Ontario's Third Quarter Finances: Fiscal Strategy

Office of the Budget
MINISTRY of FINANCE

Presentation to FPC on February 1, 2017

Preliminary Draft

Draft – January 27, 2017 9:30 AM

Context

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

- Be released on or before February 15th (publication can be delayed if a letter is sent to the Clerk).
- Include updated information about the major components of revenue and expense **for the current fiscal year only.**

It also provides an **opportunity for the government to reiterate key fiscal messages** from the Budget or pre-condition for future updates.

A Third Quarter Finances has only been published once in the last eight years (in 2012-13).

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

- Both have acknowledged that balance is within reach in 2017-18, but have also highlighted key risks to the 2016 Budget fiscal plan.

Purpose and Key Decisions

Currently working towards **a release date of February 13, 2017** – need to **confirm the approach to publishing Ontario's Third Quarter Finances**, including:

- The core updates to **the fiscal outlook and supporting revenue and expense details** to be published, as well as the **fiscal narrative and messaging**.
- Positioning the content and the rollout of Third Quarter Finances relative to the release of the Pension Panel's Report and recommendations, and other publicly available information.

Evolution of the 2016-17 Outlook

- The Third Quarter Finances will present a fiscal update relative to the 2016 Budget and address changes since FES in narrative only.
- The 2016 FES highlighted Ontario's stronger economy and the government's approach to fiscal management, which supported strategic investments in new child care spaces, hospitals and electricity cost relief for consumers.
- To support these investments while accommodating the Pension Adjustment, the government took on a number of fiscal tools in order to meet its targets.

2016 Budget Fiscal Plan $ Billions	2016-17	Change to FES 2016-17	FES Outlook 2016-17
Revenue	**130.6**	***2.1***	**132.7**
Expense			
Programs	122.1	*3.1*	125.3
Interest on Debt	11.8	*(0.4)*	11.4
Total Expense	**133.9**	***2.7***	**136.6**
Surplus/(Deficit) Before Reserve	**(3.3)**	***(0.6)***	**(3.9)**
Reserve	1.0	*(0.6)*	0.4
Surplus/(Deficit)	**(4.3)**	***(0.0)***	**(4.3)**

Total revenue changes of $2.1 billion, consisting of:

- Base Forecast Change $1.0 billion
- Reversal of Homecare $(0.2) billion
- Federal Agreements $0.4 billion
- Higher assumed revenue to accommodate pensions $0.9 billion

Total expense changes of $2.7 billion, consisting of:

- In-Year Approvals $0.2 billion
- Pension Adjustment of $2.2 billion
- Electricity Cost Relief $0.3 billion
- Support for Hospitals $0.1 billion
- Green Investment Fund $0.3 billion
- New Federal Agreements $0.4 billion
- Contingency Fund Offsets $(0.5) billion
- Interest on Debt Savings $(0.4) billion

Change to the Reserve $(0.6) billion

End of Year Projection for 2016-17

- An early-read indicates that end of year projections for the 2016-17 deficit could range from $0.6 billion (if there is a significant improvement to the outlook) to $2.7 billion (if there is a moderate improvement to the outlook).

	Significant Year-end Improvement		**Moderate Year-end Improvement**
	2016 Budget **(4.3) billion**		**2016 Budget** **(4.3) billion**
+	Pension Adjustment and Tools	+	Pension Adjustment and Tools
	2016 FES **(4.3) billion**		**2016 FES** **(4.3) billion**
+	Higher Revenue ***1.7 billion***	+	Higher Revenue ***0.7 billion***
−	Re-profiling Cap and Trade Proceeds ***0.5 billion***	−	Re-profiling Cap and Trade Proceeds ***0.5 billion***
−	Lower Net Contribution from Assets Optimization ***75 million***	−	Lower Net Contribution from Assets Optimization ***75 million***
−	Accounting Adjustments: Accounting Framework (IFRS) ***75 million*** Unchanged Contaminated Sites	−	Accounting Adjustments: Accounting Framework (IFRS) ***75 million*** Contaminated Sites ***50 million***
	Unchanged Program Expense	−	Higher Program Expense ***1.0 billion***
+	Reverse Pension Adjustment ***2.2 billion***	+	Reverse Pension Adjustment ***2.2 billion***
+	Lower Interest on Debt ***0.1 billion***		Unchanged Interest on Debt
+	Reduce Reserve ***0.4 billion***	+	Reduce Reserve ***0.4 billion***
	Early-Read **(0.6) billion**		**Early-Read** **(2.7) billion**

