Ontario

Rating Agency Background

Key Messages For Rating Agencies

- The government is projecting a return to balance in 2016–18 and continued balance in 2018-19 and 2019–20.
- The balanced budget and the government's continued focus on capital investment will add to economic growth, resulting in GDP growing more quickly than debt, helping to further lower the net debt-to-GDP ratio to the government's pre-recession level of 27% by 2029–30.
  - The government is setting an interim target to reduce the net debt-to-GDP ratio to 35% by 2023-24.
- The Province is forecast to spend 8.2 cents of every revenue dollar received on interest.
  - This ratio is lower than it has been for the last 25 years and is forecast to remain even lower through the outlook period to 2019–20.
- Ontario was one of the strongest growing provincial economies in Canada during the last three years and, on average, private-sector economists expect that trend to continue until at least 2018.
  - Over the 2014–16 period, Ontario's real GDP growth has outpaced that of Canada and all other G7 countries.

Ontario's Credit Rating Overview

- Ontario current long-term ratings:
  - Moody's Aa2, removed the Negative outlook on April 26, 2016
  - Standard & Poor's A+, confirmed on June 1, 2016
  - DBRS AA (low), confirmed on May 20, 2016
  - Fitch AA-, confirmed on June 22, 2016

- Ontario's short-term credit ratings are:

• Moody's:	P-1
• Standard and Poor's:	A-1+ (UCO)
• DBRS:	R-1 (mid)
• Fitch:	F1+

UCO - Under Criteria Observation

Rating Agency Key Concerns

- Rating agencies use a number of key debt ratios when assessing Ontario's rating including:
  - Deficit-to-Revenue
  - After-Capital Deficit-to-Revenue
  - Net Debt-to-GDP
  - Debt-to-Revenue
  - Interest on Debt-to-Revenue
- Concerned about ongoing significant borrowing for capital.
- Concerned about the government's spending increases.
- Worried that electricity debt might not be self supporting.
- Revenue forecast or economic growth may be too optimistic. Remove asset sales which are viewed as temporary one-time factors.

Rating Agency Comments

Moody's

- Modest size of surpluses forecast does not have a material impact on the credit quality of the province.
- Ontario's debt burden and debt service costs will remain manageable thanks to low interest rates, as well as the province's improving fiscal position and conservative debt management policy.
- The policy decision to borrow for infrastructure spending at a time of historically low interest rates has helped to support the province's rating. Despite an increase in total debt, the debt relative to revenues should improve over the medium-term.

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

- Ontario's debt burden is very high, well surpassing international and domestic peers.
- Ontario continues to have sizeable after-capital deficit given its large capital spending.
- Balanced or near-balanced after-capital results and continuing declines in Ontario's tax-supported debt burden could result in a positive outlook or upgrade.

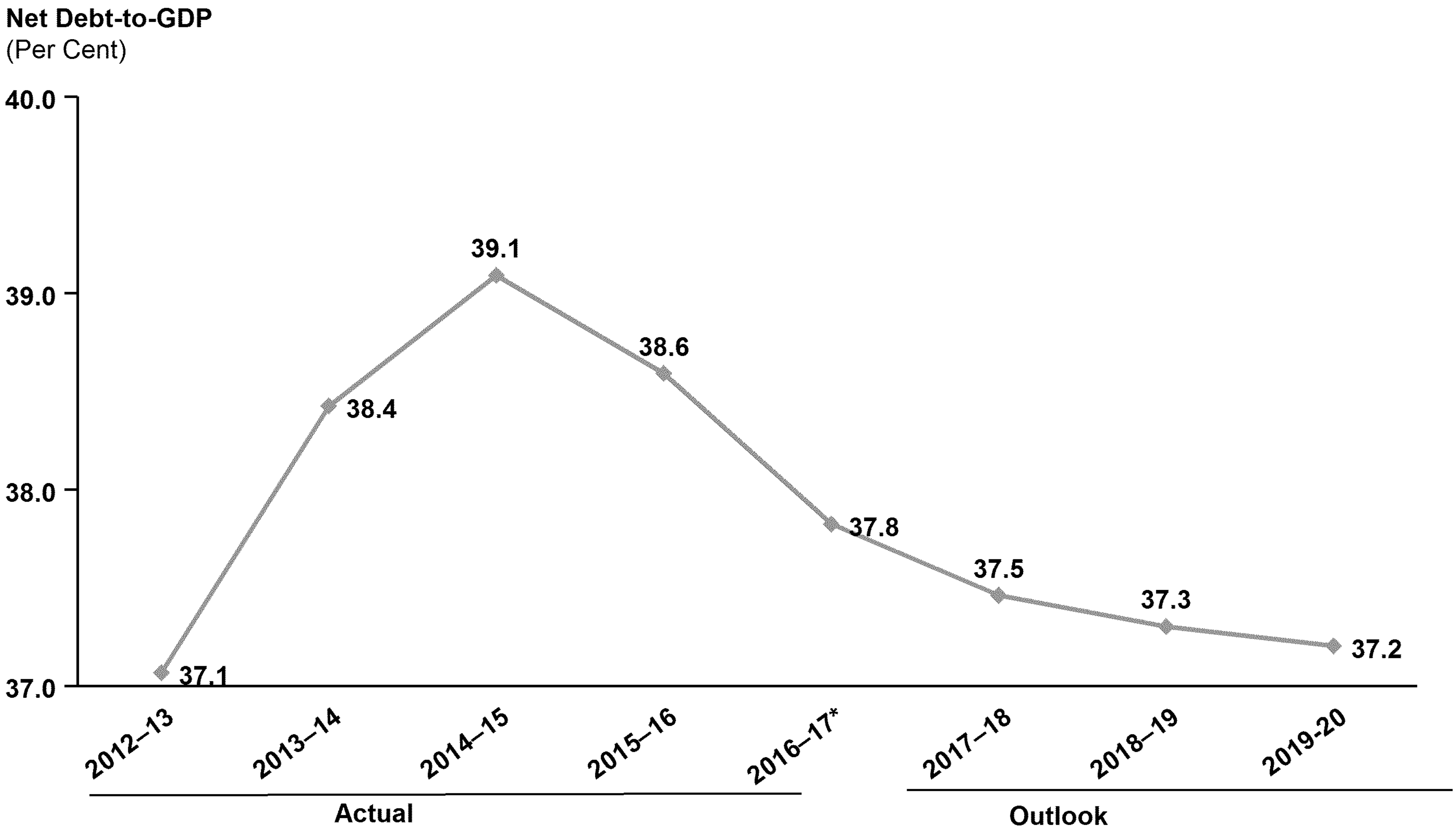
DBRS

- The return to balance is encouraging and suggests that there will likely be some modest improvement in the Province's credit metrics over the medium term, which will slowly rebuild flexibility within the rating.
- Ontario Hydro Relief is Credit Neutral.
- Little fiscal flexibility to withstand another downturn without negatively impacting rating.

FitchRatings

- The province has demonstrated the ability to exert considerable expenditure restraint while instituting revenue changes as necessary to achieve its deficit reduction objectives.
- The rating is sensitive to achieving deficit targets and restoring fiscal balance.
- High ongoing capital spending will make it difficult to lower the high debt burden.

