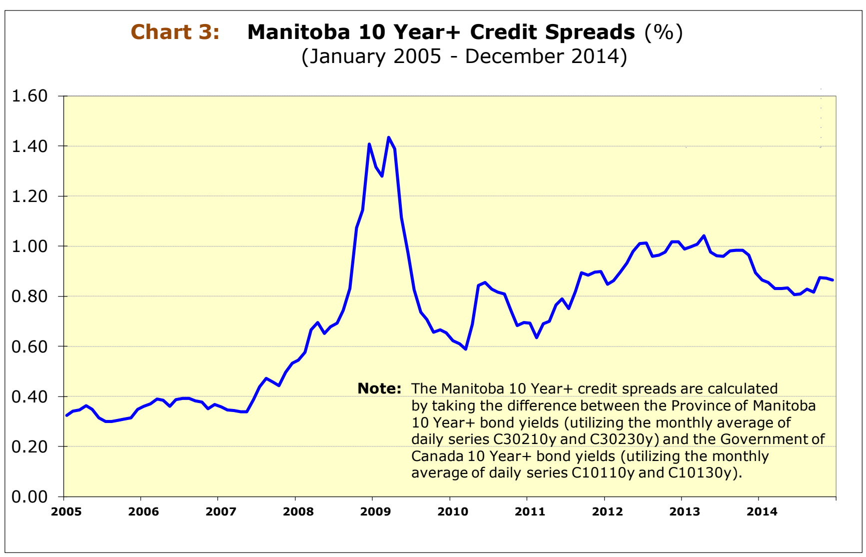
5.0 Analysis and Commentary

> "Unexpectedly slow global recovery has meant that monetary conditions in advanced economies, including Canada, have been very stimulative for much longer than envisioned in the aftermath of the financial crisis."
>
> Bank of Canada, *Financial System Review*, December 2014, page 5.

While short term interest rates remain artificially anchored at their extraordinary low levels by central bank monetary policy interventions, long term interest rates began to rise in May 2013 as the financial markets anticipated the potential tapering of the U.S. Federal Reserve's quantitative easing program in the latter part of 2013. Since early 2014, yields in the long end have once again trended downward with the uncertainty regarding the pace of the U.S. economic recovery, the re-emergence of geopolitical issues, global growth concerns and falling oil prices.



The long term interest rates in the Canadian capital markets showed a similar trajectory. As shown on historical interest rate chart for the **Benchmark Canada 10 Year+ bond yields** (Chart 1), while the interest rates in the 12 month period prior to May 2013 were generally range bound at historically low levels, by September 2013 interest rates rose nearly 1%. Since then, long term interest rates have drifted downward, once again approaching historically low levels.



The **credit spreads** between the benchmark long term Government of Canada bonds and the all-in cost to the Province of Manitoba have tightened since May 2013 (Chart 3). The net impact of these movements is that Manitoba Hydro's current interest rate environment continues to be low in comparison to historical rates across the entire spectrum of the yield curve. This situation 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 externally forecasted interest rates to 2034 (Chart 4).

