EXHIBIT 5 – COST OF CAPITAL AND CAPITAL STRUCTURE

Interrogatory 5-Staff-65

Cost of Capital – Long-term Debt
Ref 1: Exhibit 5, Tab 1, Schedule 2, page 3
Ref 2: Appendix 2-OB (Revised August 12, 2022)

Preamble:

Kingston Hydro filed revised versions of Appendix 2-OB – Debt Instruments on August 12, 2022. The revisions provided the following:

- ***Appendix 2-OB for the 2023 Test Year***
- ***Revisions to 2-OB for various historical years and the 2022 bridge year, for day- weighting of principal, interest and weighted average long-term cost of debt for debt instruments that either matured in that calendar year or started in the calendar year.***

On page 3 of Exhibit 5/1/2, Kingston Hydro notes that it expects to execute a loan with a principal of $2 million in December 2022. Appendix 2-OB shows an estimated date of the loan of December 8, 2022 and a rate of 4.57%. Kingston Hydro states that it will update the information when it becomes available.

Question(s):

a) For 2-OB for the 2022 Bridge Year, the calculation of the day-weighted principal and interest expense, and of the weighted average cost of long-term debt in the year are missing, due to incorrect cell references. Please provide a revised version of 2-OB, in working Microsoft Excel format, for the 2022 Bridge Year, showing corrected calculations for the day-weighted principal and expense, and the weighted average cost of long-term debt.

b) Please confirm or correct that the weighted average cost of long-term debt for the 2022 bridge year is 3.52%.

c) What is the status of the forecasted loan of $2 million dollars to be executed in December 2022? If there is any update, please provide, and reflect in updated 2- OB schedules for the 2022 Bridge Year and 2023 Test Year.

<u>Response</u>

a) Kingston's August 12, 2022 submission corrected the day-weighted principal for the December 1, 2022 loan. Actual interest expected to be paid and the day weighted principal for the year were updated.

b) Confirmed.

c) The latest rates obtained from our lender reflect 4-year term rate of 5.05%, 5 year rate of 5.08% and a 10 year term rate of 5.35%. Kingston has updated the rate to 5.05% in Appendix 2-OB and the RRWF.

EXHIBIT 5 – COST OF CAPITAL AND CAPITAL STRUCTURE

<u>Interrogatory 5-Staff-66</u>

Cost of Capital – Long-term Debt
Ref 1: Exhibit 5, Tab 1, Schedule 2, page 3
Ref 2: Exhibit 5, Tab 1, Schedule 2, Attachment 1
Ref 3: Appendix 2-OB (Revised August 12, 2022)
Ref 4: (EB-2009-0084) Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, pages 53-54

Preamble:

In Exhibit 5/Tab 1/Schedule 2, on page 1, Kingston Hydro describes the affiliated debt, a Promissory Note between Kingston Hydro and the Corporation of the City of Kingston. A copy of the Promissory Note, as amended in 2011, is provided as Attachment 1 to Exhibit 5/Tab 1/Schedule 2.

Kingston Hydro notes that the Promissory Note has a principal of $10,880,619, has no fixed term and no terms for repayment. The debt rate of the Promissory Note is 5.87% per the 2011 amendment.

On page 1 of Exhibit 5/Tab 1/Schedule 2, Kingston Hydro states:

The interest rate included is estimated to be the deemed interest rate in effect in 2023. It is based on the lending rate provided from our lender in March 2022, plus 0.5%.

Kingston Hydro proposes to update this rate once more information becomes available.

In Appendix 2-OB for the 2023 Test Year, filed on August 12, 2022, the rate for the Promissory Note is shown as 5.07%. This is different than the 4.54% rate shown for the Promissory Note for 2016-2022.

The EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities states, on pages 53-54, that:

> ***The deemed long-term debt rate will act as a proxy or ceiling for what would be considered to be a market-based rate by the Board in certain circumstances. These circumstances include:***
>
> - ***For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario Business Corporations Act, 1990) with a fixed rate, the deemed long-term debt rate at the time of issuance will be used as a ceiling on the rate allowed for that debt.***
> - ***For debt that is callable on demand (within the test year period), the deemed long term debt rate will be a ceiling on the rate allowed for that debt. Debt that is callable, but not within the period to the end of the test year, will have its debt cost considered as if it is not callable; that is the debt cost will be treated in accordance with other guidelines pertaining to actual, affiliated or variable-rate debt.***
> - ***A Board panel will determine the debt treatment, including the rate allowed based on the record before it and considering the Board's policy (these Guidelines) and practice. The onus will be on the utility to establish the***

need for and prudence of its actual and forecasted debt, including the cost of such debt. [Emphasis in original]

Question(s):

a) Please explain the derivation of the 5.07% rate estimated for the 2023 Test Year.

b) Please explain what 0.5% addition to the lending rate provided by the lender (banking institution) represents, and how the resulting rate is a market-based rate.

c) When, and on what new information, is Kingston Hydro "propos[ing] to update this rate once more information becomes available"?

d) Please explain what rate Kingston Hydro is proposing for the 2023 Test Year, and how the proposed rate is compliant with the OEB's policy and practice as documented in the 2009 Cost of Capital Report. In the alternative, please explain.