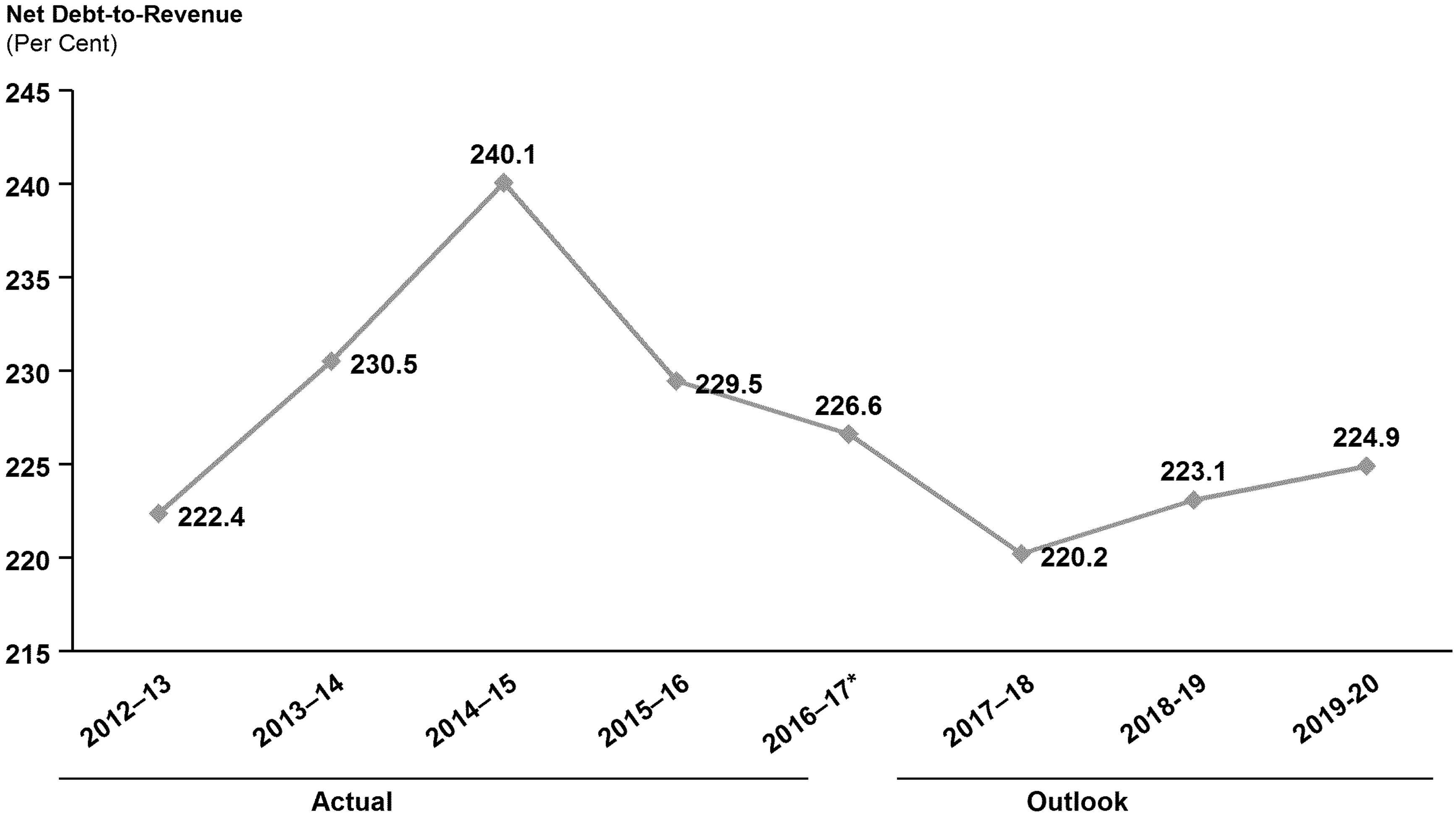
Net Debt-to-GDP Has Declined Sharply



*Interim result for 2016–17

Source: Ontario Financing Authority (2017 Ontario Budget).

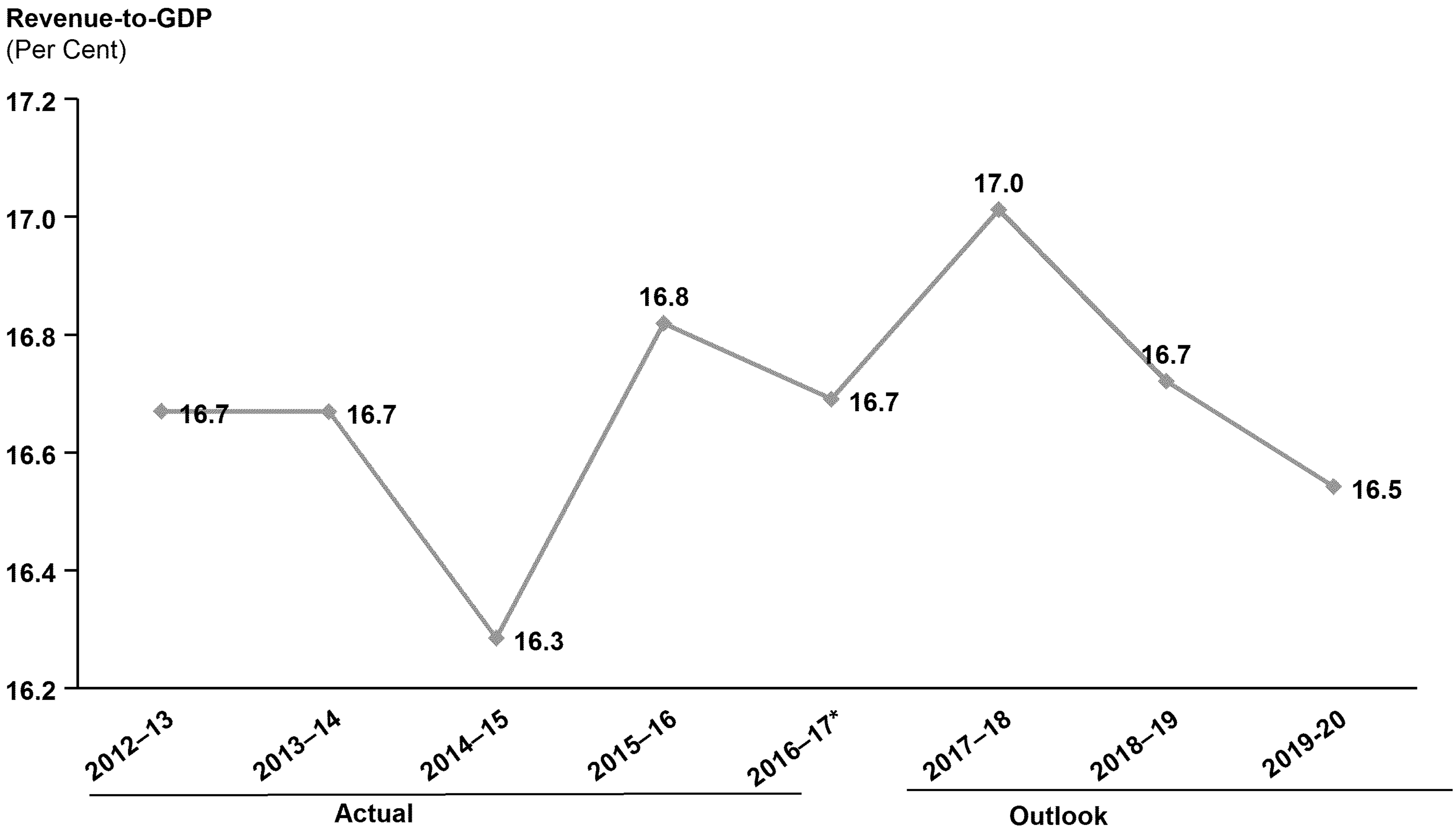
Net Debt-to-Revenue has Declined but will Edge Higher



*Interim result for 2016–17.

Source: Ontario Financing Authority (2017 Ontario Budget).

