REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q2 2023 Hydro One Ltd Earnings Call

EVENT DATE/TIME: AUGUST 09, 2023 / 12:00PM GMT

CORPORATE PARTICIPANTS

Christopher Felix Lopez *Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer*
David Lebeter *Hydro One Limited - President, CEO & Director*
Omar Javed *Hydro One Limited - Vice President of Investor Relations*

CONFERENCE CALL PARTICIPANTS

Andrew M. Kuske *Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research*
Benjamin Pham *BMO Capital Markets Equity Research - Senior Energy Infrastructure Analyst*
David Quezada *Raymond James Ltd., Research Division - Director & Equity Research Analyst*
Linda Ezergailis *TD Securities Equity Research - Research Analyst*
Mark Thomas Jarvi *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*
Maurice Choy *RBC Capital Markets, Research Division - MD & Analyst*
Patrick Kenny *National Bank Financial, Inc., Research Division - MD*
Robert Hope *Scotiabank Global Banking and Markets, Research Division - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Hydro One Limited's Second Quarter 2023 Analyst Telecom. (Operator Instructions) As a reminder, the call is being recorded.

I would now like to introduce your host for today's conference, Mr. Omar Javed, Vice President, Communications, Marketing and Investor Relations at Hydro One. Please go ahead.

Omar Javed ***Hydro One Limited - Vice President of Investor Relations***

Good morning, and thank you for joining us in Hydro One's quarterly earnings call. Joining us today are our President and CEO, David Lebeter; and our Chief Financial and Regulatory Officer, Chris Lopez.

In the call today, we will go over our quarterly results and then spend most of the call answering as many of your questions as time permits. There are also several slides that illustrate some of the points we will address in a moment. This should be up on the webcast now, or if you're dialed into the call, you can also find them on Hydro One's website in the Investor Relations section under Events and Presentations.

Today's discussions will likely touch on estimates and other forward-looking information. You should review the cautionary language in today's earnings release and our MD&A, which we filed this morning regarding the various factors, assumptions and risks that could cause our actual results to differ as they all apply to this call.

With that, I'll turn the call over to our President and CEO, David Lebeter.

David Lebeter ***Hydro One Limited - President, CEO & Director***

Thank you, Omar, and good morning, and thank you for joining us for our second quarter earnings call. This morning, I will provide an update on our recent activities, and then Chris will take you through the Q2 financial results.

I am pleased to report our teams are doing an excellent job in progressing our capital program and have achieved several significant milestones since our last call. Our investment in modernizing and expanding the grid are playing a pivotal role in accelerating the adoption of sustainable electricity solutions that will contribute to Ontario's economic growth. At the same time, we continue to advance our reconciliation efforts with our First Nations partners, ensuring they also benefit from the expected growth. Coupled with strong project execution, our commitment to sustainability, namely people, planet and community, and our focus on delivering unparalleled service to our customers, it is no surprise that we remain the transmitter of choice for the province of Ontario.

Turning to our recent achievements. First, on July 31, we filed our leave-to-construct application, otherwise known as the Section 92 for the Waasigan Transmission Line. As mentioned in last quarter's call, Phase 1 of the Waasigan Transmission Line is a double-circuit 230 kilovolt transmission line from Thunder Bay to Atikokan, which is expected to be in service by the end of 2025. Phase 2 is a single-circuit 230 kV transmission line from Atikokan to Dryden, which will be in service by the end of 2027. Waasigan will bring an additional 350 megawatts of electricity to the region, which is more than 2x what it takes to power the city of Thunder Bay.

I am pleased with the efforts our teams put forth and the hard work that went in getting us to this point. I also want to acknowledge and thank our First Nations partners for their support of the application and the project. The infrastructure investment for both phases of this FIT project is expected to be approximately $1.2 billion.

Hydro One is proud to co-invest with our First Nations partners in the Ontario grid, which will have a positive impact on Ontario's economy. Once built, the Waasigan Transmission Line project will provide Northwest Ontario with clean and reliable electricity to meet forecasted energy demands in the region and support economic growth, job creation and mining operations. The project is being built in partnership with 9 First Nations in the region who will have the opportunity to invest in the ownership of up to 50% of the transmission line component of the project when complete.

Second, we broke ground on the Chatham to Lakeshore line, which when completed will provide clean electricity to support growth in the agro-food and manufacturing industries in Southwestern Ontario. The line will add approximately 400 megawatts of clean electricity into the region, which is enough power to supply a city the size of Windsor. The $268 million project is expected to be in service by the end of 2025.

