Fiscal Strategy: Ontario's First Quarter Finances

Office *of the* Budget
MINISTRY *of* FINANCE

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Preliminary Draft – All Numbers Subject to Change

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Context

Ontario's First Quarter Finances is generally the **first public fiscal update** after the release of the Budget and before the release of the prior year's Public Accounts and the Fall Economic Statement.

- Given that the 2017 Budget was released in late April, there are few updates to report

Under the *Fiscal Transparency and Accountability Act, 2004* (FTAA), the First Quarter Finances is required to:

- Be released on or before August 15th; and
- Include updated information about the major components of revenue and expense for the current year

Key stakeholders like the Financial Accountability Officer will assess the fiscal outlook and narrative presented.

- Based on the government's accounting for pension assets, the FAO predicts Ontario will run a small deficit of $0.5 billion in 2017-18, but also projects that a balanced budget is "within the government's reach in 2017-18"

Key Building Blocks for First Quarter Finances

Fiscal Anchor: Continue the 2017 Budget narrative of balance in 2017-18
The deficit target in the past four Q1 Finances has remained status quo from Budget

Legislated Content

"Updated information about the major components of the revenues and expenses as set out in the fiscal plan"

Typical Content

In-year approvals since Budget

Updates to economic performance and outlook

Updates to Ontario's 2017-18 Borrowing Program

Optional Content

Revenue updates (risks and/or revised forecast) *(narrative or numbers)*

Updates on 2017 Budget announcements

Signalling new investments for FES

Revise c-fund or reserve

Changes to the surplus or deficit

Key Considerations in Developing the Q1 Update

1. **First Quarter Finances provides an opportunity for the government to reiterate and update key fiscal messages from the Budget and pre-condition for future updates**
   - Presents an opportunity to profile spending commitments made since budget and highlight risks to the expense and revenue forecasts that may materialize by FES or the 2018 Budget
   - Government could signal investments in newly identified priority areas that are not currently built into the fiscal plan (e.g. investments to support small businesses and senior supports).
2. **Timing of Information – It is early in the year and the information will continue to evolve**
   - The fiscal outlook in Q1 could foreshadow information that will be published in the Public Accounts (as early as Aug 28th), especially information that would affect the 2017-18 forecast (e.g. PIT data)
     - Final revenue results for 2016-17 could impact the medium-term revenue outlook, including significant downside PIT risks
     - Q1 Finances have traditionally NOT updated figures for the previous or forecast for the current year based on previous year developments, as Public Accounts has not been finalized and/or released at the time Q1 is posted.
   - Additional revenue information becomes available towards the end of December, which could materially affect the forecast

Early Read: Range of Potential Fiscal Outcomes

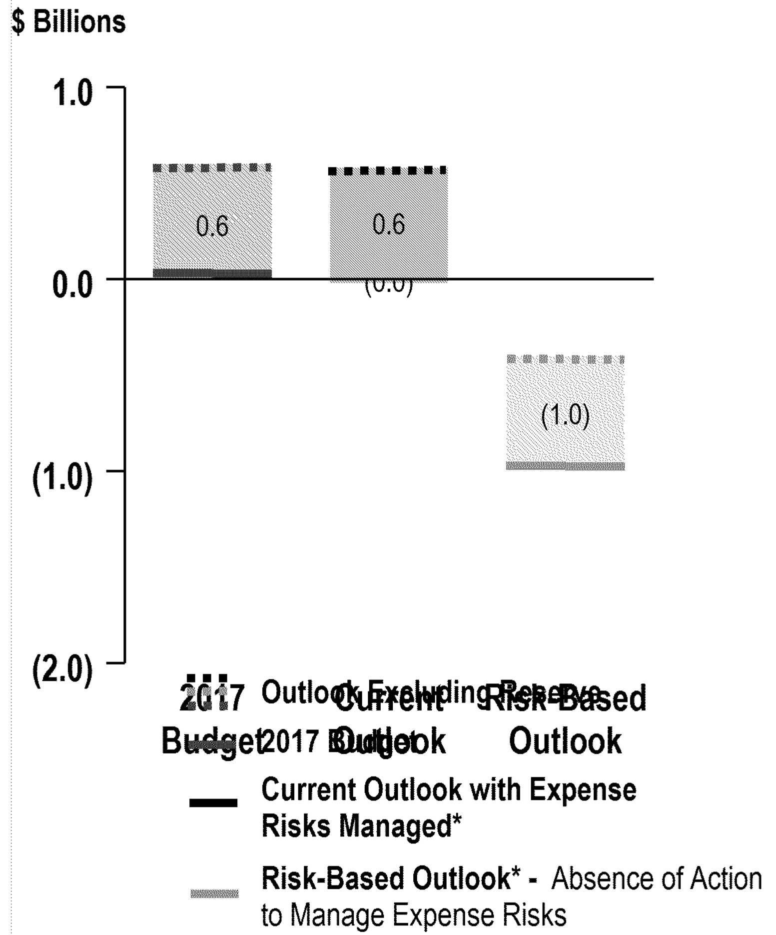
An early read of the information to date suggests that **balance remains achievable in 2017-18**.

