

Financial Statements

Fair Hydro Trust
December 31, 2018



INDEPENDENT AUDITOR'S REPORT

To the Unitholders of the **Fair Hydro Trust**

Opinion

We have audited the financial statements of the **Fair Hydro Trust** (the Trust), which comprise the balance sheets as at December 31, 2018 and 2017, and the statements of income and comprehensive income, and statements of cash flows for the year and period then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2018 and 2017, and the results of its operations and its cash flows for the year and period then ended in accordance with United States generally accepted accounting principles.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Trust in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with United States generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Trust's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Trust or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Trust's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered

material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Trust's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Trust to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

/s/ Ernst & Young LLP

Toronto, Canada
April 25, 2019

Chartered Professional Accountants
Licensed Public Accountants

FAIR HYDRO TRUST**STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME**

	For the year ended December 31, 2018	For the 12 days ended December 31, 2017
<i>(thousands of dollars)</i>		
Revenues		
Interest income <i>(Note 8)</i>	60,770	858
Cost recovery revenue <i>(Note 8)</i>	1,230	2,855
Other income	188	-
	62,188	3,713
Expenses		
Interest expense <i>(Note 4 and Note 8)</i>	60,770	882
Operations, maintenance and administration	1,230	2,831
	62,000	3,713
Net income and comprehensive income	188	-

See accompanying notes to the financial statements

FAIR HYDRO TRUST

STATEMENTS OF CASH FLOWS

<i>(thousands of dollars)</i>	For the year ended December 31, 2018	For the 12 days ended December 31, 2017
OPERATING ACTIVITIES		
Net income	188	-
Adjustment for non-cash items:		
Amortization of deferred issuance fees <i>(Note 4)</i>	1,006	24
Decrease (increase) in unbilled cost recovery revenue from IESO	4,669	(6,600)
(Decrease) increase in accounts payable and accrued charges	(2,805)	2,831
(Decrease) increase in payable to OPG	(3,710)	5,734
Increase in interest payable	7,452	858
Increase in advances from IESO	9,881	3,153
Cash provided by operating activities	16,681	6,000
INVESTING ACTIVITIES		
Acquisition of financing receivables <i>(Note 4)</i>	(609,000)	(1,179,000)
Cash used in investing activities	(609,000)	(1,179,000)
FINANCING ACTIVITIES		
Issuance of long-term debt to third parties <i>(Note 4)</i>	1,210,590	601,290
Issuance of long-term debt to OPG <i>(Note 4)</i>	1,163,116	577,710
Repayment of warehouse facilities issued to third parties <i>(Note 4)</i>	(900,000)	-
Repayment of warehouse facilities issued to OPG <i>(Note 4)</i>	(864,706)	-
Payment of debt issuance fees <i>(Note 4)</i>	(4,700)	(1,600)
Contribution from unitholders <i>(Note 7)</i>	-	10
Cash provided by financing activities	604,300	1,177,410
Net increase in restricted cash	11,981	4,410
Restricted cash, beginning of the period	4,410	-
Restricted cash, end of the period	16,391	4,410

See accompanying notes to the financial statements

FAIR HYDRO TRUST

BALANCE SHEETS

As at December 31 <i>(thousands of dollars)</i>	2018	2017
ASSETS		
Current		
Restricted cash	16,391	4,410
Unbilled cost recovery revenue from IESO <i>(Note 8)</i>	1,931	6,600
	18,322	11,010
Non-current		
Financing receivables <i>(Note 4 and Note 8)</i>	1,788,000	1,179,000
Deferred issuance fees <i>(Note 4)</i>	776	1,576
	1,788,776	1,180,576
Total assets	1,807,098	1,191,586

See accompanying notes to the financial statements

FAIR HYDRO TRUST**BALANCE SHEETS**

As at December 31*(thousands of dollars)*

	2018	2017
LIABILITIES AND UNITHOLDERS' CAPITAL		
Current		
Accounts payable and accrued charges	26	2,831
Payable to OPG <i>(Note 5 and Note 8)</i>	2,024	5,734
Interest payable	8,310	858
Advances from IESO <i>(Note 8)</i>	13,034	3,153
	23,394	12,576
Non-current		
Long-term debt <i>(Note 4)</i>	1,783,506	1,179,000
Unitholders' capital <i>(Note 7)</i>	198	10
Total liabilities and Unitholders' capital	1,807,098	1,191,586

