

EXHIBIT 5 – COST OF CAPITAL

2025 Cost of Service

Hydro 2000 Inc.
EB-2024-0030

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5.1 CAPITAL STRUCTURE

In this Exhibit, H2000 outlines its capital structure, debt financing, and the calculation of its return on equity (ROE) for the 2025 Test Year. The utility seeks to recover a weighted average cost of capital of 6.50% through rates in the 2025 Test Year, adhering to the appropriate policies for determining the cost of capital.

Key Components of Cost of Capital Calculation:

Capital Structure: H2000 has used the Ontario Energy Board's (OEB) deemed capital structure, which includes 56% long-term debt, 4% short-term debt, and 40% equity.

Return on Equity (ROE): The utility has applied the most recently published ROE rate of 9.21%, as per the OEB's prescribed Cost of Capital Parameters for 2024 Cost of Service applications.

Commitment to Update

H2000 acknowledges that the OEB is likely to update the deemed ROE, LTD and STD rates for 2025 rate year applications. Consequently, H2000 commits to revising its application to reflect any new Cost of Capital Parameters issued by the OEB for 2025 applications, ensuring that the most current information is used.

Capital Structure Consistency:

H2000 is not proposing any changes to its Capital Structure from the 2020 Board-approved structure. The utility notes that it does not have any actual debt, and as a result, several considerations are not applicable:

No Debt Instruments:

H2000 does not hold any actual debt and therefore any preference shares or common equity shares, retirements of debt or preference shares, buy-back of common shares, preference shares, and common share offerings do not apply. Additionally, the calculation of notional debt and Appendix 2-OB are not applicable.

Profit Status:

H2000 confirms that it is a for-profit corporation, and therefore, none of the requirements related to non-profit entities are relevant.

Financial Forecast:

H2000's forecasted cost of capital and return on rate base for the 2025 Test Year is presented in Table 1. For comparison, Table 2 shows the previously approved Capital Structure.

Table 1 – 2025 Capital Structure and Statement of Rate Base (Appendix 2-OA)

Particulars	Capitalization Ratio		Cost Rate	Return
	(%)	(\$)	(%)	(\$)
Debt				
Long-term Debt	56.00%	\$720,271	4.58%	\$32,988
Short-term Debt	4.00%	\$51,448	6.23%	\$3,205
Total Debt	60.0%	\$771,719	4.69%	\$36,194
Equity				
Common Equity	40.00%	\$514,479	9.21%	\$47,384
Preferred Shares		\$ -		\$ -
Total Equity	40.0%	\$514,479	9.21%	\$47,384
Total	100.0%	\$1,286,198	6.50%	\$83,577

Table 2 – 2020 Capital Structure and Statement of Rate Base (Appendix 2-OA)

Particulars	Capitalization Ratio		Cost Rate	Return
	(%)	(\$)	(%)	(\$)
Debt				
Long-term Debt	56.00%	\$538,065	3.21%	\$17,272
Short-term Debt	4.00%	\$38,433	2.75%	\$1,057
Total Debt	60.00%	\$576,498	3.18%	\$18,329
Equity				
Common Equity	40.00%	\$384,332	8.52%	\$32,745
Preferred Shares	0.00%	\$ -		\$ -
Total Equity	40.00%	\$384,332	8.52%	\$32,745
Total	100.00%	\$960,830	5.32%	\$51,074

5.2. RETURN ON EQUITY

Calculations of the cost for each capital component are presented in table 1. The following section addresses the return on equity, both historical vs. the actual ROE up to 2023, as reported in the annual RRR filings.

5.2.1 Return on Equity

Hydro 2000's historically achieved ROE has fluctuated both within and beyond the 300 basis points of the Board-approved ROE of 9.12%. As part of its budget process, Hydro 2000 analyzes its forecasted ROE. However, it's important to note that managing ROE fluctuations is particularly challenging for small utilities. With limited revenue streams and profits, even minor changes in earnings or expenses can lead to significant swings in ROE. Many of Hydro 2000's costs—such as contractual agreements with software providers, rent, and payroll—are fixed and remain constant regardless of revenue fluctuations. If revenues decline, ROE can drop sharply because these fixed costs still need to be met. Even a slight increase in expenses can substantially impact the utility's profitability and, consequently, its ROE.

Hydro 2000's proposed ROE is 9.21%, pending updates to the deemed ROE for 2025 rate applications. Moving forward, Hydro 2000 will continue to budget with consideration to the Board-approved ROE and the 300-basis points threshold.

Table 3 – Historical Return on Equity Achieved

	2020	2021	2022	2022	2022	2023
2020 Board Approved	9.12%	9.12%	9.12%	9.12%	9.12%	9.12%
Actual Achieved	-7.16	11.53	5.77	0.10	-5.46	-11.09

5.2.3 Long-Term, Short-Term Debt

Hydro 2000 is not forecasting any debt for 2025. However, if circumstances change in the near future, the utility will make every effort to secure a loan from its shareholder, a financial institution, or Infrastructure Ontario at a rate consistent with the current cost of capital parameters or lower if possible. For the purpose of the application Hydro 2000 has employed the OEB's deemed LTD and STD rates for 2024 rate applications, and will update those parameters to reflect the OEB's deemed LTD and STD rates for 2025 applications once those rates are released.