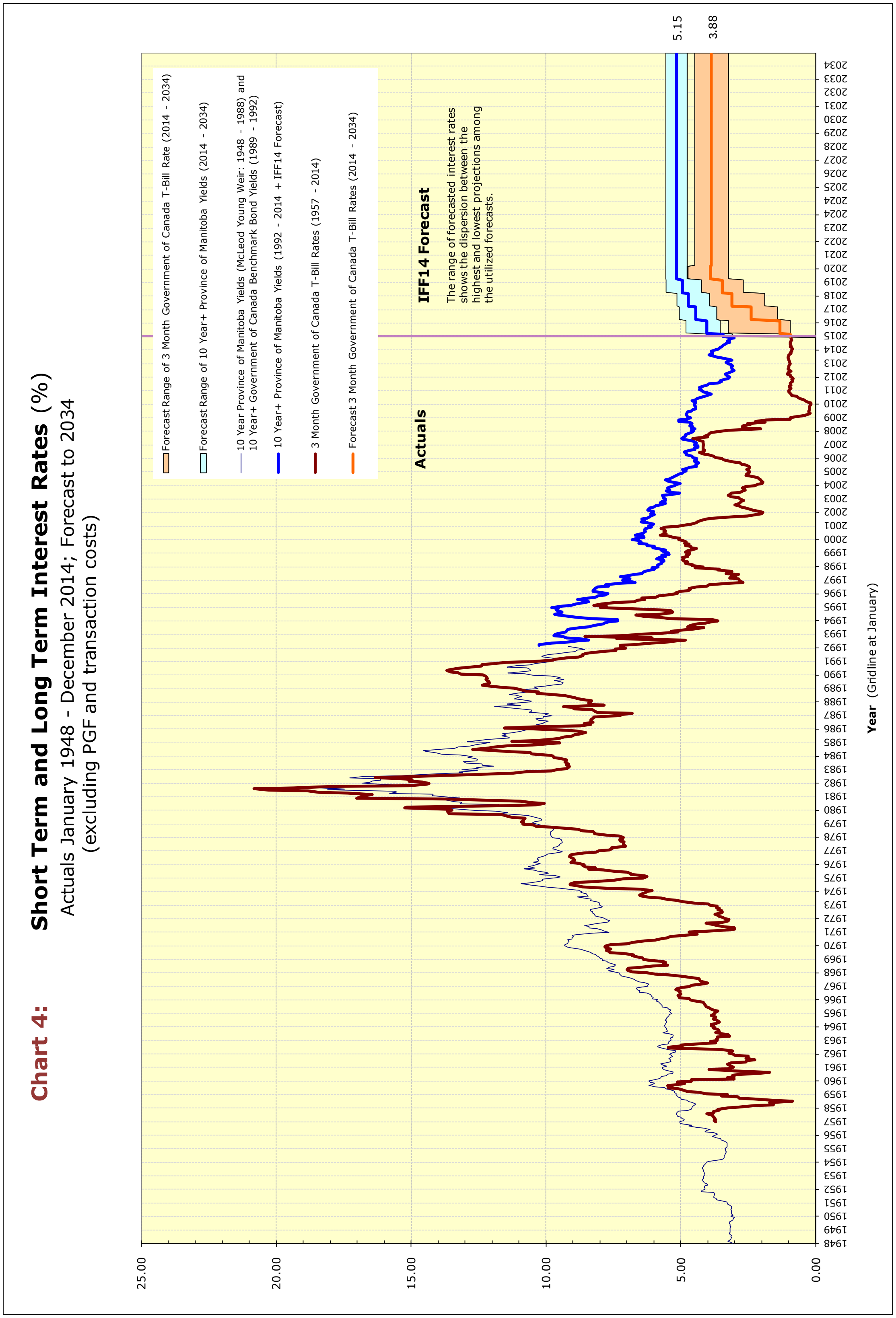


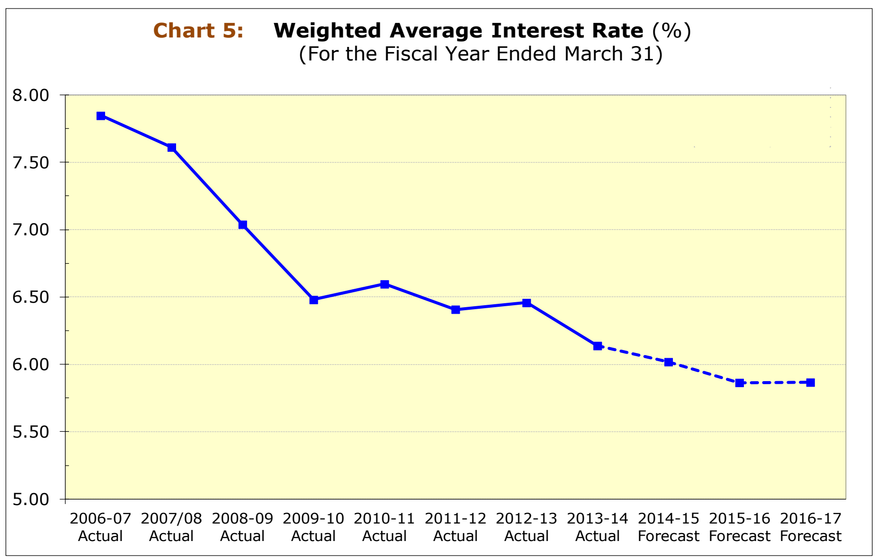
Chart 4:
Short Term and Long Term Interest Rates (%)
Actuals January 1948 - December 2014; Forecast to 2034
(excluding PGF and transaction costs)
Forecast Range of 3 Month Government of Canada T-Bill Rate (2014 - 2034)
Forecast Range of 10 Year+ Province of Manitoba Yields (2014 - 2034)
10 Year Province of Manitoba Yields (McLeod Young Weir: 1948 - 1988) and 10 Year+ Government of Canada Benchmark Bond Yields (1989 - 1992)
10 Year+ Province of Manitoba Yields (1992 - 2014 + IFF14 Forecast)
3 Month Government of Canada T-Bill Rates (1957 - 2014)
Forecast 3 Month Government of Canada T-Bill Rates (2014 - 2034)
Actuals
IFF14 Forecast
The range of forecasted interest rates shows the dispersion between the highest and lowest projections among the utilized forecasts.
5.15
3.88
25.00
20.00
15.00
10.00
5.00
0.00
Year (Gridline at January)

Chart 4 illustrates that for a prolonged period of time from the mid-1970's to the early 1990's, the long term interest rates for the Province of Manitoba were in excess of 10%, and in 1981 the long term interest rate exceeded 18%. The