Higher revenue due to stronger economic growth and higher projected corporate income tax is offset by significantly lower PIT revenues due to tax planning that occurred in 2015, resulting in **no material change to** the fiscal plan.

- Fiscally neutral federal childcare agreement, and higher-than-expected carbon proceeds, results in an overall increase to the revenue forecast, but do not improve the fiscal outlook

To date, **in-year expense approvals** have been **managed within the 2017 Budget fiscal plan**, however, a low contingency fund balance and high year-end savings target result in pressure on the fiscal plan. In addition, program expense risks of **$1.0 billion, have been identified** for which management strategies are being developed.

Early Read: 2017-18 Outlook



* Assumes $0.4 billion contingency funds remains available to apply against risks and $1.2 billion year-end savings target is met. Also assumes upside Cap and Trade revenues are offset by expense (i.e. they are fiscally neutral).

Decision on First Quarter Fiscal Strategy

1. **Seeking decision on the fiscal outlook and expense items to report**:
   - What to include in the revenue and expense updates
     - **Revenue:** Update for fiscally neutral Early Learning and Childcare Bi-Lateral Agreement. Provide ***narrative only*** update on downside and upside risks from PIT and CIT, slowing housing market, auction of carbon allowances, strengthening economy. A complete revenue forecast update would be deferred to FES when additional information is available and a multi-year update is published.
     - **Program Expense:** Select TB/MBC approvals, including Early Learning and Childcare Bi-Lateral Agreement, items that are offset from contingency fund as well as inter-Ministry transfers.
     - **IOD & Prudence:** No changes to IOD or the reserve.
   - Both program expense and revenue will increase by $145 million, maintaining the "**balanced outlook**"
     - See appendix for complete list of revenue and expense items to report in First Quarter Finances and those to report later.
2. **Confirm type and timing of release**

Potential 2017-18 Q1 Outlook $ Billions	2017 Budget Plan	Q1 Update	Change
Revenue	**141.7**	**141.8**	**0.1**
Expense			
Programs	129.5	129.6	0.1
Interest on Debt	11.6	11.6	-
Total Expense	**141.1**	**141.2**	**0.1**
Surplus/(Deficit) Before Reserve	**0.6**	**0.6**	**-**
Reserve	0.6	0.6	-
Surplus/(Deficit)	**0.0**	**0.0**	**-**
Net Debt as a Per Cent of GDP	**37.5**	**37.5**	**-**