Third, after a thorough evaluation of several routes, we announced the preferred route for the St. Clair Transmission Line. This transmission line will run from near Sarnia to Chatham with a target completion date of 2028. In addition to technical and cost advantages, the preferred route has the least impact on natural environment, biodiversity, indigenous values, landowners, and agricultural operations. 80% of its route uses existing transmission corridors and upgrades an existing transmission line.

These achievements form a key component of our continued growth. And as we look for additional growth opportunities, I was pleased to see the province's commitment to economic development and energy transition as presented in their Powering Ontario's Growth plan. The plan outlines support for critical transmission infrastructure in the coming years, which will provide Hydro One with additional growth opportunities.

As part of the plan, the government proposed the prioritization of the regulatory approval process for 3 transmission lines in Northeastern and Eastern Ontario. This will ensure these projects can quickly support the rapid demand for growth in the region. The ministry also proposed to designate Hydro One as a transmitter to undertake the development work and seek all necessary approvals to construct these priority projects.

I have no doubt that the government's confidence in Hydro One is rooted in our execution track record and ongoing engagement with the First Nations communities towards advancing reconciliation. None of this progress is possible without the dedicated employees of the Hydro One family. Our employees are the heartbeat of our organization and we recognize their invaluable contributions to our success.

I am pleased to report we have reached tentative settlements for 2 collective agreements, the main collective agreement and the customer service operations agreement with the Power Workers' Union. These agreements cover employees in frontline and customer-facing roles across the company's operations. I want to thank our respective teams for negotiating in good faith in search of an agreement which met the needs of employees, customers and Hydro One. To respect the bargaining process between the teams, we will not be commenting on the specifics of the agreement until it's been ratified by the Power Workers' Union.

Bargaining with the Society of United Professionals continues with the parties working towards reaching an agreement. As is normal during bargaining, we won't be providing any further comments on this process.

Today, we released our latest sustainability report, encompassing 3 priority areas: People, Planet and Community. These areas reflect our commitment to conducting business responsibly, energizing life for all Ontarians while focusing on delivering a sustainable future.

Under the People section, we prioritized employee safety, health and well-being and providing a welcoming inclusive, equitable work environment where every employee can thrive professionally and personally. Nothing is more important than ensuring our people return home safely. This year, we are on track to match our lowest ever recordable injury frequency of 0.62 per 200,000 hours work achieved in 2022. However, we recognize there's more work to do to achieve a workplace free of life altering injuries and fatalities.

Additionally, we highlight our ongoing efforts to promote diversity, equity and inclusion within our organization. We are creating an inclusive workplace where diverse perspectives thrive, enable us to, one, better understand and serve the needs of our varied customer base; two, innovate; and three, continue to identify and actualize efficiency improvements. While we continue to exceed our targets for gender diversity, both at the Board and executive levels, we have not yet met our commitments to the Black North initiative. We continue to remove the biases and barriers in our hiring and selection processes by running educational sessions on anti-black racism and diversity, equity and inclusion foundational trainings, but we have more work to do.

The Planet section of our report outlines our comprehensive approach to environmental stewardship. It outlines the efforts and work that goes into building, operating and maintaining the grid that is resilient and can reliably serve the needs of Ontario today and for generations to come. This grid must be one that is environmentally sustainable and can adapt to future worsening climatic change impacts. We continue to make progress towards our goal of achieving net 0 greenhouse gas or GHC emissions by 2050 and 30% GHC reduction by 2030. Our GHC reduction figures from last year were rebased to account for new Canadian industry guidelines. As a result, 2021's reduction from a 2018 base year, which we reported last year, was recalculated from 9% to 4%. Using the same guidelines at the end of 2022, we had reduced GHG emissions by 7% compared to 2018.

After a slow start in 2021 due to vehicle availability, we converted 17% of our fleet of SUVs and sedans to electric vehicles or hybrid at the end of 2022. We still expect to convert 50% of our fleet to EVs or hybrids by 2025 and 100% by 2030.

The Community section of our report highlights our dedication to being a responsible corporate citizen. We believe that our success is intricately linked to the well-being of the communities we serve. As such, we are deeply invested in various social and philanthropic activities that empower and uplift communities. Through targeted programs, charitable giving and partnerships, we strive to make a positive and lasting impact on the lives of our customers, neighbors and partners.