average 10 year+ interest rate in the April 1992 – July 2007 period before the financial crisis was slightly over 6.5%, while in the post-financial crisis period from August 2007 to December 2014 the average 10 year+ interest rate was slightly below 4.0%. Looking forward, the average 10 year+ interest rates are forecast to rise from their actual at December 31, 2014 of approximately 3.0% to the average consensus forecast of approximately 5.2% by 2019/20.

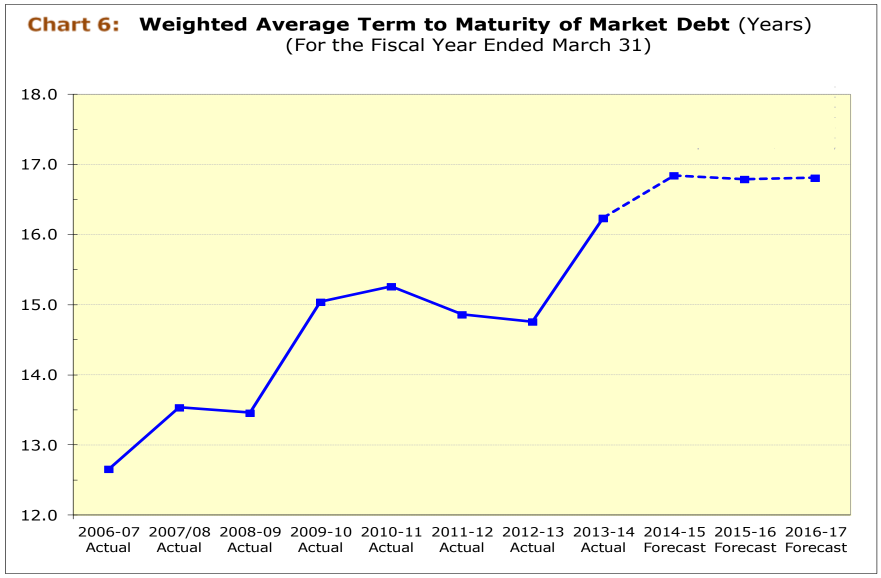
With respect to the interest rate environment for Manitoba Hydro's Canadian long term floating rate debt, historically there has been significant volatility in interest reset rates.[1] As compared to the 10 year+ interest rates, the average 3 month Canadian T-Bill interest rate (as a proxy for both the variable interest reset rates on Manitoba Hydro's portfolio of Canadian long term floating rate debt and Manitoba Hydro's short term interest rate) have had higher peaks and lower valleys, along with more intervening variability. Looking forward, by 2019/20 average consensus forecast for the 3 month T-Bill rate is projected to be approximately 3.9%.