This is due to a Decline in Revenues-to-GDP

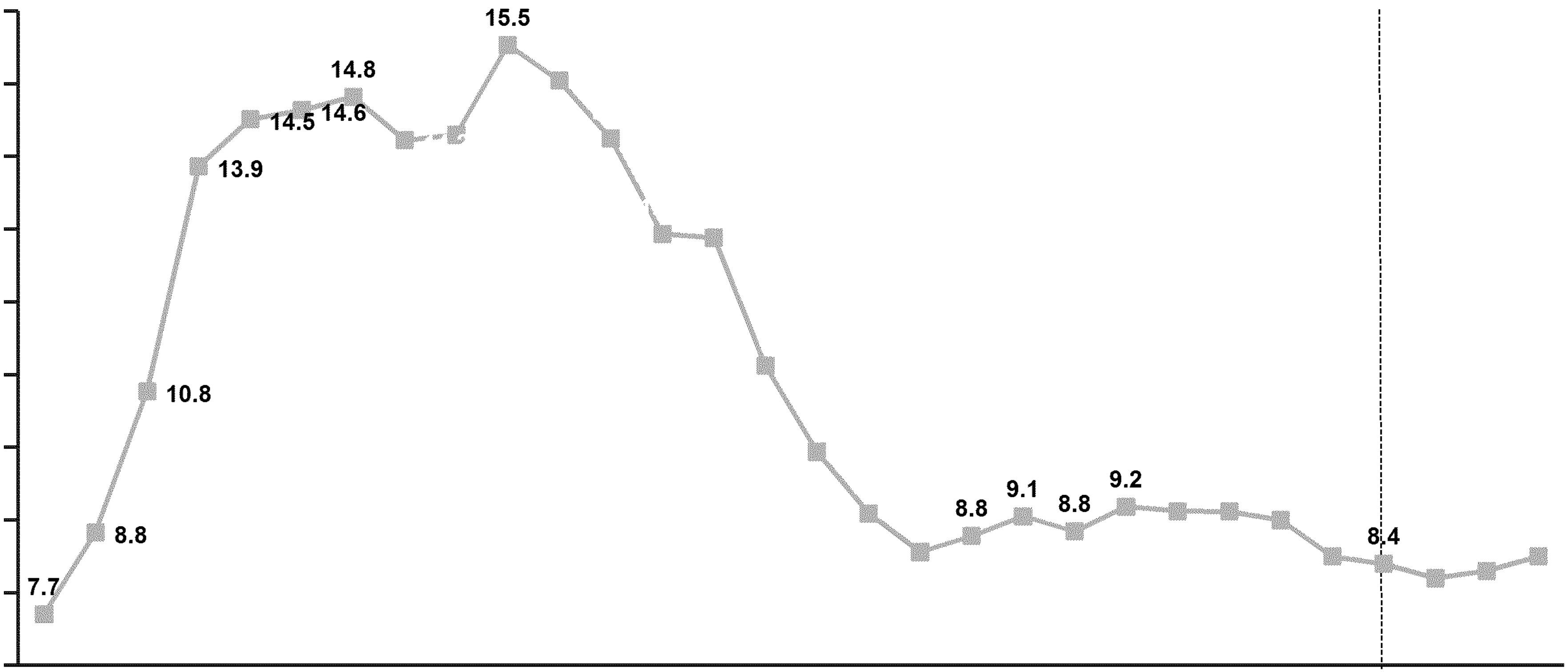


*Interim result for 2016–17

Source: Ontario Financing Authority (2017 Ontario Budget).

Interest on Debt-to-Revenue to Remain Low

Interest on Debt-to-Revenue
(Per Cent)

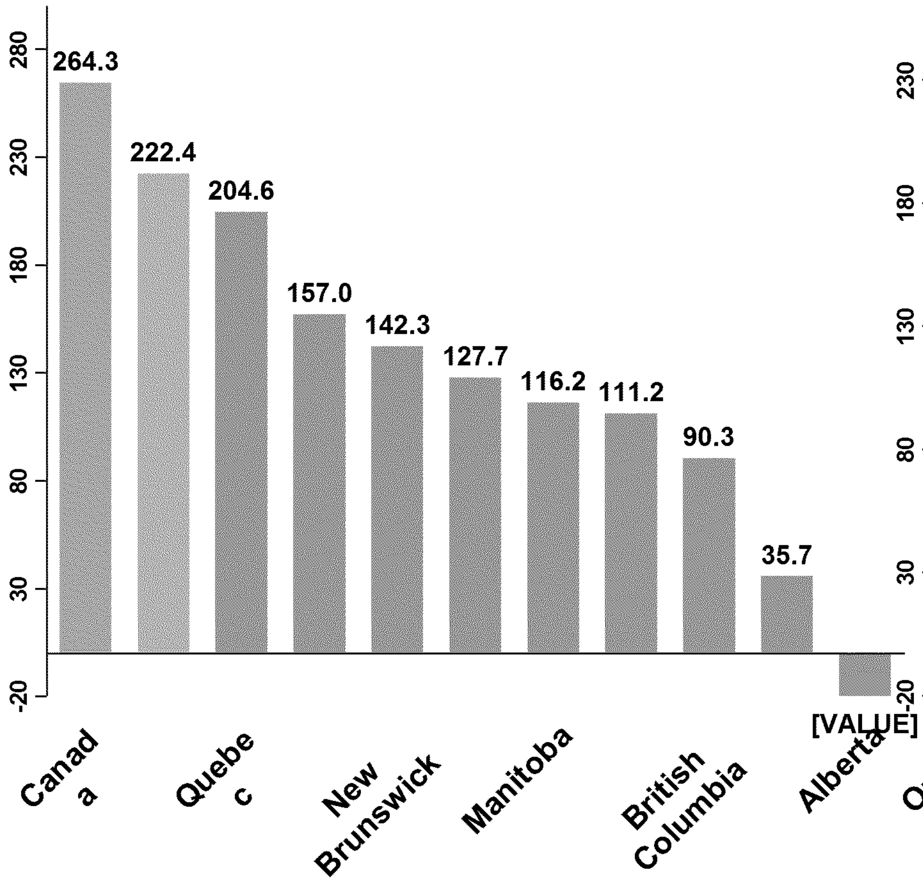


Note: Chart dates represent fiscal years ending March 31st.
Source: Ontario Financing Authority.

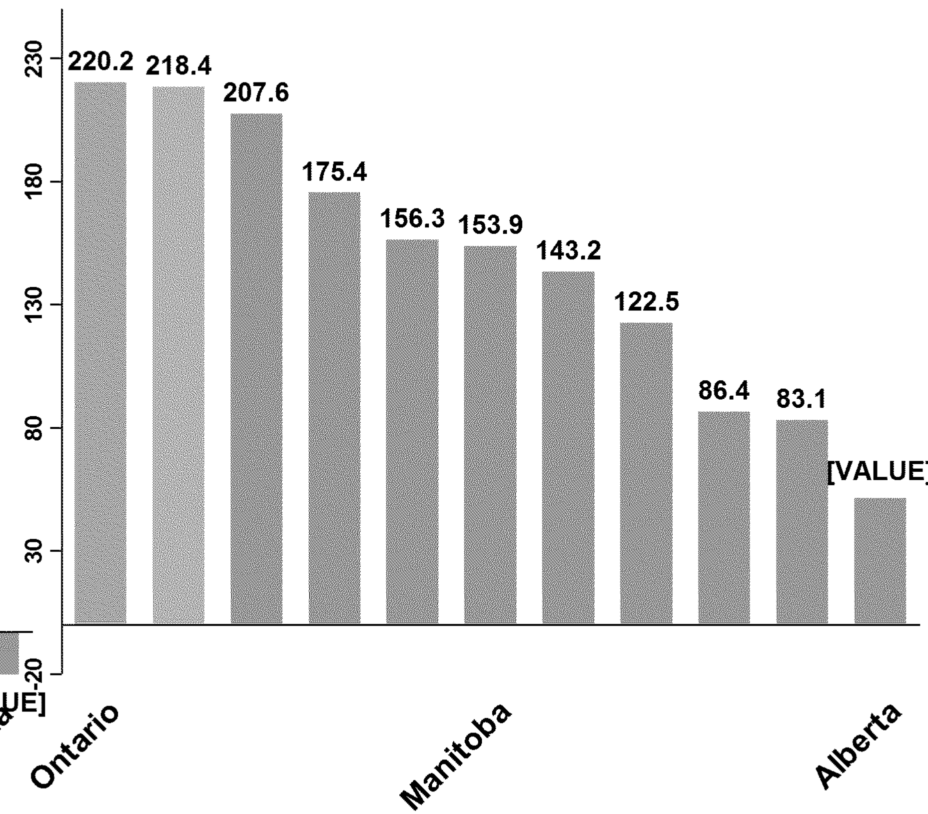
Ontario

Net Debt-to-Revenue: Provincial Comparisons

2012–13
Net Debt-to-Revenue
(Per Cent)

