Society Interrogatory #5

Interrogatory

Reference:
Exhibit D3-1-2, Attachment 2, Clarington Corporate Campus Business Case Summary.

The Clarington Campus BCS describes a number of financial evaluation assumptions that support the $65M present value of cost reductions. These include: cost of capital, costs related to real estate, and other one-time costs related to employee relocation.

a) The BCS quotes a Cost of Capital of 3.5%, while other Value Enhancing BCSs in this application have used higher rates. For example, the 700U Workplace Transformation BCS (Exhibit D3-1-2, Attachment 1, page 6) quotes a discount rate of 9%. Please describe OPG's methodology for choosing the Discount Rate or Cost of Capital for evaluating Value Enhancing projects?
b) Please explain why a 3.5% rate was used for the financial evaluation? And why is such a low rate appropriate for a capital project that is seeking cost recovery from ratepayers?
c) Please recalculate the present value savings using a cost of capital of 6% and 9%, and for whatever rate OPG would normally apply to value enhancing capital projects.
d) Please clarify whether DEC renovation costs were included in the financial evaluation even if they are not part of this project? If not, were any costs excluded from the Base Case that would correspond to the additional capacity being added to the DEC?
e) Does the financial evaluation for this project include all the costs related to purchasing or relocating the contents of the building required for occupancy (furniture, IT equipment, etc.)?
f) Under Key Assumptions, the Campus BCS states: "Certain training facilities and specialized lab / testing equipment will not be located in the new building." Please explain if and how the related costs were included the financial evaluation.
g) Does the financial evaluation include an estimate for severance costs for employees unwilling to move to the new office location as well as the costs to hire and train replacement staff including the costs to engage temporary staff in the interim? If not, explain why not and estimate this impact on the $65M NPV cost reductions.
h) Over the 40-year time horizon for this project, have any costs for a mid-life refresh (for example: renovations, roof replacement, etc.) been included for the new building? If not, please explain why not and also provide an estimate of the impact of this on the $65M cost reductions.

i) Are there any other costs included in the evaluation that are not mentioned in the assumptions? If so, please describe them.

Response

a) OPG's methodology for selecting a discount rate to evaluate investment alternatives impacting regulated operations is not driven by investment classifications such as value enhancing. Rather, it is driven by whether the investment forms part of the prescribed assets or is an unregulated asset for which the regulated business is being charged a service fee. The 700 University Workplace Transformation Project is an example of the latter, unregulated category and thus utilized a discount rate of 9%.

b) The rate of 3.5% (pre-tax) was used as an approximation of OPG's incremental long-term cost of debt. The evaluation between the base case and the preferred alternative for the Clarington Campus BCS is, in substance, a "lease versus own" decision, which is an assessment of financing alternatives. In concept, long-term leasing is similar to financing the purchase of an asset with a loan. The after-tax cost of debt is therefore the appropriate rate for evaluating such financing alternatives on a comparable basis, as consistent with established finance theory. This differs from assessments of investment alternatives discussed in part (a) above.

c) Using a discount rate of 6%, the present value savings would be approximately $1M in favour of the preferred alternative, which is to construct the new building. Using a discount rate of 9%, the present value savings would be approximately $37M in favour of the base case, which is continuing to lease.

As discussed in part (b) above, using a 6% or 9% rate would not reflect the embedded cost of financing in a "lease versus own" decision and therefore would inappropriately skew the outcome. If a rate other than the after-tax cost of debt is used to evaluate "lease versus own" situations, OPG expects leasing would be consistently favoured, which would not reflect the substance of the decision.

d) Darlington Energy Complex ("DEC") renovation costs were not included in the financial evaluation for the new Clarington building and no costs were included in the base case corresponding to the additional capacity being added to the DEC. As noted in Ex. D3-1-2, Attachment 2, p. 7, retention and renovation of the DEC is common to both the preferred alternative and the base case, resulting in no impact to the financial evaluation outcome.

e) Yes.

f) The costs related to the training facilities and specialized lab / testing equipment were not included in the financial evaluation as there are no incremental costs associated with these. OPG plans to continue using its existing specialized facilities at Pickering and Darlington learning centers to satisfy such training and testing needs.

g) [redacted] OPG does not expect to incur any material incremental costs to hire and train replacement staff for those employees who choose not to relocate and no such costs are included in the proposed revenue requirements in this application.

h) The mid-life refresh costs have not been included in the financial evaluation. However, with both the preferred and base case alternatives assumed to be utilizing agile workspaces and spanning the 40-year time horizon, the need for a mid-life refresh and associated costs for the corresponding properties is expected to be common to both options, resulting in no material incremental impact to the financial evaluation outcome of the $65M (NPV) cost reductions.

i) No.