Response

a) Kingston Hydro attempted to provide a reasonable estimate of the projected deemed debt rate for 2023 in its application so that stakeholders could review the most realistic information. It utilized the most recent long-term rate from our 3rd party lender plus an amount of 0.5% was added in anticipation of future rate increases in 2022.

b) An addition of 0.5% to the market rate provided in March, 2022 was in anticipation of future rate increases in 2022. In retrospect, an estimated additional 0.5% may have been too low as the Bank of Canada has raised interest rates 2.0% since March, 2022.

c) The interest rate included is estimated to be the deemed interest rate in effect in 2023. Kingston proposes to update the affiliate debt rate for rate making purposes when the cost of capital parameters for 2023 are released.

d) Kingston is proposing that the long-term debt rate used for rate making purposes be based on the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities.

"For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario *Business Corporations Act*, 1990) with a fixed rate, the deemed long-term debt rate at the time of issuance will be used as a ceiling on the rate allowed for that debt."

To comply with the above-noted Report of the Board, the rate would then be the lower of 5.87% and the deemed long term debt rate for 2023, which is unknown at this time.

Interrogatory 5-SEC-24

[Ex.5-1-2, p. 1, Appendix 2-OB] Kingston Hydro has Long Term Affiliate Debt outstanding in the amount of $10,880,619 with an interest rate of 5.87%, the deemed interest rate at the 2011 cost of service proceeding. As the interest on this debt represents approximately 1/3 of total debt, has Kingston Hydro tried to renegotiate the debt or interest rate on this debt? For example, based on the current deemed long term debt of 3.49% this could represent a savings of $172k.

Response

Kingston Hydro has affiliate debt that is subordinate to other debt and is payable interest only. Kingston Hydro has not attempted to renegotiate the debt or interest rate. Kingston has reviewed the Report of the Board on the Cost of Capital for Ontario's Regulated Utilities that deals with affiliate debt. Also refer to responses to IR 5 Staff 66.

COST OF CAPITAL AND RATE OF RETURN (EXHIBIT 5)

Interrogatory 5.0-VECC-31

Reference: Exhibit 5, Tab 1, Schedule 2 / Appendix 2-OB

a) KHC expects to borrow $2 million in 2022 and has costed this at 4.57%. What is the proposal of the Utility with respect to updating this interest cost in this proceeding?

b) If the interest cost forecast in the evidence is to be utilized in the final order of the Board issued prior to the end of 2022 please provide the evidence relied upon for that interest cost rate.

c) Similarly, please provide the evidence relied upon to use 5.07% for the long-term debt issuance in 2023 ($1million and shown at half year of $500,000 in Appendix 2-OB).

d) Please explain the difference between the $2 million referenced in the evidence and the $1,983,581 shown in Appendix 2-OB.

Response

a) Kingston proposed to update this rate at future stages in the process to ensure the most accurate and timely information is available when the issue is settled. In the interim, the RRWF has been updated along with Appendix 2-OB to reflect the most recent updated interest rate.

b) The interest rate was used as a placeholder and Kingston proposed to update this as the process moved through the stages.

c) This was an estimate based on rates received by our lender in March, 2022 plus 0.5%. Kingston proposes to update this as well to better reflect the more timely market activity. In the interim, the RRWF has been updated along with Appendix 2-OB to reflect the most recent updated interest rate.

d) The difference would be the average debt outstanding in 2023 for the 2022 loan.

COST OF CAPITAL AND RATE OF RETURN (EXHIBIT 5)

Interrogatory 5.0-VECC-32

Reference: Exhibit 5, Tab 1, Schedule 2 / Appendices 2_oA and 2-OB

a) KHC is overleveraged with a regulated rate Long-term Debt component of $36,931,698 as shown in Appendix 2-OA and a projected actual debt amount in 2023 of $38,441,614 as shown in Appendix 2-OB. Please explain how the resulting $1,509,916 is prorated or removed in the calculation of the overall cost of long term debt interest rate as shown calculated in Appendix 2-OB.

b) If KHC does not proposed to adjust the weighted cost of long-term debt for the overleveraging please provide the rationale.

Response

Kingston Hydro response to a) and b):

Per review of the ROE calculation from our RRR filings, it can be noted that the "overleveraging" occurred in 2020 and 2021 (see table below).

Year	LTD Per ROE	Per APP OB	Difference	Incremental	Rate on new loan
2019	33,250,517	33,076,512	- 174,005		
2020	34,682,269	35,158,395	476,126	476,126	2.02%
2021	35,343,283	36,880,471	1,537,188	1,061,062	3.21%
2023	36,931,698	38,441,614	1,509,916	N/A	

Therefore the loans taken out in those years were too high according to final rate base calculations in those years. Appendix 2-OB could be redone to lower the debt for those years however it would also serve to lower these lower interest loans in the overall calculation. The impact would be increasing the debt rate on Appendix 2-OA to 3.78% from 3.75% increasing the total return by approximately $12,000.

The ROE calculation and rate base calculation is very dependent on Cost of Power calculations which can fluctuate in any given year depending on factors not within the control of Kingston Hydro or its customers. Therefore overleveraging can occur in one year and underleveraging in another year due to factors outside the control of the LDC.

For the above-noted reason Kingston does not propose to adjust the weighted cost of long-term debt for the estimated 2023 overleveraging.