Commitments *(Note 9)**See accompanying notes to the financial statements*

Computershare Trust Company of Canada,
in its capacity as trustee of **Fair Hydro Trust,**
by **Ontario Power Generation Inc.,**
not in its individual capacity but solely as Manager

Alec Cheng (signed)
Vice President – Treasurer
Ontario Power Generation Inc.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

1. DESCRIPTION OF BUSINESS

Fair Hydro Trust (FHT or the Trust) is a special purpose trust established under the laws of the Province of Ontario (the Province) by Computershare Trust Company of Canada, acting as Issuer Trustee, pursuant to the Declaration of Trust dated December 20, 2017 and was caused to be established by Ontario Power Generation Inc. (OPG). The Trust was established as the financing entity contemplated by the *Ontario Fair Hydro Plan Act, 2017* (the Fair Hydro Act or the Act), which reduced electricity bills for residential, farm, small businesses and other eligible consumers (Specified Consumers) in the province by refinancing a portion of the Global Adjustment costs over a longer period of time. The Global Adjustment includes the difference between Ontario's electricity market clearing price used to dispatch generation and the prices paid to contracted and regulated generators in the province and the cost of conservation and demand management programs. The Act received Royal Assent on June 1, 2017 and the associated general regulation came into force in June 2017. The general regulation provides details on the structural, operational and financial elements required to implement the Act.

Pursuant to the Act, effective May 1, 2017, the Independent Electricity System Operator (IESO) began to defer the collection of a portion of the Global Adjustment costs. The Act allowed the IESO to transfer a portion of the deferred balance to a financing entity that would fund the deferral in exchange for an irrevocable right to recover the balance and associated financing and other costs from Specified Consumers in the future (Investment Interest). The legislation appointed OPG as Financial Services Manager under the Act and conveyed upon it statutory obligations, including the creation of one or more financing entities that may acquire Investment Interests from the IESO. The Trust is a financing entity under the Act.

The Declaration of Trust established FHT to carry on activities for the exclusive benefit of its unitholders including FHP2017 Inc. (FHP2017), a wholly owned subsidiary of OPG, and the Indenture Trustee BNY Trust Company of Canada (BNY) (collectively, the Unitholders). The beneficial interest and rights generally of the Unitholders in the Trust are limited to the right to participate in distributions when and as declared by the Issuer Trustee and distributions upon the termination of the Trust. The legal ownership of the Trust's property and the right to conduct the activities of the Trust are vested exclusively in the Issuer Trustee and no Unitholder has any right of ownership in any of the Trust's property. The Unitholders will also not be subject to any liability arising out of the activities of the Trust.

In order for the Trust to finance the Investment Interest acquired from the IESO, it incurred senior debt from capital markets and subordinated debt from OPG. The Trust's investment attracts financing amounts and other related fees.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

The Issuer Trustee, on behalf of the Trust, entered into a Management Agreement with OPG, as manager, whereby all of the powers and duties of managing the Trust have been delegated to OPG. OPG is entitled to charge the Trust a management service fee, comprised of a base fee and a variable fee, and to recover costs and expenses incurred by OPG on behalf of the Trust or in relation to the establishment, management and administration of the Trust and its Investment Interest without margin. All fees to be charged by OPG as Financial Services Manager are subject to the provisions outlined in sections 10.1 to 10.15 of the general regulation of the Act and are subject to an annual review by the Ontario Energy Board (OEB). OPG's entitlement to fees is subject to the payment priorities set forth in the Master Trust Indenture. With the introduction of the proposed legislation in Bill 87 in March 2019, OPG would no longer be entitled to compensation as of January 1, 2019 for acting as the Financial Services Manager of the Trust.

