Office of the Budget MINISTRY of FINANCE

Financial Accountability Office
"An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan" – Draft Report
May 16, 2017

ISSUE

- The Financial Accountability Office of Ontario (FAO) has produced a draft report titled: *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*.
  - The FAO has shared the draft report with the government for review and fact checking.
- Ministry of Finance (MOF), Ministry of Energy (MOE) and Treasury Board Secretariat (TBS) have reviewed the report and are preparing comments to be transmitted to the FAO on May 16.
- This note presents a brief overview of the report and a summary of the main comments on the draft report from MOF and TBS.
  - MOE will send comments on the draft report directly to the FAO.

SUMMARY OF THE FAO'S REPORT ON THE FAIR HYDRO PLAN (FHP)

- The FAO's report reviews the impact of the proposed Fair Hydro Plan (FHP), including the expected cost to the Province and the financial impact on electricity ratepayers over a 29-year time period (2017-2045).
- The FAO provides a brief overview of the FHP, which includes the following initiatives:
  - **Harmonized Sales Tax (HST) Rebate**: A rebate to residential ratepayers of the 8% provincial portion of the HST on electricity bills.
  - **Electricity Cost Refinancing**: the Province is proposing to borrow an average of $2.5B per year through 2027 to pay a portion of electricity generation costs, thereby temporarily reducing the cost of electricity for residential ratepayers. The Province would recover the borrowed funds, including interest, from ratepayers over an estimated 17-year period starting in 2028.
  - **Adjusting Electricity Relief Programs**: currently the cost of the Rural or Remote Ratepayer Program (RRRP) and Ontario Electricity Support Program (OESP) is recovered from all electricity ratepayers through the cost of electricity. The Province is proposing to take the cost of these programs from electricity bills and to transfer the cost to the Province.
- The FAO estimates that the FHP will have a net cost of $21B, which is a result of:
  - A total cost to the Province of approximately $44B*;
  - Overall savings to eligible electricity ratepayers of $23B.

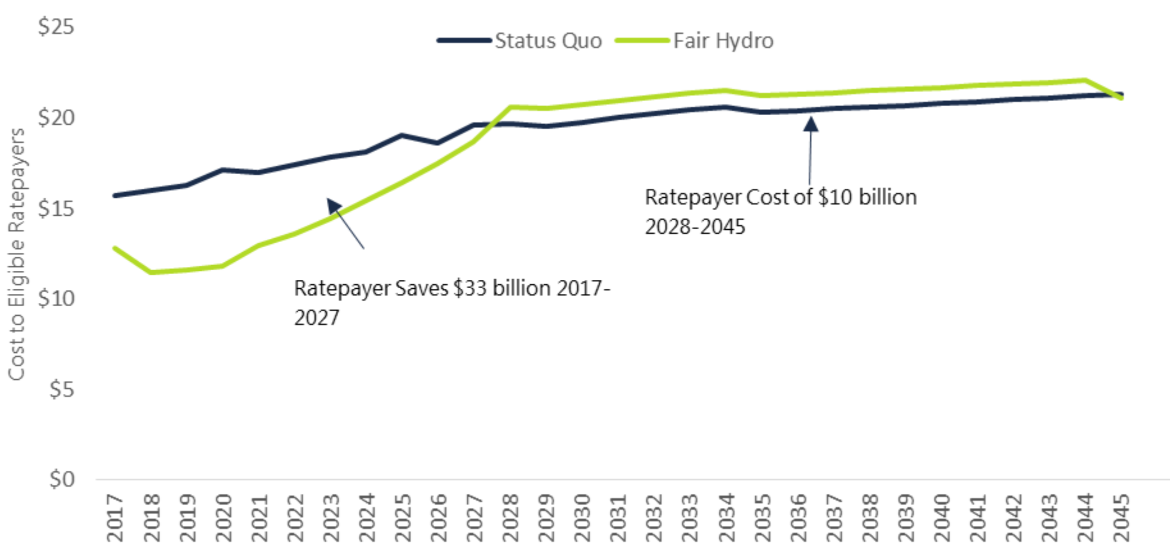
  * The FAO states that if the Province funds the cost of the FHP through debt, the cost to the taxpayer could increase to between $68B and $93B.
- The FAO concludes that:
  - The **HST rebate** and **adjusting the electricity relief programs** will transfer costs from ratepayers to the Province and have no net impact on the cost of electricity; and
  - **Electricity cost refinancing** will increase the cost of electricity to be paid by ratepayers as a result of the interest due on borrowed funds.