Treatment of Pension Adjustment

Panel Recommendation

- The Pension Asset Expert Advisory Panel will be releasing its findings in the coming weeks.
  - The report is expected to include advice that government jointly sponsored pension plans be recognized in the Province's financial statements.
  - If taken on, this would result in a positive fiscal impact to the government's outlook in all years.

Treatment of Pension Adjustment

- The Third Quarter Finances provides the government with an immediate opportunity to align its fiscal strategy with recommendations of the panel, and frame the pension narrative in advance of the 2017 Document.
- While the reversal of the pension adjustment to the Ontario Public Service Employees Union Pension Plan (OPSEUPP) and the Ontario Teachers' Pension Plan (OTPP) will result in an improved 2016-17 deficit, expectations may need to be tempered about how much fiscal room is created in the out-years.
- For consistency and comparability, an adjustment to the 2015-16 actuals may be required to reflect the government's decision to adopt the Panel's recommendations. The adjustment to historical results would impact the previously reported net debt and deficit results.

Key Building Blocks

- In addition to the reversal of the Pension Adjustment, other key building blocks will either need to be reported in the Third Quarter Finances or be considered for the 2017 Document.

Report in Q3	Could Report in Q3	Report in Document
Pensions $2.2 billion Reverse Pension Adjustment for OPSEU and TPP	**Cap and Trade** $0.5 billion Reprofile 2016-17 auction proceeds to 2017-18	**Reserve** $0 - $0.4 billion Reduce reserve from $0.4 billion
Expense Approvals Minuted before December 31, 2016	**HST and Other Tax Updates** $0.9 billion	**H1 & OPG Accounting (IFRS)** $75 million smoothed – $1 billion non-smoothed
	Asset Optimization $75 million Lower net contribution from asset optimization	**Interest on Debt** $0 - $63 million
	Expense Pressures $0.2 billion Increased expense pressures, such as social assistance, etc.	

—/- - **Potential Improvement to gap**

—/- - **Potential Improvement/ deterioration to gap**

—/- - **Potential deterioration to gap**

Building Block Considerations

There are a number of considerations for whether key building blocks should be taken on in the Third Quarter Finances or deferred to the 2017 Document.

Could Report in Third Quarter Finances | **Report in Document**

Cap and Trade

- The Cap and Trade auction notice that was released on January 20 stating that certification will occur on April 3, 2017.
- Stakeholders (e.g. FAO and Auditor General) may question why the government has not updated its fiscal plan to reflect this change.

HST and Other Tax Updates

- HST and other tax information has been received since the FES, and no further significant updates are expected in advance of the 2017 Document.
- Stakeholders are aware of the timing of these information flows and may question if updates are not taken on in Third Quarter Finances.

Asset Optimization

- Updating for revised estimated net contribution from Asset Optimization would build some deterioration into the outlook.
- There is uncertainty on the timing and potential gains for the H1 Brampton and Seaton Lands sales, and uncertainty on the final net gains reported H1 shares sold to OPG, potentially necessitating additional updates in the 2017 Document.

Expense Pressures

- Ministry risks represent potential pressures in the fiscal plan, and are not typically included in Quarterly updates.
- However, it may be prudent to address risks which may materialize before the 2017 Document, such as increased expense pressures associated with social assistance etc.