The IESO is required under the general regulation to pay and remit to the Trust any amounts charged to the IESO by the Trust in respect of carrying costs incurred from June 1, 2017 to July 31, 2021. Carrying costs include all funding costs, such as interest on all notes outstanding, and other expenses of the Trust, other than repayment of debt principal. Commencing May 1, 2021, a charge in respect of the Clean Energy Adjustment will be included on invoices by local electricity distribution companies sent to Specified Consumers and will be collected and remitted to the Trust through the IESO. The three-month overlap in 2021 is intended to cover the billing and collection lag from the introduction of the Clean Energy Adjustment. Under the proposed legislation in Bill 87, the IESO would no longer be required to pay and remit carrying costs to the Trust or enforce the Clean Energy Adjustment on the invoices of Specified Consumers. The Province would then be responsible to pay and remit amounts for the portion of carrying costs related to existing funding obligations. OPG would be responsible to pay the portion relating to operating costs of the Trust.

In September 2018, the Province announced its intention to make future proposed legislative changes to the Fair Hydro Act to cancel the Global Adjustment refinancing component of the Fair Hydro Plan. The Province also stated that it intends to fund all of the Trust's obligations issued and outstanding as of the date such legislative changes occur.

On October 2, 2018, the Legislative Assembly of Ontario passed a motion to appoint a Select Committee on Financial Transparency (the Committee) to consider and report to the House its observations and recommendations with respect to the report submitted by the Independent Financial Commission of Inquiry. The mandate required that the Committee table an interim report by November 1, 2018 and its final report by December 13, 2018, or on a date to be determined by the Committee. The interim report issued on November 1, 2018 and the final report issued on March 26, 2019 did not have any impact on the Trust and its financial statements.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

In March 2019, the Province released a draft of Bill 87, an Act to amend various statutes related to energy, including the Fair Hydro Plan. The proposed legislative amendments will result in replacement of the Global Adjustment refinancing structure of the Fair Hydro Plan so that the Province and OPG replace Specified Consumers as the parties that will pay certain amounts. The Province will be responsible for paying existing funding obligations. OPG will be responsible for paying the operating costs of the Trust. The Trust will also be prohibited from issuing any new debt. The IESO will no longer provide for the administration or servicing of the Investment Interest on behalf of the Trust. FHT will continue to monitor all developments relating to Bill 87 and associated regulations.

2. BASIS OF PRESENTATION

These financial statements have been prepared and presented in accordance with United States generally accepted accounting principles (US GAAP) and are presented in Canadian dollars. Certain of the 2017 comparative amounts have been reclassified from financial statements previously presented to conform to the 2018 financial statement presentation.

The Trust has evaluated subsequent events and transactions through April 25, 2019 and concluded that there were no events, other than those disclosed in Note 1 regarding the March 2019 release of draft Bill 87 that require disclosure in the notes to these financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES**Use of management estimates**

The preparation of the Trust's financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses. On an ongoing basis, management reviews these estimates. Changes in facts and circumstances may result in revised estimates and actual results could differ materially from those estimates.

Restricted cash

Restricted cash represents restricted cash on deposit that is subject to contractual restrictions. Pursuant to the Master Trust Indenture, all of the Trust's bank accounts are under the exclusive control of the Indenture Trustee and have been established in its name. All amounts on deposit are restricted in purpose and the distribution of use is subject to the order of priority outlined in the Master Trust Indenture.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

Financing receivables

Financing receivables consist of the current and irrevocable right to collect payments from Specified Consumers in the future in accordance with the Act and associated general regulation. These amounts are measured at the transaction price entered into with the IESO upon acquisition and subsequently measured on an amortized cost basis. The basis of amortization follows the effective interest method. Proposed legislation in Bill 87 would change the right to collect payments from Specified Consumers to the Province, for funding obligations, and OPG, for Trust operating costs.

Financial assets and financial liabilities

Financial assets and financial liabilities are measured at amortized cost. Financial instrument transactions are recorded at fair value on the transaction date.

Deferred bond issuance fees

The Trust capitalizes the costs of obtaining long-term debt financing and records them as a reduction to the carrying amount of the debt liability. This amount is amortized over the life of the related debt on an effective interest basis and included in interest expense.

Deferred issuance fees

The Trust capitalizes the costs of obtaining a short-term warehouse credit facility and records the costs as a separate deferred asset regardless of whether the credit facility has an outstanding balance. The deferred asset is amortized on a straight-line basis over the term of the related credit facility and is included in interest expense.