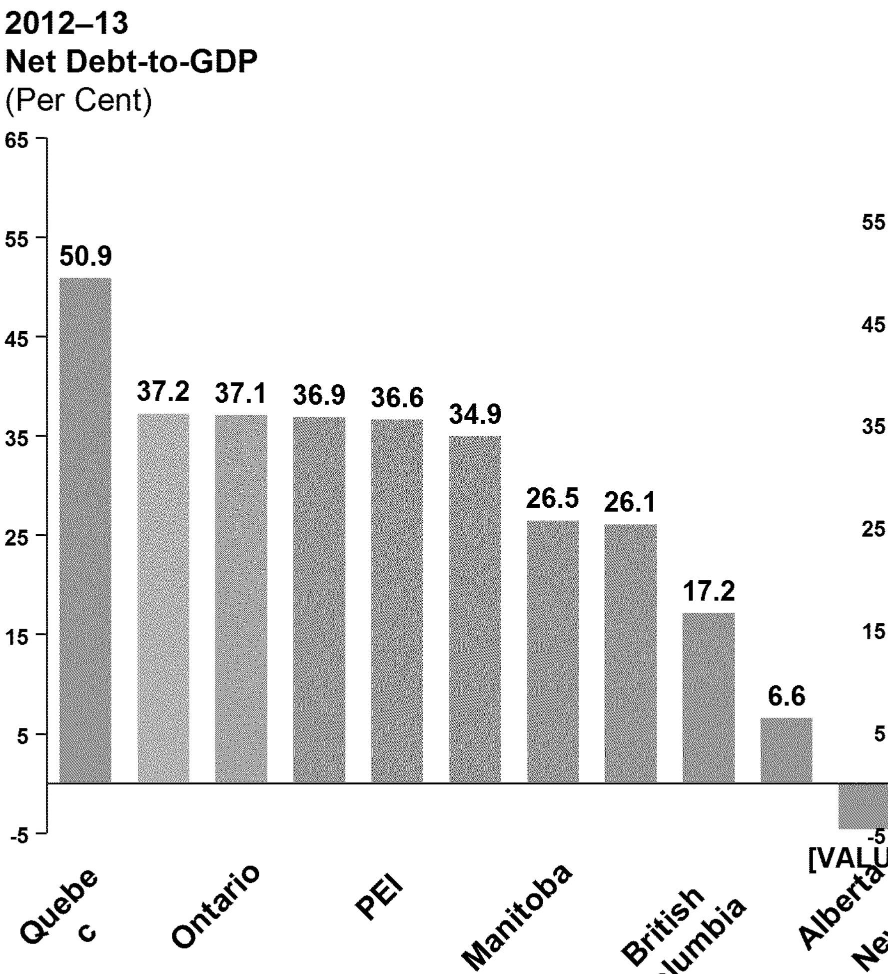


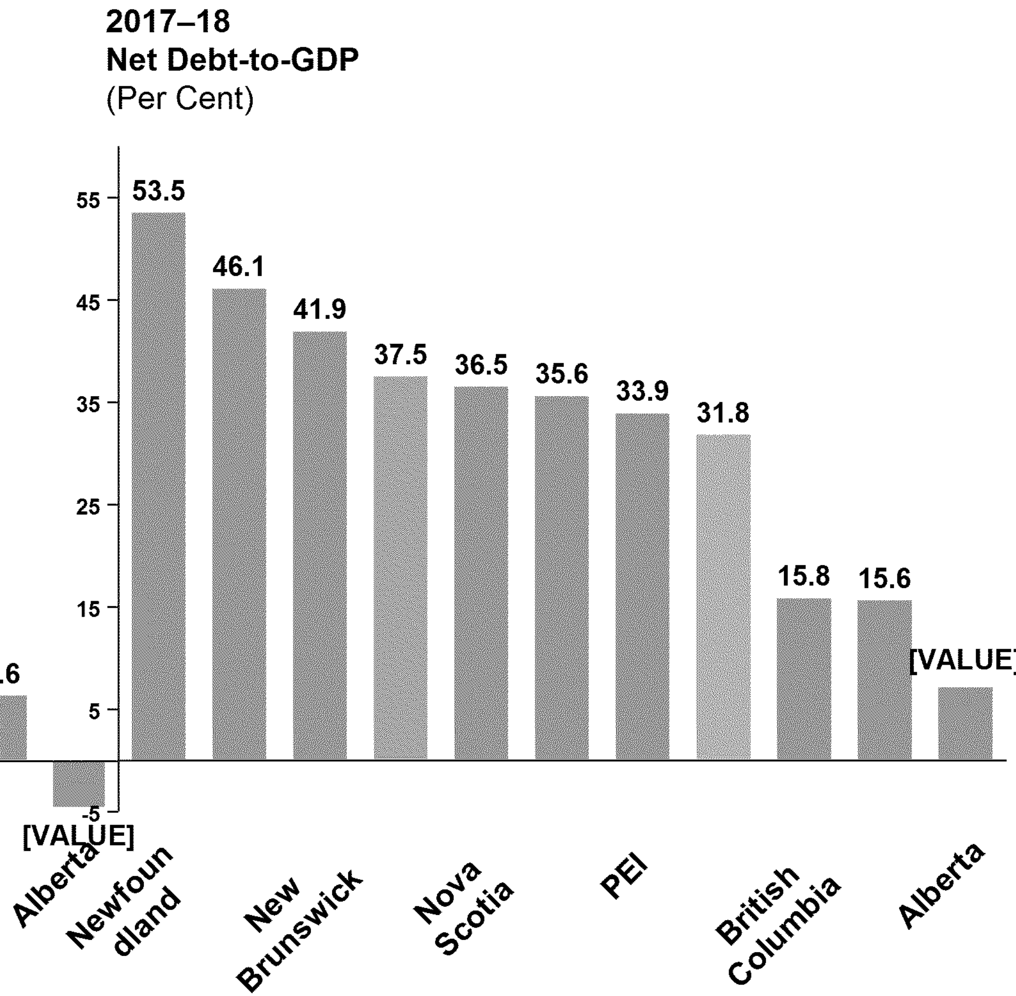
2017–18
Net Debt-to-Revenue
(Per Cent)



Sources: Ontario Financing Authority (2017 Ontario Budget), Federal and Provincial Budgets