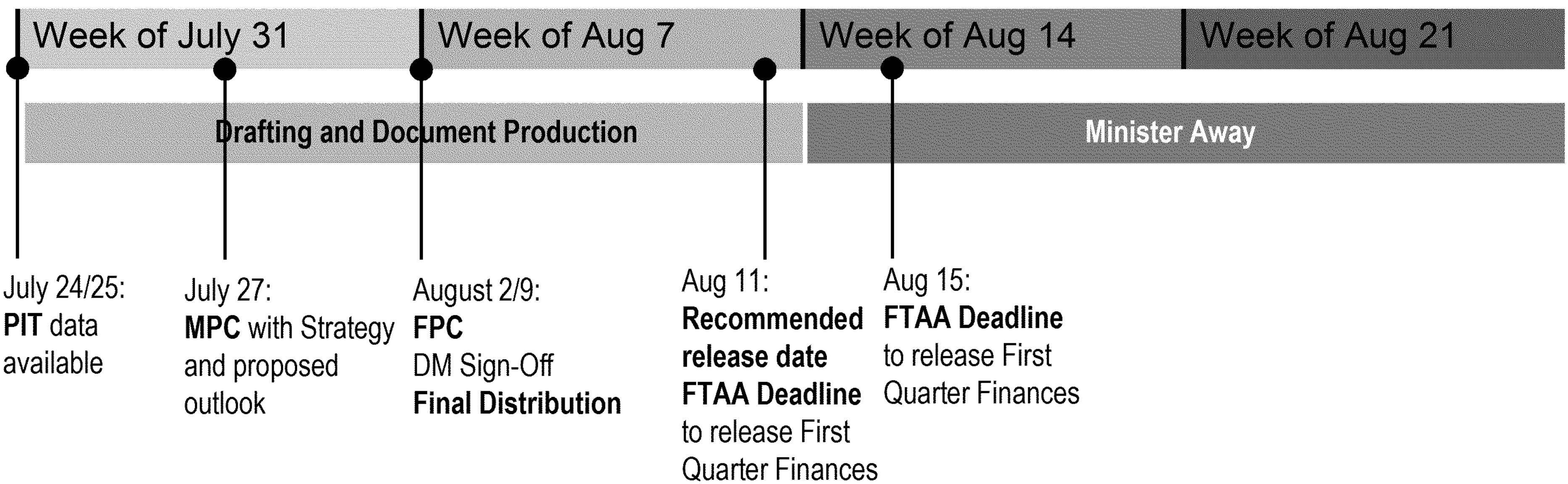
Note: Numbers may not add due to rounding

Early Read: Narrative

- *The government is continuing to project balance in 2017-18, unchanged from the 2017 Budget forecast.*
- *A strong economy, together with a balanced budget, is creating more opportunities for the government to invest in health care, education and other public services allowing individuals and businesses in Ontario to get ahead and stay ahead. These initiatives include [placeholder for Q1 highlights – Grassy Narrows, Federal Flow Throughs for Childcare investments].*
- *At this early point in the year there are a broad range of risks that could materially affect the revenue outlook. Economic growth has been stronger than expected in the 2017 Budget and private sector forecasts have been rising. There are also risks related to the processing of 2016 tax returns and updated entitlements under the Harmonized Sales Tax and federal transfer payment programs that will persist until late in the year.*
- *With the economy expected to grow, and the Province's ongoing commitment to transform government programs and services, Ontario is well positioned for long-term sustainability and is projecting to remain balanced in 2018–19 and 2019–20.*
- *Maintaining balance will help keep net debt-to-GDP on a declining track.*

Potential Timeline for Release

- Typically, First Quarter Finances are published online with an accompanying news release. No press conferences have been given in recent years.
- Releasing on August 11th would fulfil legislative requirements to release by the FTAA deadline.
- Publishing after the August 15th deadline will require that a **letter be sent to the Clerk of the Legislature** advising of the delayed release and providing a rationale.



Appendix

Recap: 2017 Budget Fiscal Architecture for 2017-18

Ontario's Fiscal Plan $ Billions	Interim 2016-17	Plan 2017-18
Revenue	**133.2**	**141.7**
Expense		
Programs	123.5	129.5
Interest on Debt	11.3	11.6
Total Expense	**134.8**	**141.1**
Surplus/(Deficit) Before Reserve	**(1.5)**	**0.6**
Reserve	-	0.6
Surplus/(Deficit)	**(1.5)**	**0.0**
Net Debt as a Per Cent of GDP	**37.8**	**37.5**

Note: Numbers may not add due to rounding

Revenue projected to grow by 6.3% in 2017-18, with the following assumptions built into the plan:

- **Net revenue increase of $3.9 billion** compared to 2016 Budget plan
- **Revenue growth continues at a stronger pace than would normally be forecast** given the economic outlook and removes prudence from the nominal GDP forecast; assumes a modest slowing of the housing market.
- **High-Yield Tax assumptions** of $1.3 billion
- **Revenue Integrity Targets** of $0.1 billion
- **Asset Optimization,** including final Hydro One share sales: $0.9 billion
- **Proceeds from auctions of GHG emission allowances** of $1.8 billion

Program expense projected to grow by 4.8% in 2017-18, and assumes:

- **Net increase in program expense of $5.3 billion** compared to the 2016 Budget plan due to key investments in health, education, electricity cost relief and other public services.
- $0.6 billion in **contingency funds;** $1.2 billion **year-end savings target**
- $1.8 billion in **GHG reduction initiatives**

- The **Interest on Debt forecast is $0.9 billion less** than the forecast in 2016 Budget, consequently the prudence is very limited.
- **Reserve** of $0.6 billion – equivalent to a $0.6 billion surplus
- **Net debt-to-GDP** expected to decline to 37.5% from 37.8% in 2016-17

Key Expense Updates and Risks Since the 2017 Budget

Potential Updates

- $110 million in approvals with Contingency Fund offsets/set asides
  - Famine relief in Middle East and Africa ($2.5M)
  - Lac des Mille Lacs flooding claim settlement ($14.8M)
  - Grassy Narrows research/clean-up ($87.7M)
  - Climate Change Modelling Consortium ($3.0M)
  - Francophone Community Grants ($1.1M)
  - Fair Housing Plan Reportback ($ 1.3M)
- $168 million items approved with revenue offsets
  - Early learning and childcare bi-lateral agreement ($145M)
  - Bad debt expense – resolute FP Canada Inc. ($22.5M)
  - Grievance settlement board reform ($1M)
- Fiscally neutral inter-ministry transfers

Key Risks

- Risks of $0.9 billion have been identified through Ministries Q1 submissions:
  - Compensation risks (physician services; compensation increases)
  - Demand driven/forecast risks (social assistance forecast)
  - Other risks (e.g, emergency firefighting; land claims settlement funding; benefits transformation)
  - Emerging/ new policy items with fiscal implications (investments to support small business; senior supports)
    - Many of these risks do not include expense estimates and will result in additional pressures above the $0.9 billion:
- Approvals where ministries have been asked to manage from within increase total risks by $0.1 billion.

- See appendix for additional details on expense updates and risks.

IOD, Net Debt-to-GDP, Borrowing and Prudence Updates Since the 2017 Budget

Interest on Debt

No Potential Updates

- IOD forecast is currently unchanged from the 2017 Budget.
- IOD expense is forecast to be $11.6 million in 2017-18.

Risks

- Bank of Canada recently raised interest rates. IOD expense could exceed forecast if actual rates are higher than the interest rates forecast in the Budget.
- For every $1 billion increase in borrowing in 2017-18, IOD could increase by $30 million in 2017-18.

Net Debt-to-GDP

No Potential Updates

- Net Debt-to-GDP forecast is currently unchanged from the 2017 Budget.
- Net Debt-to-GDP is forecast to be 37.5 per cent in 2017-18.

Risks

- Every 1 per cent change in GDP impacts the net debt-to-GDP ratio by ~0.5 per cent.

Prudence

Potential Updates

- Contingency fund drawn down by $105 million to show balance of $510 million in Q1.
- Reserve maintained at $600 million.
- Year end savings target maintained at $1.2 billion. No savings reported in First Quarter Finances.

Risks

- With additional potential draws against the contingency fund, balance currently tracking at $328 million.