Impact on Ratepayers

- The FAO projects that the FHP will result in net savings of $23B over 29 years for ratepayers:
    - From 2017 to 2027 – costs will be lower under the FHP compared to the status quo (for a total savings of $33B), and
    - From 2028 to 2045** – costs will be higher under the FHP compared to the status quo (for a total cost of $10B).

      ** Under the electricity cost refinancing plan, ratepayers do not begin repayment until 10 years after borrowing commences.
- The estimated $23B savings for eligible electricity ratepayers under the FHP is made up of the following components:
    - HST Rebate: savings of $41B.
    - Electricity Cost Refinancing: cost of $21B.
    - Adjusting Electricity Relief Programs: savings of $3B.
- The FAO flags two key risks to the Electricity Cost Refinancing Initiative as follows:
    - Eligible ratepayer demand increases or higher than expected costs to generate/deliver electricity would increase borrowing requirements, thus increasing the interest paid by ratepayers.
    - Changes in the interest rate on funds borrowed to refinance electricity costs would impact the interest costs paid by ratepayers.

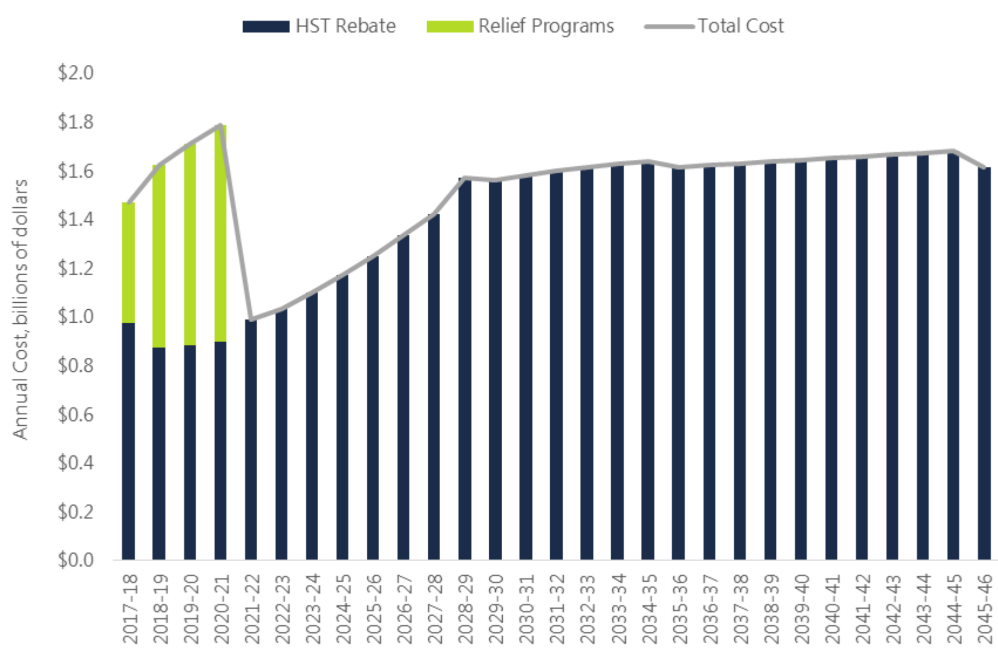
Figure 2-1 Impact of the FHP on Eligible Ratepayer Electricity ($ Billions)