Reserve

It is recommended that the reserve be maintained at its current level of $0.4 billion, in order to mitigate any pressures that may arise before year-end.

H1 & OPG Accounting (IFRS)

Updated information on the potential fiscal impact of the move from U.S. GAAP to IFRS for Hydro One and OPG, is expected in mid-February.

Interest on Debt

Deferring improvements in the interest on debt forecast allows for upside potential in the 2017 Document.

Outstanding Information

- **Outstanding Information** could materially impact the **2016-17 outlook** in advance of the 2017 Document.

Revenue
Revisions to economic outlook
Ongoing provincially-administered tax receipts
Non-tax revenue updates from Ministry PRRT submissions
Net income updates from government business enterprises

Expense
Ministry Q3/interim submissions
Consolidations and other technical adjustments
Interest on debt forecast updates
Contaminated sites liabilities
Updated pension expense forecast

Potential improvement to gap

Potential improvement or deterioration to gap

Potential deterioration to gap

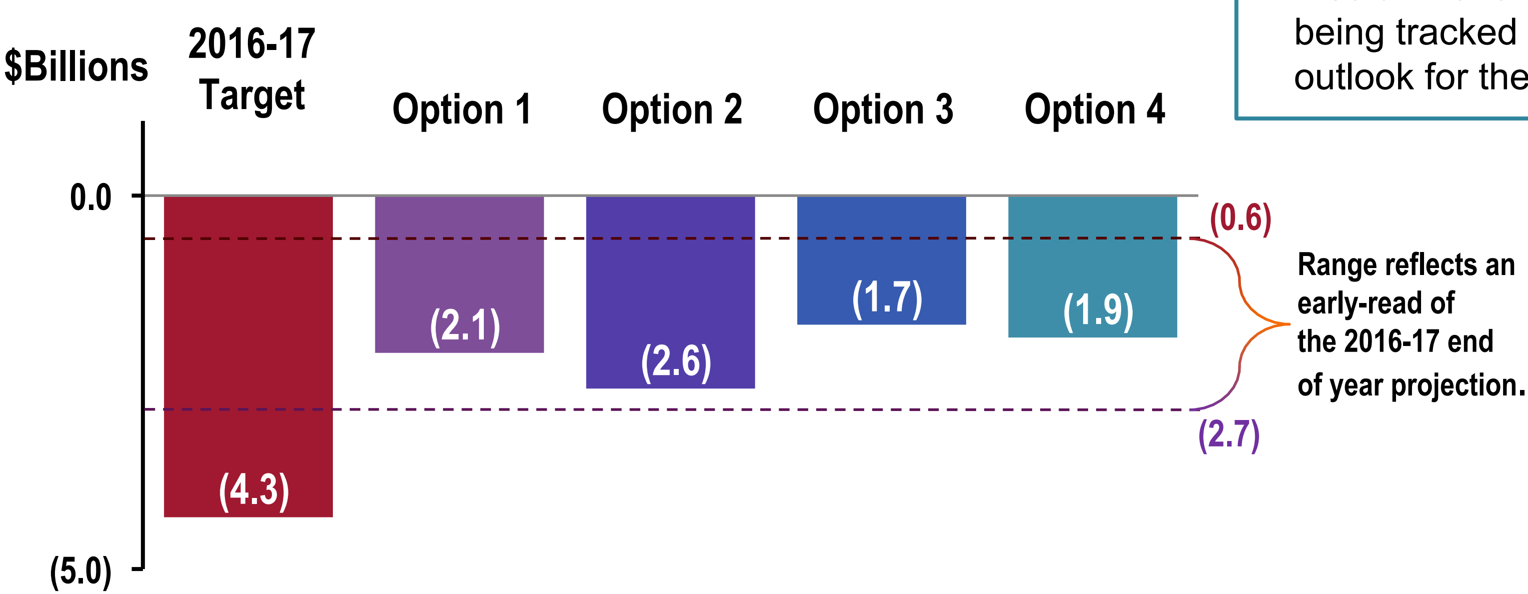
Principles for the 2016-17 Outlook

Options 1 through 4 build on each other. All options assume the pension reversal and progressively take on additional changes relative to FES .