Although economic forecasts during the last few years have generally called for a quicker economic recovery and correspondingly higher interest rates, on an actual basis, the strength and pace of a recovery has been subdued. Manitoba Hydro will continue to monitor the financial markets, along with gathering the views of external economic forecasters in order to obtain the range and consensus forecast of their opinions.

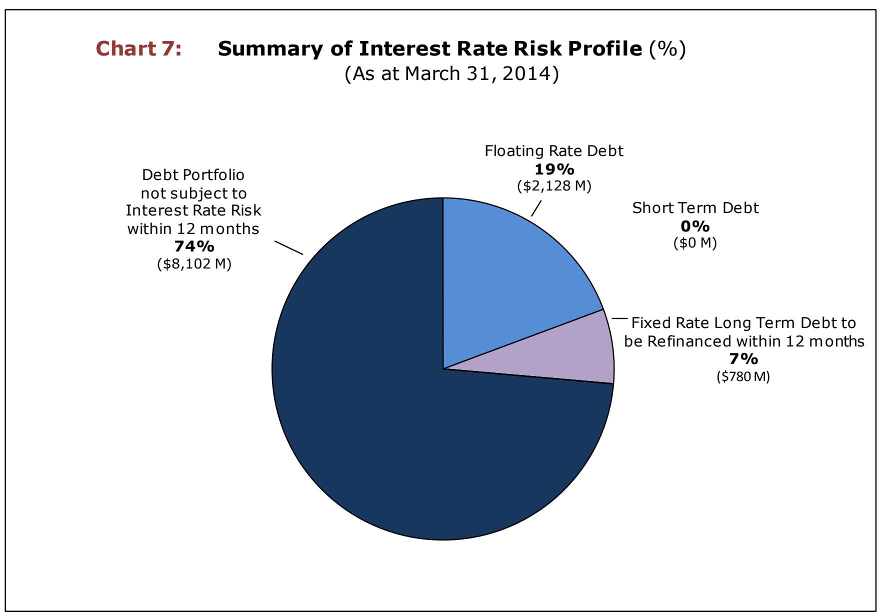
The low interest rate environment over the past few years has provided the opportunity for Manitoba Hydro to secure stable, low cost funding. As shown on Chart 5, since 2006/07, the debt portfolio's **net weighted average interest rate has decreased** by nearly 2.0%. It is anticipated that this positive trend will continue until leveling off in 2016/17.



[1] The interest reset rate for Manitoba Hydro's portfolio of Canadian long term floating rate debt is typically the 3 month Bloomberg Bankers' Acceptance rate (CDOR03). The pricing for these long term floating rate debt issues also have a fixed rate margin that is added to the variable bankers' acceptance (BA) component. For example, on March 31, 2011 Manitoba Hydro secured long term debt series C121-3 for CAD $100 million and an April 19, 2016 maturity date. C121-3 bears a floating coupon rate of CDOR03 + 20 basis points. The coupon payment rate is reset on a quarterly basis to add the variable BA component to the 20 basis point fixed rate margin.



This opportunity to secure low cost financing is balanced alongside the debt management objective to provide stability. To enhance the debt portfolio stability, the **weighted average term to maturity of its market debt portfolio has increased** by over three years since 2006/07 (Chart 6). When selecting terms for its new borrowings, Manitoba Hydro gives careful consideration to the debt maturity schedule and the total level of annual financing requirements. 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. For Manitoba Hydro's new long term debt issuance in 2013/14, the term to maturity ranged from 3 – 50 years, with a weighted average term to maturity of 28 years.