Impact on the Province's Finances

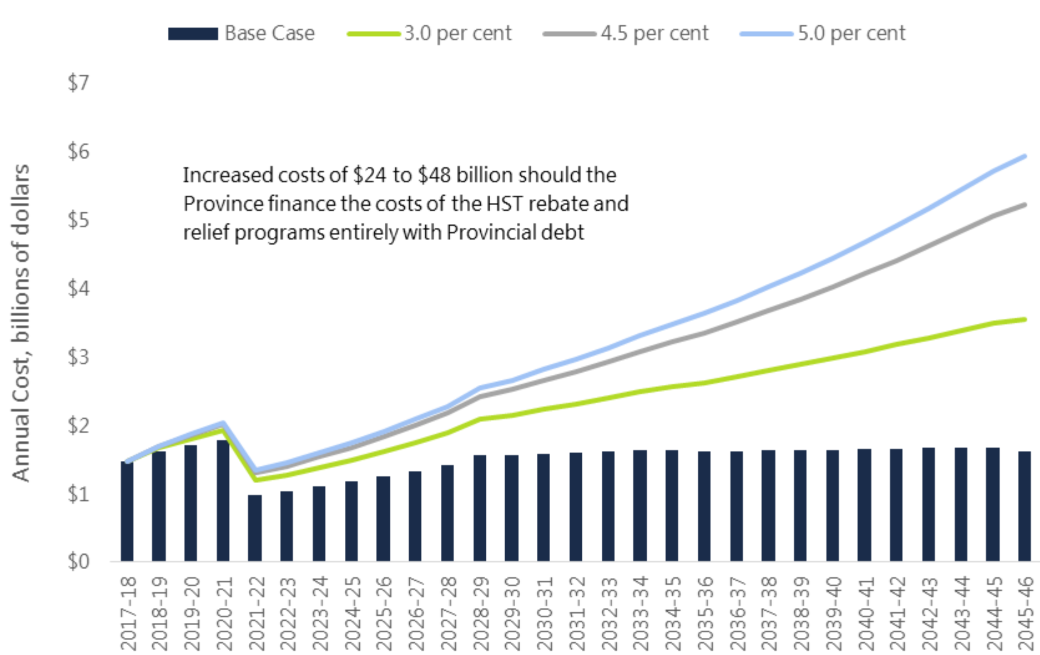
- The FAO estimates that the FHP will cost the Province approximately $44 billion over 29 years. The cost estimate is made up of the following components:
    - HST Rebate: cost of $41 billion.
    - Adjusting Electricity Relief Programs: cost of $3 billion.

Figure 2-3 FAO's Estimated Annual Cost of the FHP to the Province ($ Billions)



- This estimate assumes that the Province:
    - Will provide the HST Rebate for the entire time period (2017-2045), and
    - Will not fund the electricity relief programs after 2020-21.
- If the Province funds the electricity relief programs, along with the HST rebate, by borrowing over the 29-year period, the FAO projects that costs to the Province would increase by $24 to $48 billion (from $44B to between $68B and $93B.)

Figure 2-4 FAO's Estimated Annual Cost of the FHP to the Province ($ Billions)



Accounting Treatment

- The FAO states that the Province proposes to use a complicated accounting structure that will create a regulatory / investment asset under which the electricity cost refinancing component of the FHP will:
    - Increase gross debt by approximately $26 billion by 2027;
    - Create an obligation for ratepayers to repay the Province approximately $26 billion, thereby
    - Not impacting the annual surplus / deficit or net debt of the Province.
- The FAO is uncertain as to whether the creation and recording of the regulatory / investment asset, as proposed under the electricity cost refinancing initiative, is consistent with Canadian public-sector accounting standards.
- The FAO also comments that the overall cost of the FHP would be lower if the OFA were to fund the debt directly

Summary of MOF/TBS Comments on the Draft Report

- MOF/TBS comments on the draft report can be categorized in three buckets, as follows:
    - **Accounting treatment**

      The way the accounting treatment of the regulatory / investment asset is described in the draft report is incomplete and inaccurate with regards to PSAS references.
    - **Interest rate spread**

      The FAO's assumed interest rate spread used to calculate their borrowing cost estimates is unrealistically high, which overstates the likely total cost of borrowing through the OPG Trust.
    - **Electricity Relief Programs**

      The FAO's assumption that government support for these programs will conclude in 2020-21 is not plausible, given that the legislation introduced in the House transfers these programs from the rate-base to government-funded.

Next Steps:

- Comments on the draft report are due to the FAO by 2PM on May 16, 2017.
- A follow-up meeting will be scheduled with the FAO and relevant ADMS on May 17 to further discuss the three major categories of comments highlighted above: accounting treatment, interest rate assumptions and treatment of other electricity relief program.