2017 Document Fiscal Architecture:
Fiscal Update and Key Decisions

Office *of the* Budget
MINISTRY *of* FINANCE

TBS

OFFICE OF ECONOMIC POLICY
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Purpose

To set the frame, priorities, and approach to the 2017 Document.

To review the proposed fiscal outlook for the 2017 Document and consider options for addressing fiscal pressures.

This presentation will provide:

- An economic and fiscal update;
- Updates on the PRRT process and decisions, and;
- Proposed framework on decision-making and next steps.

Framing the Balance of Choices for the 2017 Document

The 2017 Document will need to balance a number of strategic fiscal and investment priorities.

Build on Government's Plan and Demonstrate Progress

- Show progress on the government's plan to **invest in the economy and build Ontario up for everyone**.
- Demonstrate **responsible fiscal management**, meet fiscal targets and balance the budget in 2017-18.
- Continue to **transform** and protect public services for longer term sustainability.

Launch New Priority Investments

- Support **priority investments that help people in their everyday lives** such as additional electricity relief, child care expansion, highly-skilled workforce and youth jobs strategy, income security and priority health care investments.

Determine Balanced Approach to Priorities

- **Reconciling the government's fiscal anchors –** such as balancing the budget in 2017-18 and ongoing – **with the commitment to invest in priorities –** will require **trade-offs** and difficult choices.
- While balancing the budget in 2017-18 remains a central priority, the scope, size and roll-out of new priority investments **will require the consideration of all viable revenue tools and other measures** in the lead-up to the 2017 Document.
- Need to maintain a longer-term view to the **2018 Document, Pre-Election Report** and beyond.

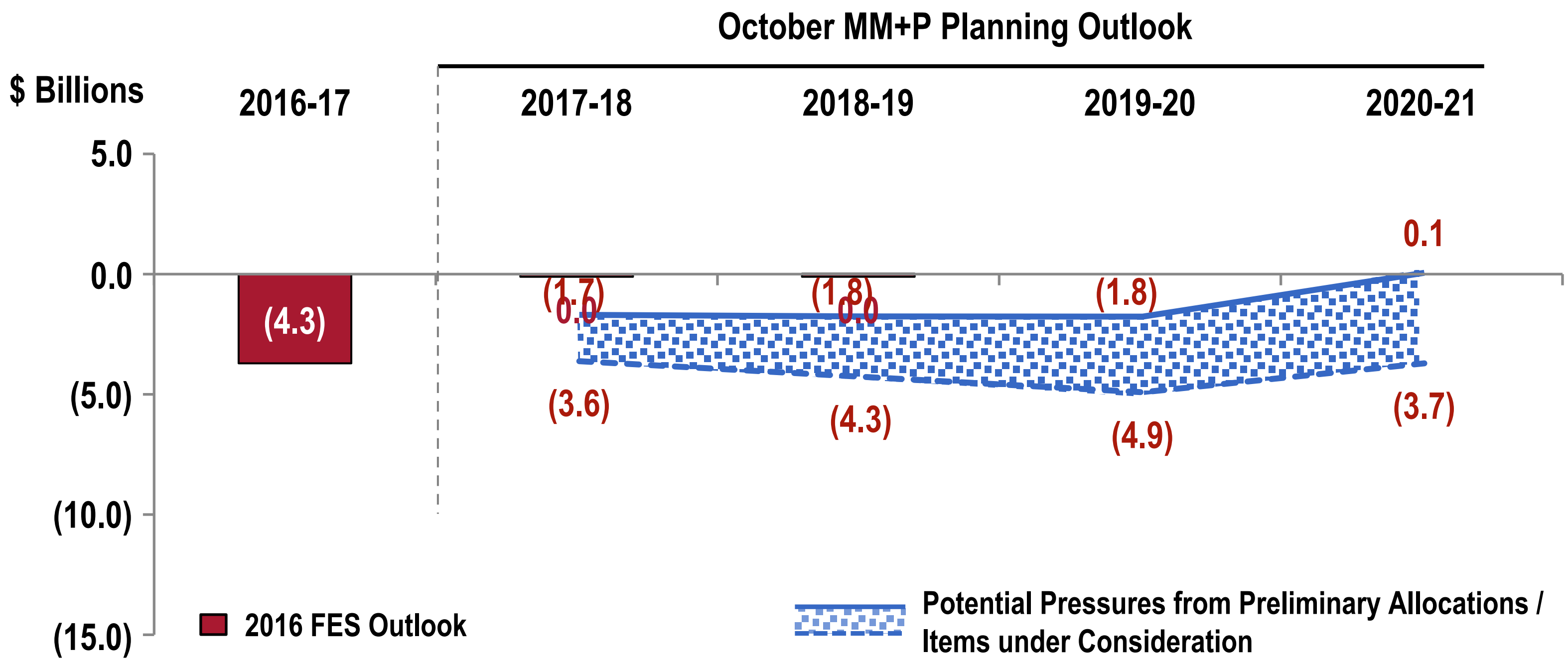
October MM+P Planning Outlook

While the 2016 Budget outlined a plan to balance the budget in 2017-18 and remain balanced in 2018-19, **changes since the Budget have created a gap compared to the government's fiscal targets.**