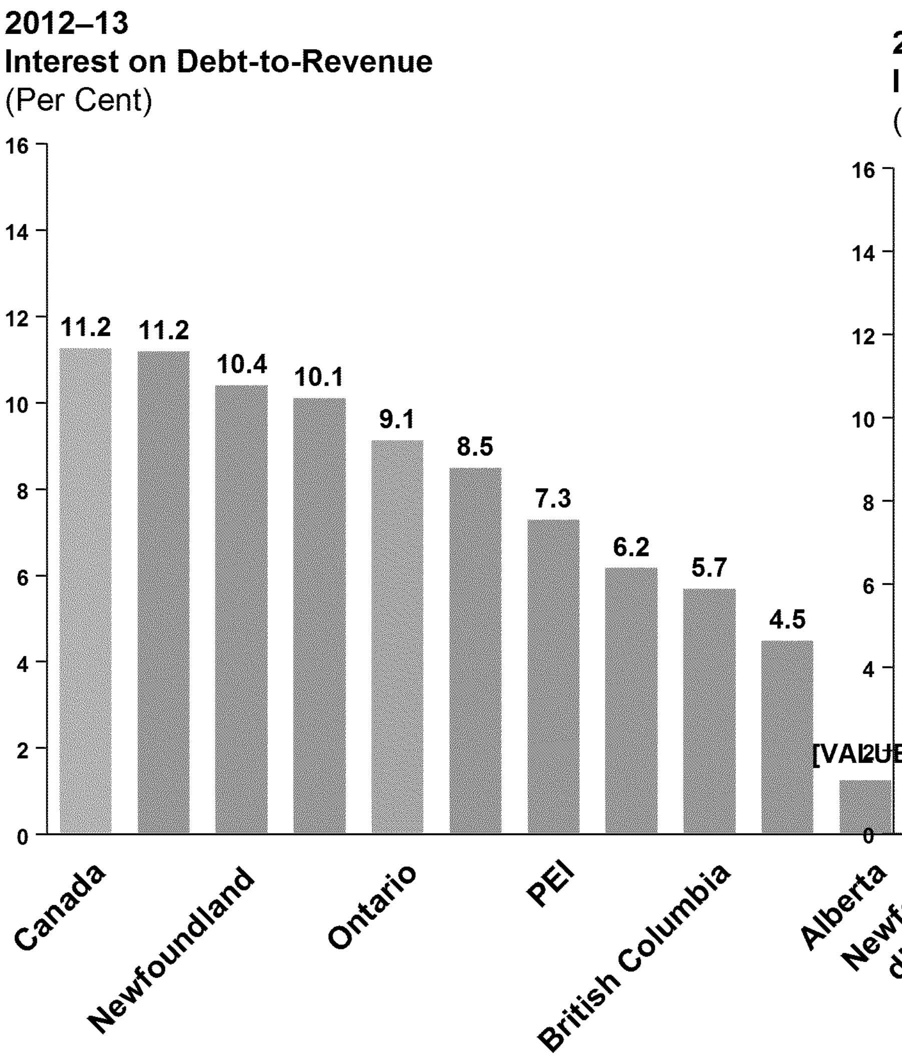
Net Debt-to-GDP: Provincial Comparisons

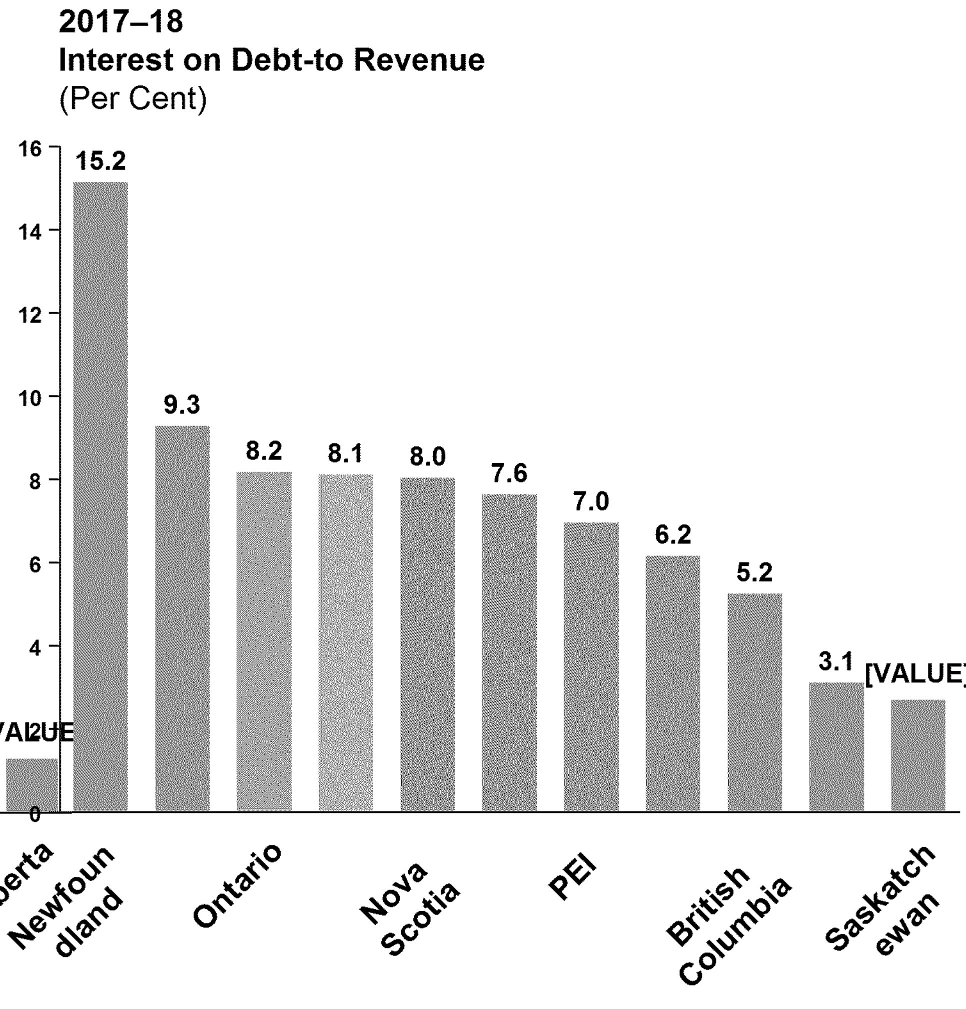




Sources: Ontario Financing Authority (2017 Ontario Budget), Federal and Provincial Budgets