Revenue Implications of Information To Date

$ Billions	2017-18	Report in Q1	Potential to Report Later
Change from 2017 Budget			
Personal Income Tax – Tax planning	(2.7)		✓
Corporations Tax – Stronger 2016 collections and profits	2.4		✓
Economic Growth – Stronger 2017	0.5		✓
Economic Growth – 2017 Budget Assumption Achieved (GDP Prudence)	(0.1)		✓
Other Tax Revenue Collections Experience	(0.3)		✓
Government Business Enterprise Net Income	0.2		✓
Change Excluding Fiscally-Neutral Items	**(0.0)**		
Carbon Allowance Proceeds *(Fiscally-Neutral once MOECC spending proposal is approved*)	0.3		✓
Government of Canada Transfers and Other NTR *(Fiscally-Neutral*)	0.2	✓	
Total Change Including Fiscally-Neutral Items	**0.4**		

Note: numbers may not add to totals due to rounding.

Expense Approvals to Report in Q1

$ Millions

	2017–18	Report in Q1	Report Later
Set Asides with Contingency Fund Offset			
MTO: Moving Ontario Forward	-		✓
MOI: Moving Ontario Forward (SCIF)	-		✓
MNDM: Ring of Fire	74.9		✓
MOECC: Grassy Narrows potential clean-up	85.0	✓	
Sub-total: Set Asides	**159.9**		
TBO With Contingency Fund Offset			
CO: Famine Relief in Middle East and Africa	2.5	✓	
MOECC: Grassy Narrows research	2.7	✓	
MIRR: Lac des Mille Lacs Flooding Claim Settlement	14.8	✓	
MOF: Restructuring Plan	-		✓
MOHLTC: Opioid Strategy	-		✓
MOECC: Climate Change Modelling Consortium	3.0		✓
OFA: Francophone Community Grants	1.1		✓
MMA/MHO: Fair Housing Plan Reportback	1.3		✓
Sub-total: TBO With Contingency Fund Offset	**25.4**		
Items w/ Corresponding Revenue Increases			
EDU: Early Learning and Childcare Bi-Lateral Agreement	145.0	✓	
MOL: Grievance Settlement Board Reform	0.7		✓
MNRF: Bad Debt Expense - Resolute FP Canada Inc	22.5		✓
Sub-total: Items w/ corresponding revenue increases	**168.1**		

Expense Approvals to Report in Q1 cont'd

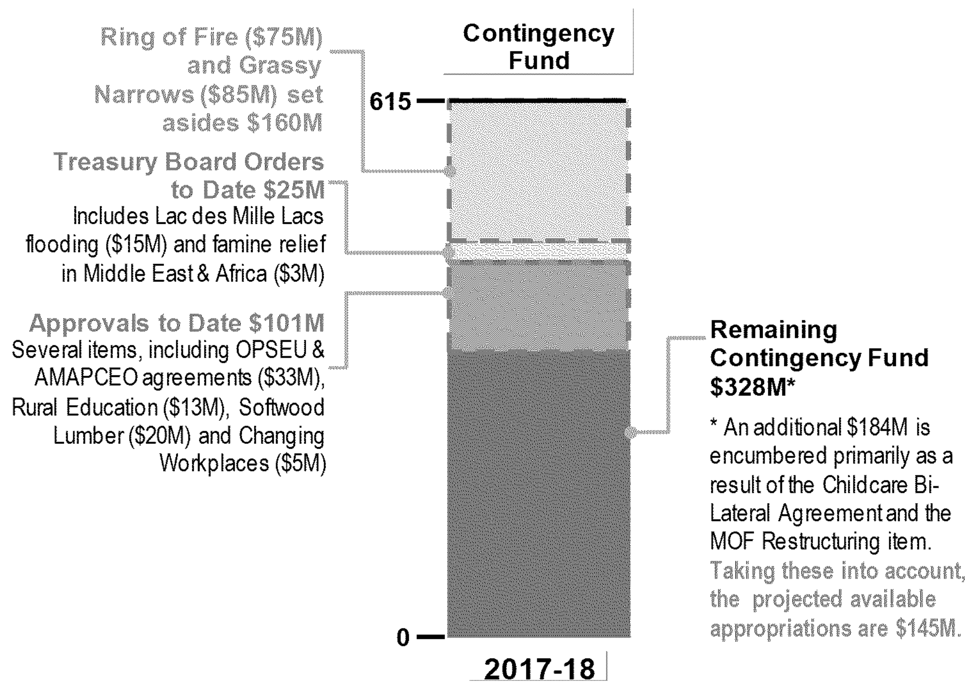
$ Millions	2017–18	Report in Q1	Report Later
Manage from Within			
EDU: Rural Education	12.6		TBD
MAG: 2nd Case Management Masters Remuneration	0.6		TBD
MAG: Local Planning Appeal Support Centre	1.1		TBD
MAG: Far North Electoral Boundaries Commission	1.5		TBD
MCSCS: OPSEU Corrections	22.4		TBD
MCSCS: Chief Coroner Inquest Legal Fee Reimbursement	1.0		TBD
MOL: Changing Workplace	4.9		TBD
MOI: Waterfront Toronto - Port Lands Flood Protection	-		TBD
MHO: Provincial Affordable Housing Lands Program	-		TBD
MNRF: Experimental Lakes Area	-		TBD
MNRF: Softwood Lumber	20.0		TBD
MTCS: Ontario Arts Council	-		TBD
Various: AMAPCEO extension	9.1		TBD
Various: OPSEU excluding corrections	21.3		TBD
Various: Management compensation	6.8		TBD
Sub-total: Approvals to Date – Proceed Fund from Within	**101.3**		