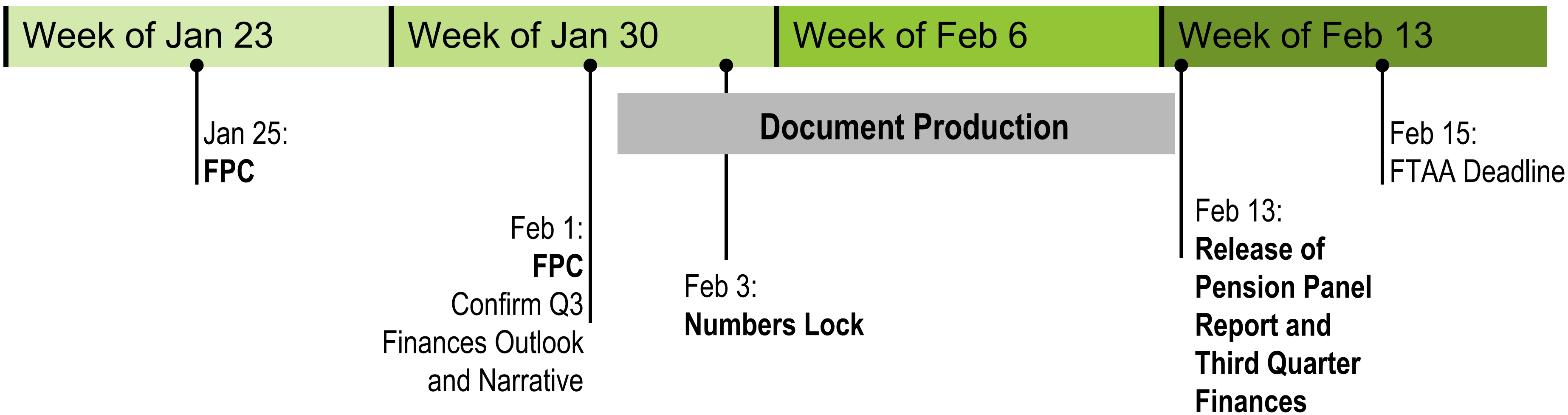
Option 1	Option 2	Option 3	Option 4
Pensions: $2.2 billion	**Pensions**: $2.2 billion	**Pensions**: $2.2 billion	**Pensions**: $2.2 billion
	Cap and Trade: $(0.5) billion	**Cap and Trade:** $(0.5) billion	**Cap and Trade:** $(0.5) billion
		Asset Optimization: $(0.1) billion	**Asset Optimization:** $(0.1) billion
		HST & Other Taxes: $0.9 billion	**HST & Other Taxes:** $0.9 billion
			Expense Pressures: $(0.2) billion

- Based on an early-read of end of year projections, the government may want to report an outlook that protects against risks or other changes between now and the Budget.
- Based on current information and taking into account key building blocks, there are a number of options for presenting the Q3 deficit, ranging from $2.6 billion to $1.7 billion. These are on the medium-to-low end of what is being tracked for the interim outlook for the 2017 Document.