A significant accomplishment last year was the launch of the equity partnership model through which First Nation's communities can invest in 50% ownership in the transmission line component, of Hydro One's new build transmission line projects that are greater than 100 million. This unique milestone agreement is industry-leading and a meaningful step towards reconciliation. I'm also proud to report that in 2022 we exceeded our targets for indigenous procurement with our highest spend ever and also exceeded our targets for corporate donations and sponsorships to indigenous communities.

During the past quarter, we were confronted by storms and wildfires. As a utility serving diverse geographies, we understand the profound impact of severe weather and natural disasters can have on our customers and communities. While we have not experienced any significant impacts from the wildfires, our response teams are ready to respond, to restore power, help and bring relief to those affected. Our dedication to preparedness, early warning systems and robust infrastructure investment allows us to respond swiftly and effectively to the challenges posed by these extreme events. We take immense pride in our ability to respond to these types of events to ensure power is restored in a quick and efficient manner for our communities.

Our commitment to disaster management extends beyond just restoring power. We continuously analyze and learn from our experiences, refining our protocols to further enhance our disaster response capabilities. Our goal is not only to minimize disruptions during emergencies, but also to actively contribute to building more resilient communities.

I am proud to share that Hydro One received our 14th Award from the Edison Electric Institute for our exemplary performance in storm restoration after Winter Storm Elliott. It reflects the dedication and resilience of our employees and the effectiveness of our disaster management protocol as well as the continuous improvements we have made to enhance our response capabilities.

In addition, we were once again recognized by Corporate Knights as one of the best 50 Corporate Citizens in Canada for our relentless commitment to sustainability and environmental stewardship. This recognition is a testament to the dedication of our teams in driving our sustainability initiatives and adopting the best practices throughout our operations.

We are humbled and inspired by these accolades. These recognitions are a testament to the collective efforts of our employees, partners and stakeholders who have contributed significantly to our achievements.

On other matters, it is my pleasure to announce the successful election of 3 new Board Members, Brian Vaasjo, Helga Reidel and Mitch Panciuk, following our Annual General Meeting of Shareholders in early June. We believe that an experienced and diverse Board is essential to effective corporate governance and strategic decision making. Our new Board Members bring a wealth of experience from diverse industries and their appointment further strengthens our company's leadership.

With that, I will turn it over to Chris to discuss our financial results this quarter. Over to you, Chris.

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Good morning, everyone, and thank you for joining us today. I want to acknowledge the substantial progress our teams continue to make in advancing our capital projects to secure a better and brighter future for all Ontario. The filing of the leave-to-construct application for the Waasigan Transmission Line was tremendous work that once approved, will begin another phase of continued economic growth for Northwestern Ontario and our First Nations partners. I also want to recognize the efforts of our team members who are on the front lines and monitoring the wildfire situation very closely. They are taking proactive measures to safeguard our infrastructure and stand ready to support our customers.

In terms of our financial results for the second quarter, basic earnings per share was $0.44 compared to $0.43 in 2022. The key drivers for the change in earnings this quarter were adjustments to OEB approved rates for transmission following the approval of the Joint Rate Application or JRAP; higher energy consumption in distribution, and lower depreciation, amortization and asset removal costs primarily due to lower asset removals resulting from fewer storm-related asset replacements. These were partially offset by higher operating, maintenance and administration or OM&A costs, primarily resulting from higher corporate support costs and work program expenditures, and higher financing charges attributable to higher weighted average interest rates on long-term and short-term debt.

And our second quarter revenue net of purchase power was higher year-over-year by 7.2%. Transmission revenues increased 8.3%, primarily due to higher revenues resulting from OEB approved rates, including the recovery of regulatory assets following the implementation of the Joint Rate Application decision. The recovery of regulatory assets had offsets in OM&A and income tax expense, making them net income neutral. The higher revenues were partially offset due to a lower average monthly peak demand, which declined by 1.2%.

Distribution revenues net of purchased power increased by 5.4%, mainly due to higher revenues resulting from the recovery of regulatory assets, which, as discussed, are net income neutral, and higher energy consumption by Hydro One customers, which increased by 0.8%.

On the cost front, operating maintenance and administration expenses increased year-over-year by approximately 17.5%. While this increase may seem large, it is driven primarily by items that are either going to be offset later in the year or are net income neutral. The largest driver was higher corporate support costs for both segments that were mainly attributable to lower capitalized overheads. As discussed in last quarter's call, these costs increased as we capitalize common costs at lower rates due to the timing and volume of capital work in relation to the rest of the year. As the capital program ramps up in the back half of the year, we expect to capitalize common costs at a higher rate, substantially offsetting the corporate support cost increases incurred in the first 2 quarters. The next impact for both segments was higher expenses associated with the recovery of regulatory assets. That, as discussed earlier, are net income neutral as they are fully recovered in revenues.