Stability is also reinforced by carefully managing the aggregate interest rate risk within the debt portfolio. Manitoba Hydro's **interest rate policy** on its existing debt portfolio is to limit the aggregate of: i) floating rate debt, ii) short term debt, and iii) fixed rate long term debt to be refinanced within the subsequent 12 month period; to a maximum of 35% of the total debt portfolio. Manitoba Hydro's interest rate risk guidelines for its existing debt portfolio include maintaining an aggregate of floating rate debt and short term debt within 15 – 25% of the total debt portfolio, and having the fixed rate long term debt to be refinanced within a 12 month period being less than 15% of the total debt portfolio. During years in which there are high levels of refinancings and/or new borrowings for prospective cash requirements, in order to manage the overall interest rate risk profile, the Corporation's interest rate risk on its existing debt portfolio may be reduced by decreasing the percentage of aggregated floating rate debt and short term debt to below 15% of the total debt portfolio. A graphical depiction of Manitoba Hydro's interest rate risk profile as at March 31, 2014 is as shown in Chart 7. During 2014/15, the interest rate risk on the existing debt portfolio will be reduced in order to accommodate the significant prospective capital borrowing requirements during 2015/16 and 2016/17. Consequenty, it is projected that the percentage of floating rate debt within the projected debt portfolio at March 31, 2015 will be approximately 15%.

Liquidity risk refers to the risk that Manitoba Hydro will not have sufficient cash or cash equivalents to meet its financial obligations as they come due. Manitoba Hydro will meet its financial obligations when due through cash generated from operations, short term borrowings, long term borrowings advanced from the Province of Manitoba, and where applicable, sinking fund withdrawals. Overall financing requirements of Manitoba Hydro and its subsidiaries are managed on a consolidated basis. The Corporation closely monitors its cash receipts and disbursements on a daily basis as part of regular cash balancing activities. The Corporation also monitors short term debt balances and forecasted cash requirements to ensure that it has sufficient cash to meet near term financial obligations as they come due. To support business continuity and enhance financing flexibility, the Corporation may maintain positive cash and/or investment balances.

The Manitoba Hydro Act grants the Corporation the power to issue short term borrowings in the name of the Manitoba Hydro-Electric Board up to a limit of $500 million and to have this debt unconditionally guaranteed as to principal and interest by the Province of Manitoba. Short term borrowings are considered to have terms to maturity of less than one year. The short term borrowing program is a credit facility with a primary objective to safeguard the Corporation from liquidity risk by providing sufficient liquidity for the Corporation's temporary cash requirements. Manitoba Hydro uses its short term debt line to fund its working capital 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 lower 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 is legislated under the Manitoba Hydro Act to make sinking fund payments to the Province of Manitoba of not less than 1% of the principal amount of the outstanding debt on the preceding March 31, and 4% of the balance in the sinking fund at such date. Sinking funds are invested in highly rated government or corporate bonds, as well as money market instruments. Sinking fund withdrawals are applied towards the repayment of advances made to, and moneys borrowed by, the Corporation.

Manitoba Hydro has significant export revenues denominated in US dollars. As part of the Corporation's **foreign currency exchange risk management program**, in order to mitigate the foreign currency exchange risk on these revenues, Manitoba Hydro maintains a natural hedge with US dollar cash flows, including outflows from US denominated debt. At December 31, 2014 the portion of Manitoba Hydro's debt portfolio that was made up of US denominated debt principal was 13%. The US debt portfolio may occasionally be rebalanced in accordance with US dollar cash flows. 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. Although provincial borrowers frequently issue long bonds in the Canadian capital markets, due to financial market conditions, provincial issuance of US dollar debt with terms greater than 10 years is unusual because the long end of the US curve has not been cost effective compared to Canada for many years.