Interest on Debt-to-Revenue: Provincial Comparisons

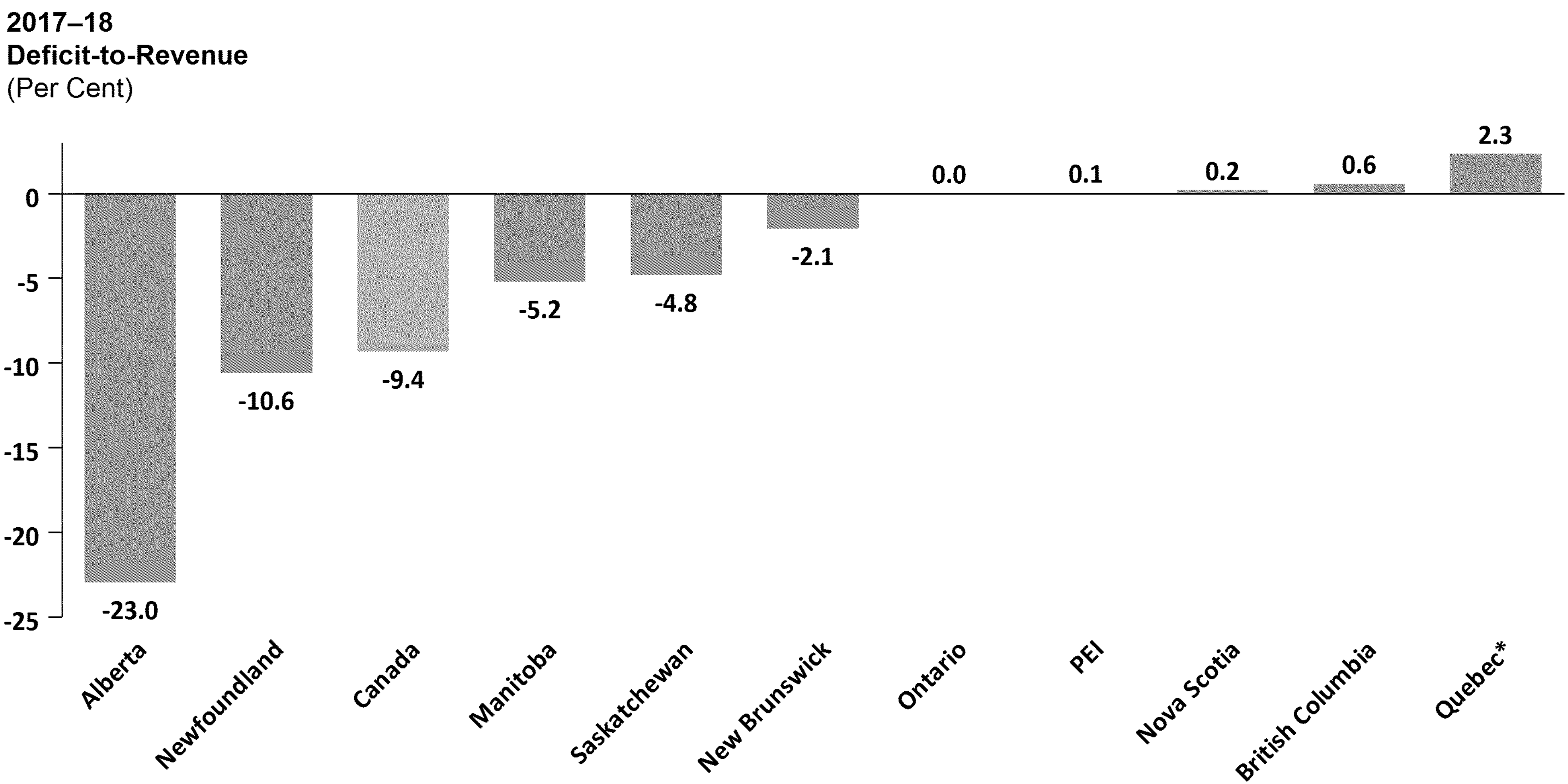




Sources: Ontario Financing Authority (2017 Ontario Budget), Federal and Provincial Budgets

Ontario

Deficit/Surplus-to-Revenue: Provincial Comparisons



* *Note:* Quebec's Budget Balance has been restated to include Deposits to Generation Fund.

Sources: Ontario Financing Authority (2017 Ontario Budget), Federal and Provincial Budgets.

Ontario's Key Ratios by Rating Agency

2016-17	S&P	Moody's	DBRS	Fitch
Current Credit Rating	A+	Aa2	AA (low)	AA-
Key Ratios:				
Deficit-to-GDP			1.3%	
Operating Surplus-to-Revenue	0.8%			
Deficit-to-Revenue		2.5%		
After-Capital Deficit-to-Revenue	8.3%			
Cash Financing Deficit-to-Revenue		7.4%		
Debt-to-Revenue	238.7%	237.1%		
Tax Supported Debt-to-Revenue	250.3%			
Total Debt-to-GDP			44.1%	
Net Debt-to-GDP				39.6%
Interest on Debt-to Revenue	8.6%	9.2%	8.4%	9.0%
Source: S&P, Moody's, DBRS and Fitch Rating Reports				

Provincial Rating Comparison

Province	S&P	Moody's	DBRS	Fitch
British Columbia	AAA	Aaa	AA (high)	AAA
Alberta	AA(N)	Aa1 (N)	AA (high)	Not Rated
Saskatchewan	AA+(N)	Aaa	AA	AA
Manitoba	AA-(N)	Aa2	A (high)	Not Rated
Ontario	**A+**	**Aa2**	**AA (low)**	**AA-**
Quebec	A+ (P)	Aa2	A (high)	AA-
New Brunswick	A+	Aa2	A (high)	Not Rated
Nova Scotia	A+	Aa2	A (high)	Not Rated
PEI	A	Aa2	A (low)	Not Rated
Newfoundland & Labrador	A (N)	Aa3 (N)	A (low)	Not Rated

Ontario's Long-Term Credit Rating History

Colour Key for Credit Rating Actions
Rating Downgrade
Rating Outlook Decline
Rating Outlook Improvement
Rating Upgrade

Year	S&P	Moody's	DBRS	Fitch	Deficit/(Surplus) ($B)
2016	A+	Aa2	AA (low)	AA-	1.5 (Interim)
2015	A+	Aa2 (N)	AA (low)	AA-	3.5
2014	AA- (N)	Aa2 (N)	AA (low)	AA -	10.3
2013	AA- (N)	Aa2	AA (low)	AA (N)	10.5
2012	AA- (N)	Aa2	AA (low)	AA (N)	9.2
2011	AA-	Aa1 (N)	AA (low)	AA (N)	13.0
2010	AA-	Aa1	AA (low)	AA	14.0
2009	AA-	Aa1	AA (low)	AA	19.3
2008	AA	Aa1	AA	AA	6.4
2007	AA	Aa1	AA	AA	(0.6)
2006	AA	Aa1	AA		(2.3)
2005	AA	Aa2	AA		(0.3)
2004	AA	Aa2	AA (N)		1.6
2003	AA	Aa2	AA		5.5
2002	AA	Aa2	AA		(0.1)
2001	AA	Aa3 (P)	AA		(0.4)
2000	AA- (P)	Aa3	AA(low) (P)		(1.9)
1999	AA-	Aa3	AA(low)		(0.7)
1998	AA-	Aa3	A(high)		2.0
1997	AA-	Aa3	A(high)		4.0
1996	AA-	Aa3	A(high)		6.9
1995	AA-	Aa3	A(high)		8.8
1994	AA-	Aa3	A(high)		10.1
1993	AA-	Aa2	A(high)		11.2
1992	AA (N)	Aa2	AA(low) (CW-N)		12.4