In addition to these costs, we had higher work program expenditures, including vegetation management, station maintenance, information technology initiatives, and emergency restoration. Recall that we had higher capitalized storm costs last year that favorably impacted OM&A. Finally, these OM&A expenses were partially offset by a lower allowance for doubtful accounts, stemming from the macroeconomic issues over the past couple of years.

Depreciation expense was lower year-over-year by 4.3%, primarily due to lower asset removal costs resulting from fewer storm-related asset replacements. As a reminder, with fewer significant storms experienced in the quarter, we saw a lower level of storm costs capitalized compared to the same period a year ago. Partially offsetting these amounts was an increase in depreciation and amortization due to the growth in capital assets, which is consistent with our stated capital investment program.

On financing, we saw a 21% increase year-over-year in our financing charges. This is primarily due to higher weighted average interest rates on long-term debt and short-term notes. These financing charges are a result of issuances and refinancings over the last 2 quarters, including a $1.050 billion in overall issuance of medium-term notes in the first quarter under the sustainable financing framework, the refinancing of short-term notes, and the payment of long-term debt. We continue to be pleased with the stability of our balance sheet and robust investment-grade credit ratings.

Income tax expense was $65 million for the quarter compared to $68 million in the same quarter last year. The decrease in income tax expense was due to higher deductible timing differences, partially offset by higher earnings and the tax on the disposition of the regulatory accounts, which as discussed is net income neutral.

The effective tax rate for this quarter was 19.6% versus the effective tax rate last year of 20.9%. This is consistent with the annual guidance provided earlier this year. As a reminder, we expect the effective tax rate to be 13% to 16% over the next 5 years. Note that the previously shared deferred tax asset or DTA amounts were fully recovered by the end of June.

Moving to investing activities. In the second quarter, we placed $413 million of assets in-service, which is a 24.5% decrease compared to the prior year. The decrease in the transmission segment was primarily related to the timing of investments placed in-service, partially offset by a higher volume of work on wood pole replacements. The decrease in the distribution segment was primarily related to a lower volume of storm-related asset replacement, partially offset by a higher volume of work on customer connections, line refurbishments and wood pole replacements.

Capital investments for the second quarter were $649 million, which is a 6% increase from the second quarter in 2022. The transmission segment saw higher capital investments relating to the new Chatham to Lakeshore and Waasigan Transmission Line projects and higher station refurbishments and equipment replacements. The distribution segment capital investments decreased due to a lower spend on store-related asset replacements, partially offset by timing of work on system capability reinforcement projects, higher volume of work on customer connections, higher volume of externally driven work attributable to joint use assets and line relocations, and a higher volume of line refurbishments and wood pole replacements.

With the recent announcement regarding the filing of a leave-to-construct application for the Waasigan Transmission Line, we have updated the future capital investment table, which outlines the regional and system growth outlook to account for the $1.2 billion of expected capital investment in this line. The capital is expected in 2 phases, with Phase 1 expected to be complete by the end of 2025 and Phase 2 to follow by the end of 2027. As a reminder, the capital investment and rate base numbers for the future years remain subject to OEB approval. In addition, the table does not include any future investments associated with the 3 Northeastern and Eastern lines that David discussed earlier today.

As discussed in our last conference call, we continue to work with Internet service providers to deliver broadband Internet access through our existing infrastructure. We have prepared our ecosystem to handle the anticipated volume of work on account of this initiative. However, the pace of progress on the initiative continues to be slower than expected, but we remain poised and ready to help deliver connectivity to families and businesses in Ontario.

We also continue to engage with local distribution companies, or LDCs, to facilitate consolidation within the sector. We are in active discussions with several LDCs, but at this point there are no definitive agreements.

On guidance, we continue to be committed to and affirm our target of 5% to 7% earnings per share growth through 2027 on the normalized 2022 EPS of $1.61. As a reminder, the EPS growth range does not factor in growth from broadband, LDC consolidation, and the transmission lines that had been previously awarded but only have preliminary estimates or are pending approval, such as the Waasigan Transmission Line, as well as any amounts from externally-driven variance accounts.

Finally, I am pleased to report that we declared a dividend to common shareholders of $0.2964 per share. I'll stop there, and we'd be pleased to take your questions.