Expense Approvals to Report in Q1 cont'd

$ Millions	2017–18	Report in Q1	Report Later
Transfers			
MAESD/EDU/MCYS: Equitable Access to Postsec. Educ.	-	✓	
CO/MIRR: Truth and Reconciliation	-	✓	
Ontario 150 TBO Transfers to Partner Ministries	-	✓	
MTCS: Budget Initiative/Talks Holdback Release	-	✓	
Sub-total: Transfers	**-**		
Total Change in Program Expense	**168.1**		

Approvals-to-date/ Contingency Fund Outlook

$ Millions	2017-18	2018-19	2019-20	2020-21
Opening contingency fund balance	615.0	682.0	1,768.1	2,035.7
Less: In-Year Impact of Treasury Board Orders to Date	20.0	-	-	-
Less: Grassy Narrows Set Aside	85.0	-	-	-
Proposed Contingency Fund to Report in Q1	***510.0***	-	-	-
Less: July 25th Draws	5.4			
Less: Moving Ontario F'wd and Ring of Fire Set Asides	74.9	302.4	653.0	856.6
Contingency fund balance less 17-18 TBOs & set-asides	**429.7**	**379.6**	**1,115.1**	**1,179.1**
Less: Out-Year Impact of In-Year Approvals	-	22.4	19.6	18.8
Less: Approvals with Direction to Manage from Within	101.3	151.7	240.8	334.7
Potential Contingency fund balance	**328.4**	**205.5**	**854.8**	**825.6**



Summary of Tier 1 Program Expense Risks

$ Millions	2017-18	2018-19	2019-20	2020-21
Demand Driven/ Forecast Risk	185	511	909	521
Emerging/New Policy Risks	56	131	261	273
Implementation Risks	163	261	394	538
Compensation Risks	475	875	1,513	2,337
Total Tier 1 Risks	**878**	**1,778**	**3,077**	**3,669**

Implementation Risks

Key Risks Include:
- Child Care (100K Spaces)
- Service Ontario Boulder Pressures
- Clean Water and Wastewater Fund

Compensation Risks

Key Risks Include:
- Physician Services Pressures
- Attorney Compensation
- Judiciary Compensation
- EDU next round of agreements (2019 onward)
- Impact of minimum wage*

Risks to Federal Assumptions

Key Risks Include:
- Incrementality associated with Phase 2 Infrastructure agreements*

Emerging/New Policy Risks

Key Risks Include:
- Corrections Reform*
- Police Oversight Implementation
- Strategy for a Safer Ontario
- Resource Revenue Sharing
- Investments to Support Small Businesses*
- Ontario Seniors Strategy*

Demand Driven/Forecast Risks

Key Risks Include:
- Increased OSAP Uptake
- Social Assistance Forecast Risk
- Emergency Fire Fighting
- Land Claims Settlement Funding
- Drive Clean Fee Elimination

Accounting Risks

- Accounting for the Ontario Fair Hydro Plan*

*Costs of these risks have not been provided and would be over-and-above the total Tier 1 Risks estimate above.

