

COST OF CAPITAL

In accordance with section 2.8 of the Ontario Energy Board (“OEB”) Filing Requirements (July 17, 2013), the following evidence provides an overview of Toronto Hydro’s capital structure and financing plans for 2015.

1. CAPITAL STRUCTURE

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

2. FINANCING PLANS

2.1. Equity

Toronto Hydro Corporation (“THC”) is the sole shareholder of Toronto Hydro.

The forecasted Return on Equity (“ROE”) used to determine Cost of Capital in the 2015 Test Year is based on the OEB’s formulaic approach as outlined in the Report of the Board (EB-2009-0084). For 2015, the ROE is calculated using the April 2014 bond yield spread (using the average 30-Year A-Rated Canadian Utility bond yield from Bloomberg L.P. as well as the average 30-Year Government of Canada bond as published by the Bank of Canada) and the Ten-Year Government of Canada Bond Yield Forecast (using the average of the forecasted Ten-Year Government of Canada bond yield as at December 31, 2014 and September 30, 2015 from Bloomberg L.P.).

Table 1 below shows the 2014 OEB-approved ROE as well as the projected ROE for 2015.

Table 1: Return on Equity

Year	Return on Equity
2014 (Board-Approved)	9.36%
2015	9.30%

Toronto Hydro has used the 2015 ROE forecast for the purpose of calculating revenue requirement for the 2015 Test Year (Exhibit 6, Tab 1) and the derivation of the C-Factor in the custom Price Cap Index (Exhibit 1B, Tab 2, Schedule 3). Toronto Hydro intends to rely on the ROE approved by the OEB in late 2014 as part of the Cost of Capital parameters for 2015 rates to determine the final revenue requirement for 2015 and the updated C-factor.

2.2. Financial Market Overview and Forecast

2013 was a record issuance year for the Canadian credit market. Positive investor sentiment combined with low Government of Canada yields to provide attractive funding opportunities. As global markets experienced volatility and uncertainty, the Canadian market proved to be resilient with stable investor demand. The utility sector remains the most active and the most stable corporate sector. During periods of volatility, investors may look to regulated utilities as a safe haven.

Rates began to rise in 2013 with a year-over-year increase of 50 to 100 basis points across the Government of Canada curve. Economic growth conditions and expectations around central bank stimulus programs, particularly tapering plans by the U.S. Federal Reserve, drove rate direction. Rates are forecasted to continue to rise, especially with the Bank of Canada expected to start increasing the overnight interest rate over the next 12 to 18 months.

Corporate credit spreads remained very stable in 2013, and as such did not see the volatility experienced over the 2008-2009 period. This is further evidenced by the 30-year A-rated Corporate Utility bond spread in 2013 ranging from lows of approximately 130 basis points and highs of approximately 145 basis points. THC's indicative spreads also remained fairly stable in 2013. For 2015, the assumption is for THC's ten-year bond spread to be 110 basis points and 30-year bond spread to be 140 basis points. These spreads are in line with historical average.

2.3. Medium and Long-Term Debt

Toronto Hydro's debt is issued at the THC level via medium term notes in the Canadian public debt market. This requires THC to obtain and maintain credit ratings. As at July 31, 2014, THC's debentures were rated by DBRS and S&P as follows:

Table 2: Rating of THC Debentures

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

The most recent ratings reports from DBRS and S&P are provided in Exhibit 1C, Tab 4, Schedule 7. The utility is assigned debt through promissory notes between the utility and the parent. 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 31, 2014, Toronto Hydro had outstanding long-term debt in the amount of \$1.50 billion, as detailed in Table 3 below.

1 **Table 3: Long-Term Debt**

Description	Maturity	Outstanding Principal	Rate
\$245M Prom Note	Nov. 14, 2017	245,057,739	5.20%
\$245M Prom Note	Nov. 12, 2019	245,057,739	4.54%
\$300M Prom Note	Nov. 19, 2021	300,000,000	3.59%
\$15M Prom Note	Jan. 1, 2022	\$15,000,000	3.32%
\$250M Prom Note	Apr. 10, 2023	250,000,000	2.96%
\$200M Prom Note	May 21, 2040	200,000,000	5.59%
\$200M Prom Note	Apr. 9, 2063	200,000,000	4.01%
\$45M Prom Note	Due on demand	45,000,000	6.16%
Total		1,500,115,478	4.30%

2 Forecasted new debt issuance for 2014-15 is driven primarily by Toronto Hydro's capital
3 plans and by the repayment requirements of the maturing debt. Details of the forecast
4 debt issues for 2014-15 are shown in Table 4.