Omar Javed ***Hydro One Limited - Vice President of Investor Relations***

Thank you, David and Chris. We ask the operator to explain how she'd like to organize the Q&A polling process. In case we can't address your questions today, my team and I are always available to respond to follow-up questions. We ask that you limit your questions to one question and one follow-up. If you have additional questions, please rejoin the queue. Go ahead, operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ben Pham with BMO.

Benjamin Pham ***BMO Capital Markets Equity Research - Senior Energy Infrastructure Analyst***

I want to start off maybe with the critical infrastructure projects, adding once again to the CapEx plan. Can you comment maybe on your balance sheet debt financing need next through 2024 with this CapEx and then the impact on guidance and EPS growth rates?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Ben, Chris Lopez here. Thanks for the question. So I'll start off with the impact of the financing plan. This is within previous guidance on financing. Just recall here that we are partnering with First Nations. It does mean they're going to pick up their share of the equity investment as we go along. So that will be the first part of the financing. We'll finance it during working construction and we'll do that. But it doesn't change our ability to finance that. There's no need for equity, if you ask me that question, as a result of this announcement today.

With regard to EPS guidance, we're going to follow general practice, which is we updated the capital guidance upon filing when it's approved, Section 92, which we expect to be in the next 6 months. It could be this side of the end of the year or slightly over. We would then update EPS guidance at that time, if it's called for. What I'll tell you is that we previously put out 5% to 7%. This would take us up closer to the top end of that guidance, but we need to go through that guidance before we would change it.

Benjamin Pham ***BMO Capital Markets Equity Research - Senior Energy Infrastructure Analyst***

Okay. That's great. And can you also comment with what First Nations maybe more specifically the process? And is the injection from them, is that more back-end weighted in terms of the construction cycle?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Yes, Ben. We handle construction at Hydro One. And when the asset goes into service is when the First Nation would invest with the equity portion of that investment. It breaks out on this particular project roughly 60% Hydro One and 40% First Nations. It is 50-50 on the line component, but there's also additional investments around stations that are Hydro One investments.

Operator

Our next question comes from the line of Maurice Choy with RBC Capital Markets.

Maurice Choy ***RBC Capital Markets, Research Division - MD & Analyst***

I just want to touch on the LDC consolidation. Chris, you mentioned that there are no definitive agreements to announce so far. I believe there are tax incentives that were introduced maybe back in 2015 that includes a reduction in tax rate for transfers, maybe some capital gains exemption when you exit the payments in lieu of corporate tax regime. Given how these incentives are set to expire at the end of next year, do you feel like the service might be more motivated to transact? Or are these incentives something that matter less?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Maurice, it's Chris. I think the incentives do help. I would expect those incentives potentially to be extended as well. But I'll comment just generally on the activity. So we had the municipal elections last October. It did start a little slow. We have seen increased activities and discussions with various councils and LDCs themselves around what potential opportunities might be.

So the activity has increased. Just as I said in my comments, no definitive agreements. I would expect that the incentives that are available for consolidation will be considered for extension. Consolidation is still the right thing for Ontario.

Maurice Choy ***RBC Capital Markets, Research Division - MD & Analyst***

And just finishing off with a more broad question, and you obviously would have seen the federal government put out a vision document yesterday called Powering Canada Forward. Any broad takes on that document, what it means for Ontario and even for Hydro One?

David Lebeter ***Hydro One Limited - President, CEO & Director***

It's David Lebeter. I think that document is really a great piece -- a great announcement because what it does do is it does show the government is committed to the 2035 development of a clean electricity system within Canada. It recognizes the different roles of provinces, territories that federal government play in achieving that. And it lays a path forward for how the federal government is going to continue to interact with the provincial governments to make this happen and continue to fund the energy transition as part of the tax base. So good document pointing us in the right direction and look forward to seeing the clean energy regulations get released later on.

Maurice Choy ***RBC Capital Markets, Research Division - MD & Analyst***

And then maybe just as a quick follow-up. Is your interpretation that the federal funding is somewhat tied or connected to the provincial climate objectives? Or is your view of how ITCs may be received unchanged even, say, before this document came out?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Yes. I don't have a view of that at this point, Maurice. That's something that we're going to have to wait and see what gets announced as we move forward and how the different announcements get actually implemented.

Operator

Our next question comes from the line of Linda Ezergailis with TD Securities.