6.0 Debt Management Activities

The following section provides an overview of Manitoba Hydro's recent actual financings, as well as the forecasted financing requirements for 2014/15, 2015/16 and 2016/17. 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 maturing debt and interest rate swaps; the term dependent on the current maturity schedule and forecasted borrowing requirements; interest rate expectations and the mitigation of interest rate risk; the management of foreign exchange risk; and the market appetite and economic environment.

2014/15 The actual and forecasted long term debt financings were as follows:

Quarter 1 During the first quarter, Manitoba Hydro secured long term debt financing totaling $856 million; of which $475 million was issued to finance new cash requirements and $381 million was for the refinancing of debt series FS-2A, FS-2B, FS-2C and FS-2D. A $100 million USD sinking fund withdrawal for the retirement of FS-1 on April 28, 2014 was also executed during this quarter.

Quarter 2 During the second quarter, Manitoba Hydro secured long term debt financing totaling $726.6 million; of which $387.4 million was issued to finance new cash requirements, $89.2 million was to fund HydroBond redemptions, and $250.0 million was for the refinancing of debt series FM-1, FM-2, FM-3 and FM-4.

Quarter 3 During the third quarter, Manitoba Hydro secured long term debt financing totaling $490 million; of which $200 million was for the refinancing of debt series FC-3, $40 million was for the refinancing of mitigation bond 5A, and $250 million was issued to finance new cash requirements. A currency swap to repatriate $200 million of USD principal into $228.38 million of CAD principal was also executed during this quarter for debt series EE.

Quarter 4 It is forecasted that $400 million of long term debt will be issued during this quarter for new cash requirements.

2015/16 The forecasted long term debt financing requirement is $2,400 million composed of the following:

- $2,088 million of long term debt for new cash requirements.
- $312 million to refinance maturing long term debt.

Manitoba Hydro will consider the availability of sinking fund withdrawals to reduce the required refinancing of maturing debt.

The long term debt financings forecasted for each quarter of this fiscal year are as follows:

Quarter 1 It is forecasted that $538 million of long term debt will be issued during this quarter for new cash requirements. In addition, the following refinancings are forecasted to occur in this quarter: a $50 million refinancing of floating rate debt issue C115 maturing May 4, 2015 and a $12 million refinancing of Winnipeg Hydro Bond 4K maturing May 12, 2015.

Quarter 2 It is forecasted that $600 million of long term debt will be issued during this quarter for new cash requirements.

Quarter 3 It is forecasted that $550 million of long term debt will be issued during this quarter for new cash requirements. In addition, the following floating rate debt refinancings are forecasted to occur this quarter: a $50 million refinancing of EY2 and a $200 refinancing of EY both maturing December 3, 2015.

Quarter 4 It is forecasted that $400 million of long term debt will be issued during this quarter for new cash requirements.

2016/17 The forecasted long term debt financing requirement is $3,200 million composed of the following:

- $2,866 million of long term debt for new cash requirements.
- $334 million to refinance maturing long term debt.

Manitoba Hydro will consider the availability of sinking fund withdrawals to reduce the required refinancing of maturing debt.

The long term debt financings forecasted for each quarter of this fiscal year are as follows:

Quarter 1 It is forecasted that $867 million of long term debt will be issued during this quarter for new cash requirements. In addition, the following refinancings are forecasted to occur in this quarter: a $100 million refinancing of floating rate debt issue C121-3 maturing April 19, 2016 and a $33 million refinancing of Hydrobonds maturing June 15, 2016.

Quarter 2 It is forecasted that $799.4 million of long term debt will be issued during this quarter for new cash requirements. In addition, the following refinancing is forecasted to occur in this quarter: a $200.6 million refinancing of floating rate debt issue AZ maturing July 17, 2016.

Quarter 3 It is forecasted that $400 million of long term debt will be issued during this quarter for new cash requirements.

Quarter 4 It is forecasted that $800 million of long term debt will be issued during this quarter for new cash requirements.