Volume 2: Cost of Capital: Expert Opinion of Mr. James Coyne – Return on Equity

Q. Volume 2, Cost of Capital Report, page 44, lines 1-2. Mr. Coyne states that his forecast of the risk free rate is conservative based on the then current 30-year bond yields. Please explain why it is appropriate to use forecasts of the risk free rate rather than the current rate for the CAPM analysis.

A. The cost of capital analysis is intended to be forward-looking because the goal is to determine what cost of capital investors will require in order to commit their capital to a particular investment rather than other available alternatives. For that reason, it is best to use projected market data whenever possible, including forecast interest rates, in the models used to estimate the cost of equity.

At the time of the analysis in Concentric's report (i.e., August 31, 2023), the 30-day average of the 30-year government bond yield was 3.46 percent in Canada and 4.21 percent in the U.S. The forecast bond yields used in Concentric's CAPM analysis were 3.52 percent in Canada and 3.98 percent in the U.S. As of January 31, 2024, 30-day average government bond yields were 3.21 percent in Canada and 4.19 percent in the U.S.

Under market conditions at the time of Concentric's ROE analysis for Newfoundland Power, forecast interest rates on both Canadian and U.S. government bonds were similar to the average actual interest rates on those bonds. Interest rates on 30-year government bonds have declined by approximately 25 basis points in Canada since August 2023 (the average yield was 3.21 percent as of January 31, 2024), while interest rates in the U.S. have remained about the same (4.21 percent vs 4.19 percent). Forecast interest rates for Canada and the U.S. have not changed substantially as compared to those used in our CAPM analysis in August 2023.