2016-17 Third Quarter Finances: Deficit Range



Next Steps

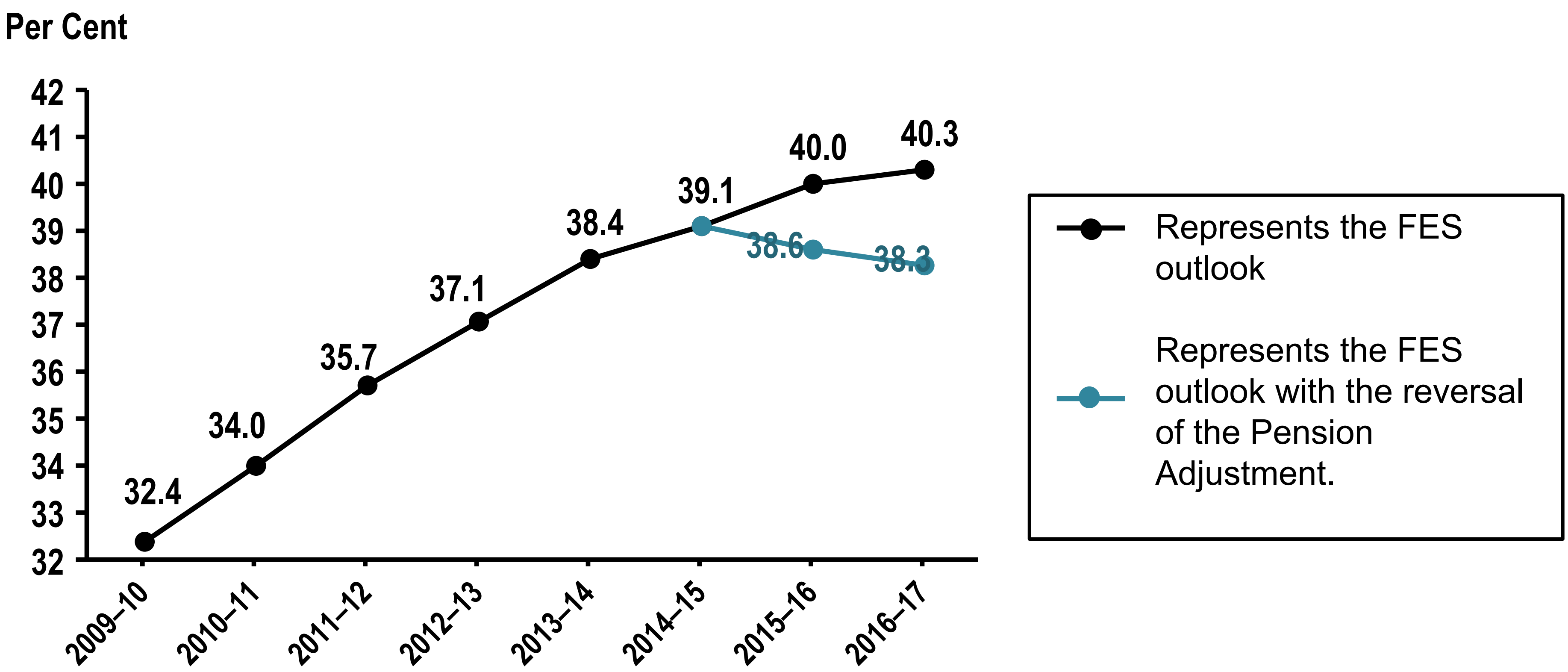

Week of Jan 23
Week of Jan 30
Week of Feb 6
Week of Feb 13
Document Production
Jan 25: **FPC**
Feb 1: **FPC** Confirm Q3 Finances Outlook and Narrative
Feb 3: **Numbers Lock**
Feb 13: **Release of Pension Panel Report and Third Quarter Finances**
Feb 15: FTAA Deadline

Appendix

Net Debt-to-GDP With Pension Reversal

***Narrative:** The impact of the reversal will change the net debt projection for 2016-17 by $X.X billion.   As a result, the government is projecting a net debt-to-GDP ratio of X.X per cent, an improvement compared to the 2016 FES projection of 40.3 per cent*

- Reflects the reversal of the Teachers Pension Plan and OPSEU Pension Plan adjustments, including reversal of the $10.7 billion debt adjustment made in the 2015-16 Public Accounts