Linda Ezergailis ***TD Securities Equity Research - Research Analyst***

I have a follow-up question with the Waasigan Line. Would it be possible to break down the $1.2 billion between Phases 1 and Phases 2? And will the Phase 2 construction start in 2025 or post 2025?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Linda, it's Chris. It's in the Section 92 application, but I'll give you a quick rundown. Phase 1 is expected to be approximately $700 million and put in service towards the end of 2025. I would expect Phase 1 and Phase 2 to be going in conjunction. It won't be started exactly at the same time, but the work will go on together. Phase 2 is $500 million, which is the balance of the $1.2 million, and will go in service in 2027.

Linda Ezergailis ***TD Securities Equity Research - Research Analyst***

That's helpful. And then for the proposed St. Clair Transmission Line, you've also offered a 50% equity stake. Can you share kind of would that be also a 60-40 split? And ditto for the Chatham to Lakeshore Transmission Line in terms of First Nations participation.

David Lebeter ***Hydro One Limited - President, CEO & Director***

Every line is a little bit different because it depends on the mix of transmission stations that are required, the length of the line. So we're not releasing any information on that at this point in time. You'll have to wait till we file the Section 92, which is on the detailed engineering; it is being done. We have a final cost estimate that's broken down between the different aspects of the project.

Linda Ezergailis ***TD Securities Equity Research - Research Analyst***

Okay. And just a quick follow-up on your broadband initiative. Recognizing that it's ramping up more slowly, are you getting more feedback or insights as to what is behind the lag? And are you rethinking your offering to build some momentum? Or can you give us an update on how you're thinking about that?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Linda, you're absolutely correct. It is ramping up slower than we had anticipated, but it is starting to pick up. We have very good partnerships with the various government ministries involved in this. And as well, we're having really good discussions with the Internet service providers. We have collectively eliminated a lot of the issues that were brought -- in fact, we've eliminated all the issues that have been brought forward, and we continue to look for ways to streamline the project and speed it up. So although it hasn't progressed as quickly as I would have liked at this point, we remain optimistic and committed to delivering it by the end of 2025.

Operator

Our next question comes from the line of Mark Jarvi with CIBC.

Mark Thomas Jarvi ***CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research***

Can you just remind us again what the authorized ROEs would be on the transmission lines as they get approved? Is that based on the existing one in the JRAP or is that every year based on when they get approved on the new updated cost of capital parameters?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Mark, Chris here. Yes, it's based on the year the asset gets approved or goes into service. So Phase 1 for Waasigan will be the prevailing rates, the application going in 2025. So it will be the prevailing rate at the end of 2024 that will apply. And for the Phase 2, it will be prevailing rates at the end of 2026 which will apply to 2027.

Mark Thomas Jarvi ***CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research***

Got it. And then does it then get folded back in when you go back in for the next multiyear cycle on the transmission business?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

No, there will be separate applications because it comes up with a separate agreement. So likely there'll be 5-year applications and they'll be renewed every 5 years with the rates at the end of that cycle.

Mark Thomas Jarvi ***CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research***

Okay. And then just as we think about some of the major projects across, I guess, North America faced cost overrun, tight labor markets, just what's the process or I guess mechanism if you do see some cost overruns versus labor and other reasons on those major projects? Is there a path to full recovery for any additional proven costs? Just sort of how well protected you are in terms of any cost pressures?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Mark, David. Fantastic question. So obviously, we're in an inflationary period that we haven't seen for a while. We're seeing tight supply of materials, which also creates upward pressure on projects. Think about -- let's think about the Waasigan Transmission Line. So you take your Section 92 forward to the OEB and they're going to look at your prudency of your costs. They're going to say, is this a reasonable cost estimate for this project. They would then approve that -- assuming they concluded it's reasonable, they would then approve that.

As we go through the construction process, we as the constructor are going to do everything we can to live within that budget. Where there are legitimate reasons why we can't live within that budget, we document those, we do a very thorough analysis of what else could have been done to prevent that from occurring, and then we go back to the OEB when the project is finished after it's gone in service, and we walk through the actual costs versus the budgeted cost. And that's where the OEB decides if your costs were prudent after the fact.

So it really comes down to demonstrating due diligence. You've done everything you could to maintain to live within the existing budget and demonstrate that the cost increases are reasonable and they're beyond your control.

Mark Thomas Jarvi ***CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research***

And that can be done in a fairly timely fashion like you don't have to wait for the next 5-year rate cycle to be trued up any cost increases?

David Lebeter ***Hydro One Limited - President, CEO & Director***

No, that happens independent after the project is completed and Hydro One has a very strong track record. I don't believe we've ever had a cost disallowance.

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

So for example, Mark, with Phase 1, we're going to put it in service in 2025. That's when the actual cost of both into service will be approved by the OEB. So any change in the estimate will be approved at that point.