Advances from IESO

Advances from IESO represent a current liability for the amount of pre-funding received from the IESO related to expected carrying costs calculated under an accrual basis of accounting. The pre-funding of carrying costs is required as the Trust is virtually debt funded and has no cash at inception to settle its liabilities. The balance of the liability is reduced when the corresponding expense is incurred or accrued by the Trust. Proposed legislation in Bill 87 would require the Province and OPG to provide pre-funding for carrying costs instead of the IESO.

Interest income

Interest income represents the amount of accretion of the financing receivables balance calculated on a tranche-by-tranche basis using the effective cost of each underlying debt issuance.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly arm's-length transaction between market participants at the measurement date. Fair value measurements are required to reflect the assumptions that market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique, such as a pricing model, and the risks inherent in the inputs to the model.

Income taxes

Under the terms of the Trust, all taxable income will be payable to the Unitholders so that the Trust will not have any liability for income tax. As such, no provision for income taxes is recorded in these financial statements.

New accounting standards effective in 2018Revenue from contracts with customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which supersedes nearly all existing revenue recognition guidance, including industry-specific guidance, under US GAAP. Effective January 1, 2018, the Trust adopted Topic 606 to recognize its revenues, utilizing the modified retrospective approach to complete the transition. No material differences in the timing or amount of revenue recognition have been identified as a result of the adoption of the new standard. The Trust's accounting policy regarding revenue recognition following the adoption of the new standard is outlined below.

Revenue recognition

Cost recovery revenue is recognized as earned when the related expense is incurred or accrued. Collection of carrying costs from the IESO for the year ended December 31, 2018 is considered to be reasonably assured, as the IESO is required by the general regulation of the Act to pay the carrying costs of the Trust.

The Trust is considered the principal for cost recovery revenues related to Trust-incurred third party costs, while it is considered an agent acting on behalf of OPG for cost recovery revenues related to OPG's fees as Financial Services Manager. Accordingly, the Trust reports cost recovery revenues related to Trust-incurred third party costs on a gross basis, as the performance obligation of securing financing for the Investment Interest is satisfied. The Trust satisfies this performance obligation as it incurs the third party costs required to facilitate the financing and thereby recognizes the related cost recovery revenue utilizing the input method. This methodology reflects the nature of the underlying performance obligation, wherein revenue recovery is dependent on costs incurred. The cost recovery revenues related to Trust-incurred third party costs are measured at the consideration the Trust is entitled to receive for recovery of these costs. No portion of the performance obligation remains unsatisfied at the end of the applicable reporting period.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

Revenues related to management service fees payable to OPG, including OPG-incurred third party costs and direct costs of OPG employees exclusively dedicated to the activities of the Trust, are reported net of the related costs. As part of proposed legislation in Bill 87, OPG would continue as Financial Services Manager of the Trust. However, on or after January 1, 2019, OPG would no longer be entitled to receive compensation as the Financial Services Manager and would be responsible for expenses of the Trust, other than principal and interest on debt and certain taxes.

All cost recovery revenues are charged without margin and the Trust receives the corresponding pre-funding from the IESO on a monthly basis. The timing of the pre-funding impacts the Trust's contract balances of unbilled cost recovery revenue from IESO. Proposed legislation in Bill 87 would no longer require the IESO to pay and remit for the Trust's carrying costs. The Province and OPG would then be responsible to pay and remit the carrying costs.

Unbilled cost recovery revenue from IESO

Unbilled cost recovery revenue from IESO represents current assets related to revenue that the Trust will invoice the IESO in subsequent months for OPG-incurred costs and Trust-incurred expenses that have not been pre-funded by the IESO. Unbilled cost recovery revenue is recorded in the period in which it is earned and measured at the amount the Trust is entitled to receive from the IESO.

Restricted cash disclosures

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*, which clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for the Trust's 2018 fiscal year, including interim periods, and is applied retrospectively. The changes in disclosures under this update are reflected in the statements of cash flows.

Recent Accounting Pronouncements**Fair Value Measurement**

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to Disclosure Requirements for Fair Value Measurement*, to continue to improve the effectiveness of disclosures in financial statements for users. Under the new guidance prescribed in this update, entities must disclose additional information regarding Level 3 fair value measurements held at the end of the reporting period. This amendment also clarified existing guidance around measurement uncertainty and investments in entities that calculate net asset value (NAV). This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Additional disclosures stemming from this update will be applied prospectively. The Trust is assessing its current fair value measurements to determine the impact from the changes in this update.