5
6 **Table 4: Forecasted Long-Term Debt Issues**

Description	Issue Date	Term	Principal	Underlying Govt Bond Rate (%)	Corporate Spread Forecast (%)	Forecast Coupon Rate (%)
\$200M Prom Note (Series 10)	Aug. 31, 2014	30 Years	\$200,000,000	3.29	1.45	4.74
\$300M Prom Note (Series 11)	Jun. 30, 2015	10 Years	\$300,000,000	3.02	1.15	4.17

7 Forecasted debt rates are based on the Ten-Year Government of Canada Bond Yield
8 Forecast (using Bloomberg L.P.) and the current spread of 30-Year over Ten-Year
9 Government of Canada Bond Yield, when applicable, plus Toronto Hydro's estimate of
10 corporate spreads at the time of issuance (inclusive of the five basis point administration
11 fee).

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.

2.4. Preferred Shares

Toronto Hydro has no plans to issue any preferred shares over 2014-15 period.

2.5. Short-Term Debt

Over the 2014-15 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.

Toronto Hydro's forecast of its short-term debt rate is outlined in the table below, and represents the forecasted 30-Day Banker's Acceptance rate (using Bloomberg L.P.) for the year, used as a proxy for Commercial Paper issuance rate, plus a five basis point administrative fees. This rate is applied a deemed weighting of 4% in Toronto Hydro's capital structure.

Table 5: Short Term Rates

Year	Short Term Rates
2014	1.25%
2015	1.43%

OEB Appendix 2-OA Capital Structure and Cost of Capital

This table must be completed for the last Board approved year and the test year.

Year: 2011 OEB Approved

Line No.	Particulars	Capitalization Ratio		Cost Rate	Return
		(%)	(\$)	(%)	(\$)
	Debt				
1	Long-term Debt	56.00%	\$1,287,007,277	5.37%	\$69,112,291
2	Short-term Debt	4.00% (1)	\$91,929,091	2.46%	\$2,261,456
3	Total Debt	60.0%	\$1,378,936,369	5.18%	\$71,373,746
	Equity				
4	Common Equity	40.00%	\$919,290,912	9.58%	\$88,068,069
5	Preferred Shares	0.00%	\$ -		\$ -
6	Total Equity	40.0%	\$919,290,912	9.58%	\$88,068,069
7	Total	100.0%	\$2,298,227,281	6.94%	\$159,441,816

Notes

(1)

4.0% unless an applicant has proposed or been approved for a different amount.

OEB Appendix 2-OA Capital Structure and Cost of Capital

This table must be completed for the last Board approved year and the test year.

Year: 2015 Test Year

Line No.	Particulars	Capitalization Ratio		Cost Rate	Return
		(%)	(\$)	(%)	(\$)
	Debt				
1	Long-term Debt	56.00%	\$1,849,297,654	4.34%	\$80,259,518
2	Short-term Debt	4.00% (1)	\$132,092,690	1.38%	\$1,822,879
3	Total Debt	60.0%	\$1,981,390,343	4.14%	\$82,082,397
	Equity				
4	Common Equity	40.00%	\$1,320,926,896	9.30%	\$122,846,201
5	Preferred Shares	0.00%	\$ -		\$ -
6	Total Equity	40.0%	\$1,320,926,896	9.30%	\$122,846,201
7	Total	100.0%	\$3,302,317,239	6.21%	\$204,928,599

Notes

(1)

4.0% unless an applicant has proposed or been approved for a different amount.

OEB Appendix 2-OB Debt Instruments

This table must be completed for all required historical years, the bridge year and the test year.