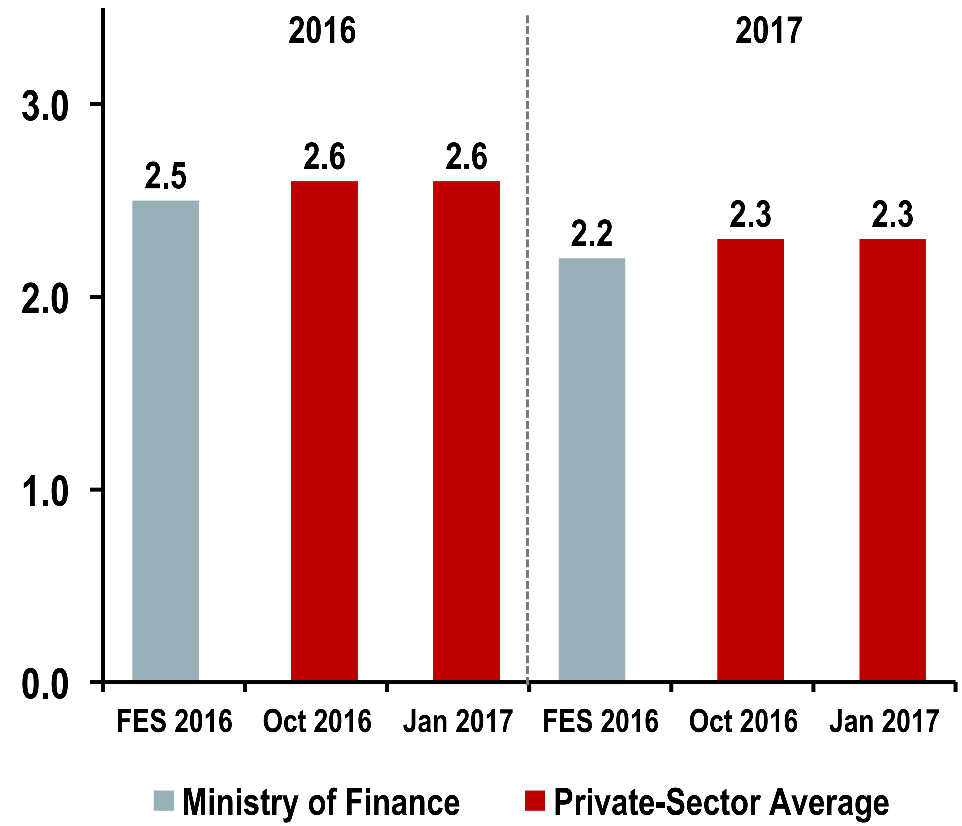
Potential Third Quarter Economic Outlook

Economic Update

- Real GDP increased by 0.7% in the third quarter (July to September) of 2016, after rising 0.2% in the second quarter.
  - Higher exports and continued growth in household spending were the primary drivers of growth
- Information available so far for the fourth quarter (October to December) of 2016 suggest growth at a more modest pace.
- Ontario's economic growth outlook remains consistent with the 2016 FES forecast

Ontario Real GDP Growth Outlook

Per cent change



Other Accounting Issues

Other Accounting Issues

- The move from U.S. GAAP to IFRS for the consolidation of Hydro One and OPG results in a fiscal impact starting in 2016-17, of either:

Basis of Consolidation of OPG and H1 (US GAAP vs. IFRS)	Fiscal Impact Relative to FES				
	2016-17	2017-18	2018-19	2019-20	2020-21
Preferred Approach (smoothed IFRS impact)**	**$75M**	**$425M**	**$525M**	**$675M**	**$675M**
High Impact (non-smoothed IFRS impact)**	$1B	$375M	$400M	$400M	$400M

*** OPG's estimate of cumulative impact for 2015-2020 is $2.5B under the preferred approach, and $2.6B under the high impact approach.*
Note: Amounts are based on estimates currently available, and are subject to updates by OPG. Revised estimates are expected by March 1, 2017.