Fair Hydro Trust**NOTES TO THE FINANCIAL STATEMENTS**

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

4. LONG-TERM DEBT, FINANCING RECEIVABLES, AND DEFERRED ISSUANCE FEES**Long-term debt and financing receivables**

Long-term debt consists of the following as at December 31:

	2018	2017
Long-term notes		
Senior secured notes		
3.44% due 2033	500,000	-
3.60% due 2038	400,000	-
Subordinated secured notes		
3.68% due 2033	382,353	-
3.88% due 2038	305,882	-
Junior subordinated secured notes		
4.01% due 2033	98,040	-
4.27% due 2038	78,431	-
Warehouse facilities ¹		
Senior secured notes		
2.74% due 2021	11,880	601,290
Subordinated secured notes		
2.84% due 2021	9,085	459,810
Junior subordinated secured notes		
2.84% due 2021	2,329	117,900
	1,788,000	1,179,000
Less: unamortized bond issuance fees	(4,494)	-
Long-term debt	1,783,506	1,179,000

¹ The interest rates disclosed reflect the weighted average interest rates during the year ended December 31, 2018.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

On December 21, 2017, the Trust entered into the following supplemental indentures under the Master Trust Indenture for the provision of an aggregate of approximately \$1.6 billion in short-term indebtedness (collectively, the Warehouse Facilities):

- a senior warehouse facility with certain commercial paper conduit purchasers and financial institutions, for the provision of an aggregate maximum principal amount of \$800,000 floating rate variable funding (Senior Warehouse Facility);
- a subordinated warehouse facility with OPG for the provision of an aggregate maximum principal amount of \$611,765 floating rate variable funding (Subordinated Warehouse Facility); and
- a junior subordinated warehouse facility with OPG for the provision of an aggregate maximum principal amount of \$156,863 floating rate variable funding (Junior Subordinated Warehouse Facility).

On February 9, 2018, the Trust issued 15-year notes due on May 15, 2033 as set out below, with interest payable semi-annually on May 15 and November 15 of each calendar year:

- \$500,000 of senior notes payable with a coupon interest rate of 3.36 per cent and an effective interest rate of 3.44 per cent;
- \$382,353 of subordinated notes payable with a coupon interest rate of 3.64 per cent and an effective interest rate of 3.68 per cent; and
- \$98,040 of junior subordinated notes payable with a coupon interest rate of 3.96 per cent and an effective interest rate of 4.01 per cent.

On March 22, 2018, the Trust purchased an Investment Interest from the IESO in the amount of \$460,000, which has been classified as a financing receivable on the balance sheets. Fifty-one per cent of the funding requirement or \$234,600 was financed by the Trust through the senior warehouse facility, 39 per cent totalling \$179,400 through the subordinated warehouse facility, and the remaining ten per cent totalling \$46,000 through the junior subordinated warehouse facility.

On April 20, 2018, the Trust purchased an Investment Interest from the IESO in the amount of \$149,000, which has been classified as a financing receivable on the balance sheets. Fifty-one per cent of the funding requirement or \$75,990 was financed by the Trust through the senior warehouse facility, 39 per cent totalling \$58,110 through the subordinated warehouse facility, and the remaining ten per cent totalling \$14,900 through the junior subordinated warehouse facility.

Fair Hydro Trust**NOTES TO THE FINANCIAL STATEMENTS**

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

On April 24, 2018, the Trust issued 20-year notes due on May 15, 2038 as set out below, with interest payable semi-annually on May 15 and November 15 of each calendar year:

- \$400,000 of senior notes payable with a coupon interest rate of 3.52 per cent and an effective interest rate of 3.60 per cent;
- \$305,882 of subordinated notes payable with a coupon interest rate of 3.83 per cent and an effective interest rate of 3.88 per cent; and
- \$78,431 of junior subordinated notes payable with a coupon interest rate of 4.21 per cent and an effective interest rate of 4.27 per cent.