Operator

(Operator Instructions) Our next question comes from the line of Robert Hope with Scotiabank.

Robert Hope ***Scotiabank Global Banking and Markets, Research Division - Analyst***

Just a follow-up question on the broadband initiatives. So I appreciate the commentary that it is ramping up slower than expected. When you take a look at the issues -- sorry, could you maybe add a little bit more color on the issues that are slowing it down? As well as just the ISPs have a lot going on right now. Is there a potential that we could see this bleed beyond 2025?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Robert, it's David. I honestly don't believe this is going to go beyond 2025. All the government ministries, the Ministry of Engineering, Ministry of Infrastructure, ourselves, and the ISPs are committed to getting it done by 2025. There's a lot of work that's gone on behind the scenes. On our part, we've streamlined the process for a joint-use application. We've setup a warehouse that's dedicated to joint use. We purchased inventory of raw materials; recognize we need to get that flowing. We've updated the standards to drive consistency across Ontario. We've been working closely with Electrical Safety Authority to make sure those standards are aligned. And the ISPs, Internet Service Providers, have been along on the journey.

So collectively, as we've identified things that could allow the process to move more smoothly or be done more efficiently, those things have been addressed and knocked off. So no one particular issue stands out. It's just that there's a lot of work that has to get done, a lot of process that had to be -- a lot of pre-upfront work before you start to put shovels in the ground. I feel we're getting -- as I said, we are seeing it start to ramp up. It's not as quick as we would like, but we have seen it ramp up and we remain committed to 2025 as do all the other partners.

Robert Hope ***Scotiabank Global Banking and Markets, Research Division - Analyst***

All right. Excellent. And then as a follow-up, you did highlight a number of transmission lines that are not yet in kind of your capital outlook or guidance. How are discussions going with kind of the market authorities in terms of kind of the next tranche of transmission projects and kind of when do you expect to get line of sight on the ones that are not in guidance as of right now, plus the next level of the transmission projects?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Robert, I assume you're referring to the 3 that were announced in the Powering Ontario's Growth plan?

Robert Hope ***Scotiabank Global Banking and Markets, Research Division - Analyst***

Yes.

David Lebeter ***Hydro One Limited - President, CEO & Director***

Right. We continue to have a very good discussion with the government on that. We support their proposed approach, which is a comment period to get feedback from all interested vendors, all interested proponents I should say. It's going to be outstanding until September 8. We're optimistic we will get a designated as a developer for those projects. But I think the government has taken a very prudent approach to moving forward with this.

Operator

Our next question comes from the line of Andrew Kuske with Credit Suisse.

Andrew M. Kuske ***Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research***

Maybe if we could come back to the municipal consolidations. The Ontario Energy Board, they're in the midst of launching an evaluation on the policy related to consolidations. So obviously, you can continue conversations with the munis. But how do you think that plays out for any potential consolidation efforts that you may be engaged in?

David Lebeter ***Hydro One Limited - President, CEO & Director***

Andrew, it's a really interesting question. Economically, consolidation makes a lot of sense for the province of Ontario. That's been well proven. Each municipality has their own set of drivers why they might want to engage in actually selling the assets or not selling their assets. So in part where you're asking us for us to speculate on what their drivers might be, which is really hard to do. What the regulatory regime is looking at doing, I believe, is how can we streamline the process, make it efficient, how can we remove red tape. So where municipalities are interested in selling their local distribution company and where there's a willing buyer, that process has moved forward quickly and with a certain degree of certainty. I think that's really what we're going to be focused on.

Andrew M. Kuske ***Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research***

Okay. Appreciate that color. And then maybe somewhat related to potential consolidation is a little bit of just the IT spend you had in the quarter. You had a little bit of an elevation in OM&A. You cited IT as being one of those issues. Obviously, that's something that you can provide scale in a consolidation effort. Maybe if you could just give us a bit of a breakdown how much was cyber, how much was maybe big data related and AI related to help improve decision-making into the future as you scale up the grid and the distribution efforts become a bit more dynamic.

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

Yes. Good question, Andrew. We won't provide specifics on the spend. What I will tell you it's the smallest part of that group and just putting that order for that reason. We are consistently investing in our IT platforms, cybersecurity included, which puts us in a good place for consolidation. So we know the OEB's going to look at it, cybersecurity specifically, and how LDCs across Ontario will stack up over time. We think we're at the forefront of that and we'll continue to invest to do that.