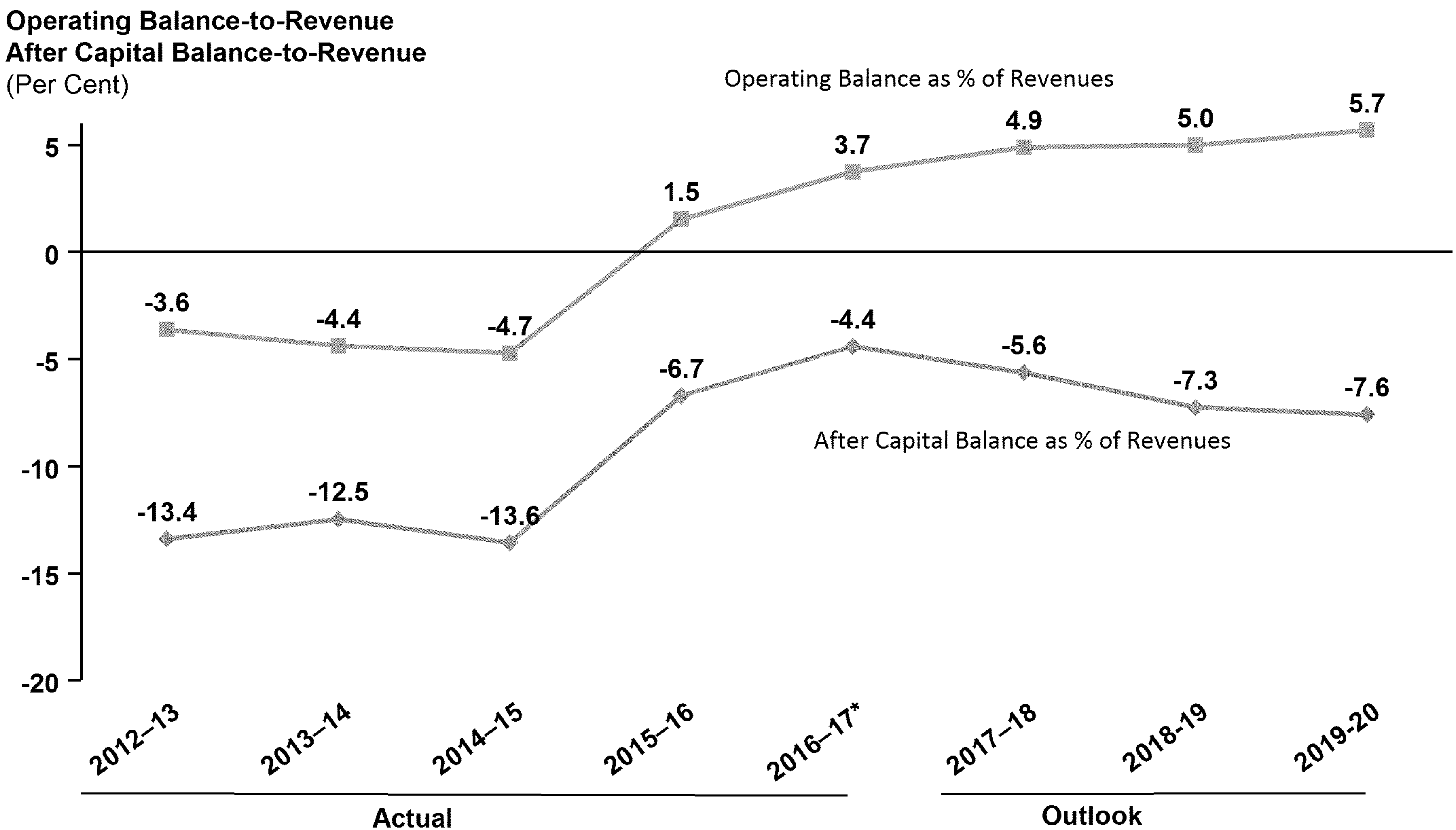
Ontario

Background on S&P

S&P: Ontario vs. Quebec Key Rating Comparison

Key Rating Factors Assessment:	Ontario	Quebec
Institutional Framework	Very predictable and well-balanced	
Economy	Very strong	
Financial Management	Strong	
Budgetary Flexibility	Average	Weak
Budgetary Performance	Weak	Strong
Liquidity	Adequate	
Debt Burden	Very high	
Contingent Liabilities	Low	Moderate
Key Ratios (Average 2014-15 to 2018-19):		
Operating balance (% of operating revenues)	0.4	6.4
Balance after capital accounts (% of total revenues)	-7.4	-1.3
Capital expenditures (% of total expenditures)	8.8	8.0
Tax-supported debt (% of consolidated operating revenues)	249.0	227.1
Interest (% of operating revenues)	8.7	10.4

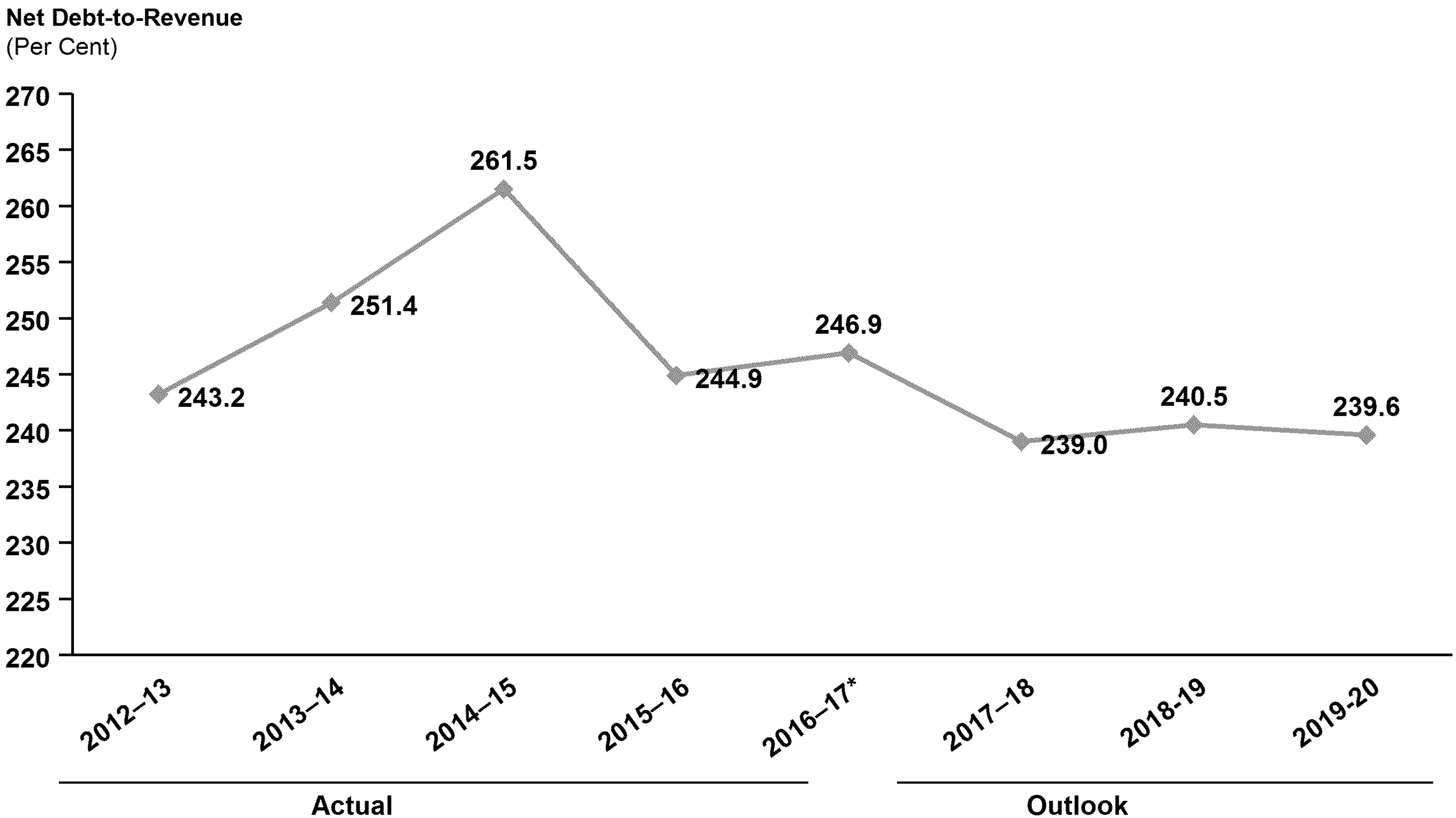
S&P: Key Ratios Updated to Reflect the 2017 Budget



*Interim result for 2015–16.

Ontario

S&P: Tax Supported Debt-to-Revenue Updated to Reflect the 2017 Budget



*Interim result for 2016–17.

Source: Ontario Financing Authority (2017 Ontario Budget).

S&P Provincial Rating Comparison

Province Ratios: 2014-15 to 2018-19	Rating	Operating Balance as % of Revenues	After Capital Balance as % of Revenues	Tax Supported Debt as % of Revenues	Interest as % of Revenues
British Columbia	AAA	4.8	-9.0	124.6	5.7
Alberta	AA(N)	-5.7	-22.0	129.1	2.7
Saskatchewan	AA+(N)	2.1	-7.0	96.7	3.9
Manitoba	AA-(N)	0.1	-10.3	289.2	6.0
Ontario	**A+**	0.4	-7.4	249.0	8.7
Quebec	A+ (P)	6.4	-1.3	227.1	10.4
New Brunswick	A+	4.2	-3.0	221.9	8.1
Nova Scotia	A+	3.1	-1.7	128.4	8.0
PEI	A	0.6	-4.0	167.0	7.8
Newfoundland	A (N)	-11.9	-18.3	166.3	7.3