The proceeds from the February 9, 2018 and April 24, 2018 issuances were used to repay the majority of the outstanding balances in the warehouse facilities. Following the repayments, the outstanding balances consisted of \$11,880 in the senior warehouse facility, \$9,085 in the subordinated warehouse facility and \$2,329 in the junior subordinated warehouse facility as at December 31, 2018. The current interest rate terms of the warehouse facilities expire in December 21, 2019 after which the interest rates increase by 200 basis points (bps) up to May 17, 2021. Subsequently, there would be incremental monthly increases of 50 bps for the next six months to a maximum increase of 500 bps. The facilities repayments occur July 2021 to October 2021 in equal amounts.

In October 2018, the capacity of the facilities was decreased to \$23 million as a result of the Province's September 2018 announcement of its intention to make future proposed legislative changes to the Fair Hydro Act to cancel the Global Adjustment refinancing component of the Fair Hydro Plan.

Substantially all of the net book value of the assets of the Fair Hydro Trust are pledged in favour of specified creditors of the Trust, including the senior debtholders and OPG in its capacity as subordinated debtholder and Financial Services Manager of the Trust.

The remaining undiscounted contractual maturities, including principal and interest, of long-term debt are as follows:

	Principal	Interest
2019	-	64,401
2020	-	64,403
2021	23,294	64,250
2022	-	63,683
2023	-	63,683
Thereafter	1,764,706	750,554

Fair Hydro Trust**NOTES TO THE FINANCIAL STATEMENTS**

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

Deferred issuance fees

As at December 31, 2018, total deferred bond issuance fees of \$4,494 (December 31, 2017 – nil) were recognized as a reduction to the carrying amount of the long-term debt. During the year ended December 31, 2018, bond issuance fees of \$206 were amortized (December 31, 2017 – nil).

During the year ended December 31, 2018, deferred issuance fees related to the warehouse facilities of \$800 were amortized and included as interest expense (December 31, 2017 – \$24).

5. PAYABLE TO OPG

The payable to OPG balance includes a current liability related to OPG's general fees as Financial Services Manager, and includes accrued base and variable management fees as well as recovery of direct costs of OPG employees who were dedicated exclusively to the Trust during the period.

The Trust has recognized recovery from the IESO of OPG's general fees for the year ended December 31, 2018 and the 12 days ended December 31, 2017 as unbilled cost recovery revenue from IESO in these financial statements. In July 2018, the OEB approved \$5,676 as OPG's 2017 general fee, which the Trust settled in August 2018. The fee for 2018 in the amount of \$1,918 was submitted in February 2019 and is subject to the OEB's review.

6. FAIR VALUE MEASUREMENT

The fair values of FHT's financial instruments as at December 31 are as follows:

	Fair Value	Carrying Value ¹	Balance Sheet Line Item
As at December 31, 2018			
Financing receivables	1,868,406	1,788,000	Financing receivables
Long-term debt	(1,854,619)	(1,788,000)	Long-term debt
As at December 31, 2017			
Financing receivables	1,179,000	1,179,000	Financing receivables
Long-term debt	(1,179,000)	(1,179,000)	Long-term debt

¹ The carrying values of other financial instruments including restricted cash, unbilled cost recovery revenue from IESO, accounts payable and accrued charges, payable to OPG, interest payable, and advances from IESO approximate their fair value due to the immediate or short-term maturity of these financial instruments.

Fair Hydro Trust

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

Valuation models use general assumptions and market data and therefore do not reflect the specific risks and other factors that would affect a particular instrument's fair value. The methodologies used for calculating the fair value adjustments are reviewed on an ongoing basis to ensure that they remain appropriate.

The fair value of the senior, subordinated and junior subordinated debt including the balances outstanding in the warehouse facilities are based on indicative pricing from the market. The fair value of these debt instruments is based on Level 2 inputs.

For the financing receivables related to the Investment Interests acquired from the IESO, fair value is based on projected cash flows and expected returns on the financing receivables. Therefore, the fair value of the financing receivables is based on Level 3 inputs.