Year 2011

Row	Description	Lender	Affiliated or Third-Party Debt?	Fixed or Variable-Rate?	Start Date	Term (years)	Principal (\$)	Rate (%) (Note 2)	Interest (\$) (Note 1)	Additional Comments, if any
1	2003 Series 1	THC	Affiliated	Fixed Rate	6-May-03	10	\$ 180,000,000	6.16%	\$ 11,088,000	
2	City Note (Part 3)	THC	Affiliated	Fixed Rate	7-May-03	8.7	\$ 245,057,739	6.16%	\$ 15,054,199	
3	City Note (Part 4)	THC	Affiliated	Fixed Rate	7-May-03	10	\$ 245,057,739	6.16%	\$ 15,095,557	
4	2007 Series 2	THC	Affiliated	Fixed Rate	14-Nov-07	10	\$ 245,057,739	5.20%	\$ 12,743,002	
5	2009 Series 3	THC	Affiliated	Fixed Rate	12-Nov-09	10	\$ 245,057,739	4.54%	\$ 11,125,621	
6	2010 Series 6	THC	Affiliated	Fixed Rate	20-May-10	30	\$ 200,000,000	5.60%	\$ 11,200,000	
7	2011 Series 7	THC	Affiliated	Fixed Rate	18-Nov-11	10	\$ 300,000,000	3.59%	\$ 1,298,301	
8										
9										
10										
11										
12										
Total							\$ 1,395,723,948	5.56%	\$ 77,604,681	

Notes

- 1 If financing is in place only part of the year, calculate the pro-rated interest and input in the cell.
- 2 Input actual or deemed long-term debt rate in accordance with the guidelines in *The Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009
- 3 Add more lines above row 12 if necessary.

OEB Appendix 2-OB Debt Instruments

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Year 2012

Row	Description	Lender	Affiliated or Third-Party Debt?	Fixed or Variable-Rate?	Start Date	Term (years)	Principal (\$)	Rate (%) (Note 2)	Interest (\$) (Note 1)	Additional Comments, if any
1	2003 Series 1	THC	Affiliated	Fixed Rate	6-May-03	10	\$ 180,000,000	6.16%	\$ 11,088,000	
2	2007 Series 2	THC	Affiliated	Fixed Rate	14-Nov-07	10	\$ 245,057,739	5.20%	\$ 12,743,002	
3	2009 Series 3	THC	Affiliated	Fixed Rate	12-Nov-09	10	\$ 245,057,739	4.54%	\$ 11,125,621	
4	2010 Series 5	THC	Affiliated	Fixed Rate	1-Apr-10	3.1	\$ 245,057,739	6.16%	\$ 15,095,557	
5	2010 Series 6	THC	Affiliated	Fixed Rate	20-May-10	30	\$ 200,000,000	5.60%	\$ 11,200,000	
6	2011 Series 7	THC	Affiliated	Fixed Rate	18-Nov-11	10	\$ 300,000,000	3.59%	\$ 10,770,000	
7	2012 Prom Note #1	THC	Affiliated	Fixed Rate	1-Jan-12	10	\$ 15,000,000	3.32%	\$ 498,000	
8	2012 Prom Note #2	THC	Affiliated	Fixed Rate	1-Jan-12	N/A	\$ 45,000,000	6.16%	\$ 2,772,000	Payable on demand
9										
10										
11										
12									\$ -	
Total							\$ 1,475,173,216	5.10%	\$ 75,292,180	

Notes

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Year 2013

Row	Description	Lender	Affiliated or Third-Party Debt?	Fixed or Variable-Rate?	Start Date	Term (years)	Principal (\$)	Rate (%) (Note 2)	Interest (\$) (Note 1)	Additional Comments, if any
1	2003 Series 1	THC	Affiliated	Fixed Rate	6-May-03	10	\$ 180,000,000	6.16%	\$ 3,797,260	
2	City Note (Part 4)	THC	Affiliated	Fixed Rate	7-May-03	10	\$ 245,057,739	6.16%	\$ 5,211,069	
3	2007 Series 2	THC	Affiliated	Fixed Rate	14-Nov-07	10	\$ 245,057,739	5.20%	\$ 12,743,002	
4	2009 Series 3	THC	Affiliated	Fixed Rate	12-Nov-09	10	\$ 245,057,739	4.54%	\$ 11,125,621	
5	2010 Series 6	THC	Affiliated	Fixed Rate	20-May-10	30	\$ 200,000,000	5.60%	\$ 11,200,000	
6	2011 Series 7	THC	Affiliated	Fixed Rate	18-Nov-11	10	\$ 300,000,000	3.59%	\$ 10,770,000	
7	2012 Prom Note #1	THC	Affiliated	Fixed Rate	1-Jan-12	10	\$ 15,000,000	3.32%	\$ 498,000	
8	2012 Prom Note #2	THC	Affiliated	Fixed Rate	1-Jan-12	N/A	\$ 45,000,000	6.16%	\$ 2,772,000	Payable on demand
9	2013 Series 8	THC	Affiliated	Fixed Rate	9-Apr-13	10	\$ 250,000,000	2.96%	\$ 5,413,151	
10	2013 Series 9	THC	Affiliated	Fixed Rate	9-Apr-13	50	\$ 200,000,000	4.01%	\$ 5,866,685	
11										
12										
Total							\$ 1,525,532,670	4.55%	\$ 69,396,789	