Operator

Our last question comes from the line of Patrick Kenny with National Bank.

Patrick Kenny ***National Bank Financial, Inc., Research Division - MD***

Just wondering if you could provide us with a bit of a live update on the affordability landscape in Ontario, just given we've seen some other provinces, other jurisdictions pull back or take a pause on certain infrastructure investments, whether it be P&D or generation. I know there were big strides made on overall customer bills a few years ago. But just wanted to get your thoughts on how you might be positioned in Ontario relative to other areas.

Andrew M. Kuske ***Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research***

Yes. Thanks for that question, Patrick. A couple of thoughts come to mind. First of all, a lot of those other jurisdictions where you've seen pullback is because they had commodity exposure to the natural resort -- the resources they're using for generating electricity. Ontario didn't experience any of that because it's largely nuclear followed by hydro and renewables. So it didn't suffer that same spike up in natural gas prices that you saw elsewhere that translated into very high energy costs. That would be the first thought I'd make about that.

The provincial government has remained committed to capping the increase on electricity bills to the rate of inflation, recognizing I believe that the energy transition is a multi-generational journey that we need to go on and that there's a role for the taxpayer to play in transitioning through that journey. So you've seen steadfast commitment from the Ontario government to cap those rates to the rate of inflation and support residents and businesses of Ontario to go through this transition.

And I think with the latest report that came out the pathways of power in Canada forward, you've seen the federal government step up looking for other options that they can help contribute to finance this transition as well. And in fact, you're starting to see other -- you're starting to see evidence now that once we get through the transition, a consumer's total energy bill might actually be lower once you're through this adjusted for the rate of inflation.

So some really good things starting to come up on the horizon. And increasingly, you're seeing people talk about the affordability, how do we make sure this moves forward at a pace that's acceptable to consumers and maintains affordability for all consumers.

Andrew M. Kuske ***Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research***

Okay. That's great. And then maybe just a quick follow-up for Chris. With 6 months of earnings here under your belt, how the year might be tracking with respect to the excess earnings portion relative to historical performance and what that might translate into as it relates to some of your FFO to debt metric targets relative to rating agencies?

Christopher Felix Lopez ***Hydro One Limited - Executive VP, Chief Financial & Regulatory Officer***

We provide long-term guidance, which is that 5% to 7%. So 6% was the middle. Just a reminder, when we set that number back in beginning of this year, we set it at 100 basis points overread. So we're tracking to that. We will achieve our intended goal this year on that particular point.

How it translates to FFO, FFO has come down a little bit this year, really driven by changes in regulatory accounts. And the other point would be the deferred tax asset. Just a reminder that we completed recovering the deferred tax asset from -- through rates here in June. So we've covered the approximately $260 million over the last 24 months and that stops here in June. So you'll see the FFO come down a little bit, but there's still plenty of financial flexibility to fund the growth that we've put in as planned.

Operator

We have one more question from the line of David Quezada with Raymond James.

David Quezada ***Raymond James Ltd., Research Division - Director & Equity Research Analyst***

Just one additional one for me. I'm just curious, it seems like it's been a pretty active season for wildfires in Ontario. I'm curious if that affects any of your route planning from a transmission perspective and/or potentially costs, do you see potentially that affect your costs in the future.

David Lebeter ***Hydro One Limited - President, CEO & Director***

So the first point I'll make is that it has been a little bit more active fire season Ontario than the 10-year average, but certainly nothing like what we've been seeing out West in B.C. and Alberta.

More specifically to your question in terms of the impact on our transmission, as we enter fire season, there are certain standard procedures that we do every year to make sure everybody is properly trained on how to work in firehouses. We make sure that we have the appropriate equipment. We liaison with the different government officials to make sure we understand any concerns they have. And then we actively monitor the fire season. And we do adjust our work plans and our work schedule based on the fire conditions in a particular area where the crews are working.

This year, despite the increased fire activity, overall the fire hazard hasn't been that severe that it's had any impact, but this is just a normal course of business for us. We monitor it and we make adjustments as per the particular condition. So no impact.

Operator

And that does conclude our Q&A session for today. I'd like to turn the call back over to Omar Javed for any further remarks.

Omar Javed ***Hydro One Limited - Vice President of Investor Relations***

Thanks, Shannon. The management team at Hydro One thanks everyone for their time with us this morning during what is a busy period. We appreciate your interest and your ownership. If you have any questions that weren't addressed on the call, please feel free to reach out and we'll get them answered for you. Thank you again and enjoy the rest of the day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone, have a great day.