Carbon Allowance Proceeds and Expense

The 2017 Budget assumed: $1,778 million in Cap and Trade Proceeds in 2017-18

- The first auction was held on March 22, 2017, generating $472 million in proceeds and the second auction took place on June 6, 2017, generating $504 million in proceeds.
- All initiatives that may be eligible for funding from cap and trade proceeds are subject to the amount of proceeds collected through auction.
- The *Climate Change Mitigation and Low-carbon Economy Act* requires that the province specify how cap and trade proceeds will be used to reduce or support the reduction of greenhouse gas by investing in green projects.
- Given the success of auctions 1 and 2, consideration could be given to scale-up cap and trade investments in 2017-18 to account for additional proceeds above and beyond forecast.

2017-18 Auction Forecast and Actual

($M)	Auction 1 (March 2017)	Auction 2 (June 2017)	Auction 3 (Sept 2017)	Auction 4 (Nov 2017)	Auction 5 (Feb 2017)	Total to date
Forecast	$357.30	$357.30	$357.30	$357.30	$348.70	$1,778
Actual	$472.03	$504.18	TBD	TBD	TBD	$976
Variance (+/-)	$114.73	$146.88	TBD	TBD	TBD	$262

Asset Optimization Outlook Update: Comparison against 2017 Budget Forecast

- The current outlook shown in the table below assumes that about 23% of Hydro One shares are sold in 2017-18. This includes the 20.2% of shares sold to the market at $23.25 per share in May 2017 and 3% of shares to be sold to First Nations/Metis at $18 per share going forward, vs. the 2017 Budget assumption of 22% of shares sold to the market at $22.59 per share and 3% of shares sold to First Nations/Metis at $18 per share.
- Transaction costs for the 2017/18 share sales (secondary offering and First Nations/Metis share sales) are still assumed to be $100M as per Energy's PRRT allocation for Strategic Asset Management and Transformation Related to Hydro One in Budget 2017.
  - *Subject to update:* Underwriting fees totalled ~$56M for the May 2017 offering, well below the amount in PRRT; return of any underspend subject to TBS / ENERGY discussion.
- **2016-17:** Tracking slightly below interim, due to a change in timing for Seaton Lands sale, partially offset by a higher expected gain from the sale of Hydro One Brampton. The Hydro One Brampton transaction is still subject to final confirmation of Hydro One Brampton accounting.
- **2017-18:** Tracking above plan, primarily due to Hydro One shares sold at a higher than assumed price (higher offering price from a higher pre-offering market price along with a lower than assumed discount). Lower than assumed percentage of shares sold in 2017/18 is also expected to result in lower forgone net income, partially offset by lower IOD savings. First Nation / Metis share sales subject to ongoing discussions and finalization of agreements.
- **2018-19:** Tracking slightly higher than plan, due to a lower than assumed percentage of shares sold in 2017/18, which is expected to result in lower forgone net income, partially offset by lower IOD savings.

$ Millions	2016-17	2017-18	2018-19
2017 Budget AO Outlook (Net impacts, including gains on sale, forgone income from cumulative sales over time & IOD savings)	**653**	**881**	**(511)**
Changes since 2017 Budget			
Hydro One	*-*	*28*	*9*
Hydro One Brampton	*11*	*-*	*-*
LCBO Head Office Lands	*-*	*-*	*-*
OPG Headquarters and Parking Garage	*-*	*-*	*-*
Lakeview	*-*	*-*	*-*
Seaton	*(20)*	*(1)*	*-*
Total AO Variance	***(8)***	***27***	***9***
Revised AO Outlook*	**645**	**908**	**(501)**

* *Hydro One impacts include the following assumed IOD savings: $120M in 2016-17, $205 M in 2017-18 / $227 M in 2018-19. IOD savings in 2017-18 and 2018-19 are subject to potential reporting reclassification. Numbers are rounded to the nearest $1M and may not add due to rounding. All asset optimization values are subject to market conditions, and with increased uncertainty in out years.*