Notes

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Year 2014

Row	Description	Lender	Affiliated or Third-Party Debt?	Fixed or Variable-Rate?	Start Date	Term (years)	Principal (\$)	Rate (%) (Note 2)	Interest (\$) (Note 1)	Additional Comments, if any
1	2007 Series 2	THC	Affiliated	Fixed Rate	14-Nov-07	10	\$ 245,057,739	5.20%	\$ 12,743,002	
2	2009 Series 3	THC	Affiliated	Fixed Rate	12-Nov-09	10	\$ 245,057,739	4.54%	\$ 11,125,621	
3	2010 Series 6	THC	Affiliated	Fixed Rate	20-May-10	30	\$ 200,000,000	5.60%	\$ 11,200,000	
4	2011 Series 7	THC	Affiliated	Fixed Rate	18-Nov-11	10	\$ 300,000,000	3.59%	\$ 10,770,000	
5	2012 Prom Note #1	THC	Affiliated	Fixed Rate	1-Jan-12	10	\$ 15,000,000	3.32%	\$ 498,000	
6	2012 Prom Note #2	THC	Affiliated	Fixed Rate	1-Jan-12	N/A	\$ 45,000,000	6.16%	\$ 2,772,000	Payable on demand
7	2013 Series 8	THC	Affiliated	Fixed Rate	9-Apr-13	10	\$ 250,000,000	2.96%	\$ 7,400,000	
8	2013 Series 9	THC	Affiliated	Fixed Rate	9-Apr-13	50	\$ 200,000,000	4.01%	\$ 8,020,000	
9	2014 Series 10	THC	Affiliated	Fixed Rate	31-Aug-14	30	\$ 200,000,000	4.74%	\$ 9,480,000	
10									\$ -	
11									\$ -	
12									\$ -	
Total							\$ 1,700,115,478	4.35%	\$ 74,008,624	

Notes

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Year 2015

Row	Description	Lender	Affiliated or Third-Party Debt?	Fixed or Variable-Rate?	Start Date	Term (years)	Principal (\$)	Rate (%) (Note 2)	Interest (\$) (Note 1)	Additional Comments, if any
1	2007 Series 2	THC	Affiliated	Fixed Rate	14-Nov-07	10	\$ 245,057,739	5.20%	\$ 12,743,002	
2	2009 Series 3	THC	Affiliated	Fixed Rate	12-Nov-09	10	\$ 245,057,739	4.54%	\$ 11,125,621	
3	2010 Series 6	THC	Affiliated	Fixed Rate	20-May-10	30	\$ 200,000,000	5.60%	\$ 11,200,000	
4	2011 Series 7	THC	Affiliated	Fixed Rate	18-Nov-11	10	\$ 300,000,000	3.59%	\$ 10,770,000	
5	2012 Prom Note #1	THC	Affiliated	Fixed Rate	1-Jan-12	10	\$ 15,000,000	3.32%	\$ 498,000	
6	2012 Prom Note #2	THC	Affiliated	Fixed Rate	1-Jan-12	N/A	\$ 45,000,000	6.16%	\$ 2,772,000	Payable on demand
7	2013 Series 8	THC	Affiliated	Fixed Rate	9-Apr-13	10	\$ 250,000,000	2.96%	\$ 7,400,000	
8	2013 Series 9	THC	Affiliated	Fixed Rate	9-Apr-13	50	\$ 200,000,000	4.01%	\$ 8,020,000	
9	2014 Series 10	THC	Affiliated	Fixed Rate	31-Aug-14	30	\$ 200,000,000	4.74%	\$ 9,480,000	
10	2015 Series 11	THC	Affiliated	Fixed Rate	30-Jun-15	10	\$ 300,000,000	4.17%	\$ 12,510,000	
11									\$ -	
12									\$ -	
Total							\$ 2,000,115,478	4.33%	\$ 86,518,624	

Notes

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