7. UNITHOLDERS' CAPITAL

FHP2017 holds one million units representing 99.9999 per cent and BNY holds one unit or 0.0001 per cent of the Trust. Unitholders' capital as at December 31 is as follows:

	FHT		
	FHP2017	BNY ¹	Total
Unitholders' capital – December 31, 2017	10	-	10
Net income for the year	188	-	188
Unitholders' capital – December 31, 2018	198	-	198
Unitholders' capital – December 20, 2017	-	-	-
Contribution by unitholders	10	-	10
Net income for the period	-	-	-
Unitholders' capital – December 31, 2017	10	-	10

¹ BNY's capital is less than one dollar.

8. RELATED PARTY TRANSACTIONS

FHT's majority unitholder, FHP2017, is a wholly owned subsidiary of OPG. As the Province owns all of the shares of OPG, related parties of the Trust include the Province and entities controlled by the Province, including the IESO. The transactions between the Trust and related parties are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Fair Hydro Trust

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

The related party transactions are summarized below:

	For the year ended December 31, 2018		For the 12 days ended December 31, 2017	
	Revenue	Expense	Revenue	Expense
IESO				
Interest income	60,770	-	-	-
Cost recovery revenue	1,230	-	2,855	-
OPG general fees ¹	3,497	-	5,734	-
OPG				
OPG general fees ¹	-	3,497	-	5,734
Subordinated and junior subordinated interest expense	-	29,003	-	429
	65,497	32,500	8,589	6,163

¹ As specified in Note 3, the Trust is considered to be acting as an agent on behalf of OPG for cost recovery revenues related to OPG's fees as Financial Services Manager and reports these revenues net of the related costs. Given that no margin is applied on any cost recoveries, revenues receivable by the Trust to be remitted to OPG for its fees equal the Trust's expenses, which net to nil in the statements of operations and comprehensive income.

The balances between the Trust and its related parties as at December 31 are summarized below

	2018	2017
Receivable from related party		
IESO ¹	1,931	6,600
Financing receivables		
IESO	1,788,000	1,179,000
Current liabilities		
Payable to OPG	2,024	5,734
Interest payable to OPG	4,283	429
Advances from IESO	13,034	3,153
Long-term debt		
Subordinated notes payable to OPG	697,320	459,810
Junior subordinated notes payable to OPG	178,800	117,900

¹ Represents unbilled cost recovery revenue.

NOTES TO THE FINANCIAL STATEMENTS

*For the year ended December 31, 2018 and the 12 days ended December 31, 2017
(thousands of dollars unless otherwise stated)*

In February 2019, OPG submitted to the OEB its fee for 2018 in the amount of \$1,918 (2017 – \$5,734) for review pursuant to the requirements of the general regulation of the Act. The OEB-approved fee will be remitted to the Trust by the IESO as part of the Trust's carrying costs and the Trust will pay OPG's fees as Financial Services Manager.

The Province has provided a limited guarantee to specified creditors of the Fair Hydro Trust. The limited guarantee would be triggered in the event that (1) the Trust's ability to receive amounts in respect of its Investment Interest to pay for certain funding obligations is adversely affected due to either of the following events: a) the Province changes the Fair Hydro Act or any other legislation or regulation; or b) the Province undertakes a significant change in Ontario's electricity market; or (2) a court declares that the Fair Hydro Act is invalid or unconstitutional.

9. COMMITMENTS**Credit facilities**

Note 4 details the warehouse facilities due in 2021 that were established to fund periodic Investment Interest acquisitions from the IESO. The cost of borrowing under the senior warehouse facility is comprised of several components including a commercial paper rate for funding through a securitization conduit, a Canadian dollar offered rate for funding through bank facilities, a margin or program fee, as well as a commitment or utilization fee. The subordinated and junior subordinated warehouse facilities have a 10 bps spread over the senior.

10. ECONOMIC DEPENDENCE

FHT is dependent upon OPG to provide financial management and ongoing administration services pursuant to the Management Agreement between the Trust and OPG.

FHT is dependent upon the IESO to pay and remit carrying costs to the Trust and to remit Clean Energy Adjustment collections from Specified Consumers to the Trust commencing on May 1, 2021. Under the proposed legislation in Bill 87, the IESO would no longer be required to pay and remit carrying costs to the Trust or enforce the Clean Energy Adjustment on the invoices of Specified Consumers. The carrying costs would then be the responsibility of the Province, for funding obligations, and OPG, for Trust operating costs.