Source: S&P Ratings Reports 2016

DBRS Comments on Ontario's 2017 Budget: Back in Black and Spending to Wynne

DBRS Limited (DBRS) has today commented on the Province of Ontario's (Ontario or the Province; rated AA (low) with a Stable trend by DBRS) 2017 budget, released on April 27, 2017. The budget is consistent with DBRS's expectations and sets the tone and agenda for the remainder of the government's term in office. While Ontario has fulfilled its long-stated commitment to balance the budget in 2017-18, the real focus is spending on new initiatives. The Province is allocating all incremental revenue to program priorities and foregoing debt reduction, despite the significant increase in debt since the financial crisis. **Nevertheless, growth in the Province's debt stock has slowed considerably, the debt burden as a share of the economy is declining, albeit gradually, and the outlook for the economy is positive. The credit profile is stable, but will remain vulnerable to an economic shock in the absence of a more concerted effort to reduce debt.**

Ontario first introduced its plan to restore balance by 2017-18 in the 2010 budget; at that time, many commentators, including DBRS, cast doubt on the government's ability and willingness to do so. The government has, to its credit, outperformed its targets each year. Efforts to constrain wages and limit spending growth in key program areas kept the plan on track initially while the Province has benefited from strong economic growth and, more recently, some one-off measures. Had expenditure restraint been sustained as initially planned, fiscal balance would have been achieved sooner. Nevertheless, DBRS-adjusted debt peaked at 44.0% in 2015-16, below original expectations when the return-to-balance plan was introduced. Preliminary estimates now indicate that the debt burden is falling, having reached an estimated 43% of gross domestic product (GDP) in 2016-17.

The government pre-announced many of the headline initiatives, including electricity and housing cost measures, funding for new child-care spaces and a significant increase in health-care spending. The DBRS-adjusted deficit, which recognizes capital spending on a pay-as-you-go basis, is estimated to be about $6.4 billion in 2017-18, or 0.8% of GDP, down from $24.4 billion, or 4.1% of GDP, in 2009-10.

Total revenue is projected to rise notably (+6.3%) with growth across most revenue sources, driven largely by a strong underlying economy. The Province has not proposed any significant tax increases, but will benefit from proceeds of the carbon emission cap-and-trade program. Federal transfers will rise modestly with growth in health, social and infrastructure-related transfers, more than offsetting the declines in equalization.

The Province has budgeted for total expenses to rise 4.8%. Health care (+3.0%) was a focal point of this budget as the government announced a 3.0% increase in hospital funding and the introduction of pharmacare for children and youth. Other program areas are seeing similar growth with funding increases or new program funding in education (+3.0%), post- secondary and training (+7.7%) as well as children's and social services (+4.3%). Interest costs are rising more modestly (+2.9%) as the net increase in debt is partially offset by a lower effective interest rate on the debt stock. Capital investment is planned to rise to $13.1 billion in 2017-18 and steadily higher in subsequent years.

The Ontario economy continues to post relatively strong growth. In recent years, growth has varied between 2.5% and 2.7% annually. Economic growth is being driven by the private sector with business investment, household spending and exports contributing strongly to the outlook. Consistent with the private-sector consensus, the Province is projecting growth of 2.3% in 2017 and for growth to track somewhat lower in subsequent years. Nevertheless, **uncertainty regarding the potential renegotiation of NAFTA and U.S. tax policy as well as political integration in Europe present downside risks to the outlook. Furthermore, elevated household debt and housing market dynamics leave Ontario particularly vulnerable in the event of an unforeseen shock that results in significant job losses or a rapid increase in interest rates.**

The multi-year fiscal outlook remains unchanged with balanced budgets projected through 2019-20. The Province intends to raise spending in lockstep with revenue, which stands in contrast with the more deliberate efforts by some other provinces to reduce debt that accumulated since the onset of the financial crisis. The Province will continue borrowing to fund its capital needs, but the debt burden as a share of the economy is projected to track lower over the medium term with economic growth outpacing debt growth. Preliminary estimates suggest that the DBRS-adjusted debt burden fell to about 43% of GDP in 2016-17 and could decline to about 40.0% of GDP by 2019-20 based on budget estimates.

The return to balance is encouraging and suggests that there will likely be some modest improvement in the Province's credit metrics over the medium term, which will slowly rebuild flexibility within the rating. Nevertheless, Ontario's debt burden will remain elevated over the medium term and the credit profile will continue to have limited flexibility to address any unexpected shocks. If a material economic shock occurs, the Province's credit profile may come under stress.

Ontario's Debt Continues to Grow as Province Forecasts Balanced Budgets

Moody's Investors Service notes that the Province of Ontario's (Aa2, stable) 2017 Budget forecasts successive balanced budgets across the 2017/18-2019/20 horizon.

The province is forecasting a thin surplus of CAD600 million (0.4% of revenue), before taking into account a contingency reserve of equal size which brings the budget squarely to balance. The same forecast is maintained for 2018/19, with the surplus rising to CAD900 million (0.6% of revenue) in 2019/20 before a contingency reserve of CAD900 million is taken into account.

"Ontario, as expected, has presented a return to balanced budgets for 2017/18", noted Michael Yake, Moody's Vice President and Senior Analyst. "**However, the modest size of surpluses forecasted does not have a material impact on the credit quality of the province.** As we have previously stated, our focus remains on the province's ability to manage its debt burden and minimize potential increases to its interest expense in the face of expected higher interest rates."

Interest expense is expected to rise 2.7% in 2017/18, the same pace of growth as forecasted in 2016/17, before accelerating to 3.4% in 2018/19 and 5.0% in 2019/20. This reflects a rise in the debt level as well as forecasted rising interest rates. Moody's forecasts that the province's interest expense will remain near 9% of total revenues across the budget horizon, a level which has been relatively stable since 2007.

After increasing 3.7% in 2016/17, revenues are forecasted to increase 6.4% in 2017/18, before slowing to 2.3% in 2018/19. On the expense side, total expenditures increased 2.2% in 2016/17 and are forecasted to increase 4.7% in 2017/18 before slowing to 2.3% in 2018/19. As previously noted by Moody's, some of the distortion in these year-over-year trends is attributable to the introduction of the Cap and Trade carbon pricing in 2017 as well as the impact of higher federal funding for home care and mental health, both of which will be offset by higher expenditures.

However, in addition to these revenue sources, the province is expecting stronger increases in tax revenues stemming from a stronger economy. Real GDP is forecasted to grow 2.3% in 2017, with nominal GDP forecasted to increase 4.3%. This will help increase tax revenues 4.9% in 2017/18. The province is also expected to generate one-time revenue through its continued plan of privation of assets, including Hydro One, throughout the year.

On the expenditure side, the province introduced a number of new spending initiatives. Among these are increases to health (3.0%), education (3.0%) and community and social services (6.0%) as well as the province's previously announced plans to provide funding relief on electricity costs amounting to CAD2.5 billion over the next 3 years.

"We noted last year that the province's spending forecasts were higher than previously planned, which is also the case this year", added Mr. Yake. "Some new spending initiatives, such as the new universal drug coverage for people aged 24 and under, could have the potential to exceed the province's forecasts. Given the slim surpluses forecasted, adhering to forecasted spending levels will be important to achieve the balanced budget targets."

Ontario also continues to forecast significant infrastructure spending, which will necessitate borrowing to remain elevated at current levels. The province plans to spend CAD156 billion over the next 10 years on infrastructure. The CAD15.6 billion average per year is higher than the average CAD11.3 billion spent in each of the past 3 years by the province.

The province forecasts borrowing requirements to be CAD26.4 billion in 2017/18 followed by CAD32.2 billion and CAD38.7 billion in 2018/19 and 2019/20 respectively. Net of refinancing for maturities, these represent increases of approximately CAD10 billion to the province's debt each year, accumulation that is slightly higher than previously forecasted by Moody's. Nonetheless**, the province's debt burden, measured by net direct and indirect debt to revenues, which peaked at 246% in 2014/15, is expected to continue to fall, albeit slightly slower than previously forecasted, over the medium-term.**

As part of its normal practice, Moody's will evaluate the 2017/18 budget's assumptions and its potential for upside and downside risks within the likely impacts on the province's credit profile.