- A stronger outlook for revenue and lower interest on debt expense are currently tracking against the Budget forecast – **however, spending pressures, new strategic investments, and the pension adjustment have also materialized**.

The **2016 FES projected that the government could achieve its fiscal targets while accommodating several new investments and the pension adjustment.**

- However, **the FES fiscal outlook did not address** the potential fiscal impact of other known pressures, namely, those associated with preliminary allocations provided to ministries and other strategic investments under consideration.

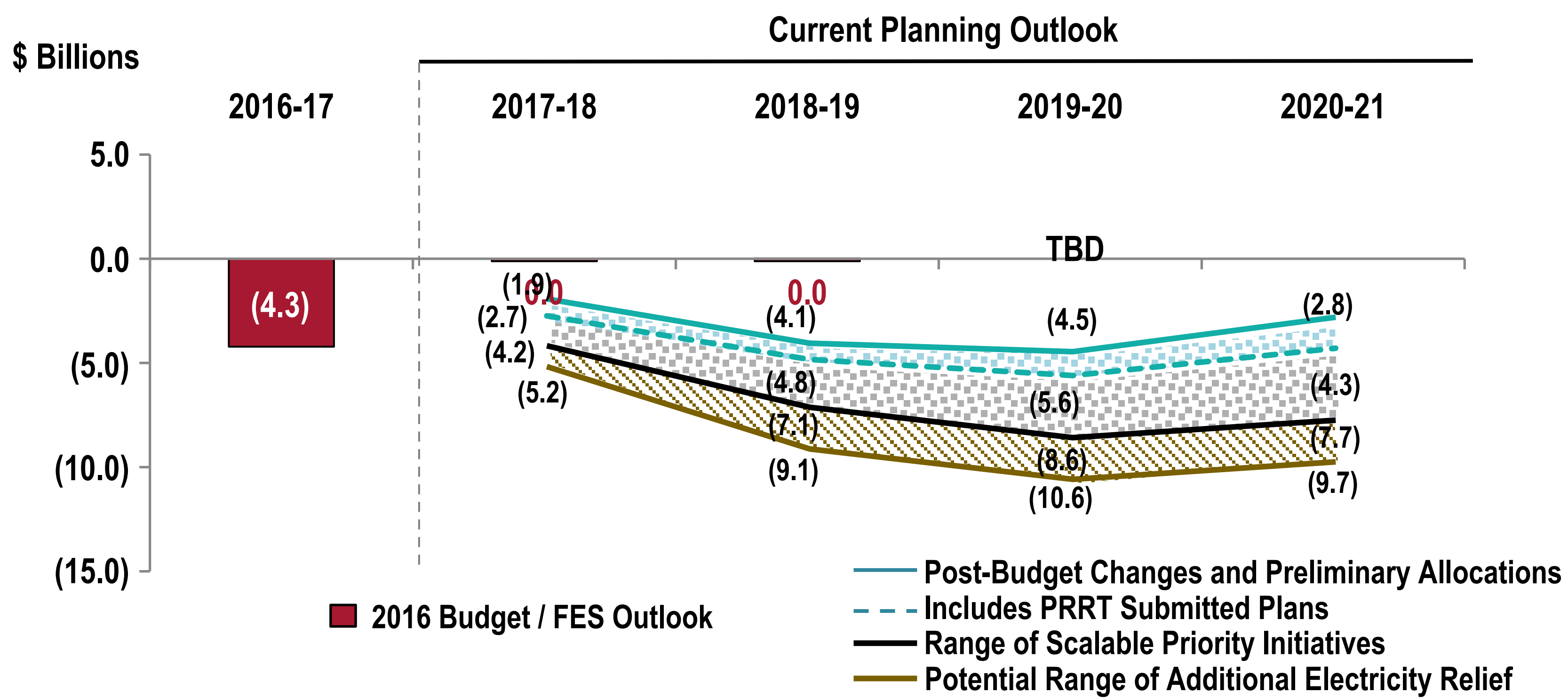


The Current Multi-Year Fiscal Challenge

Since the 2016 FES, the fiscal gap has deteriorated as a result of:

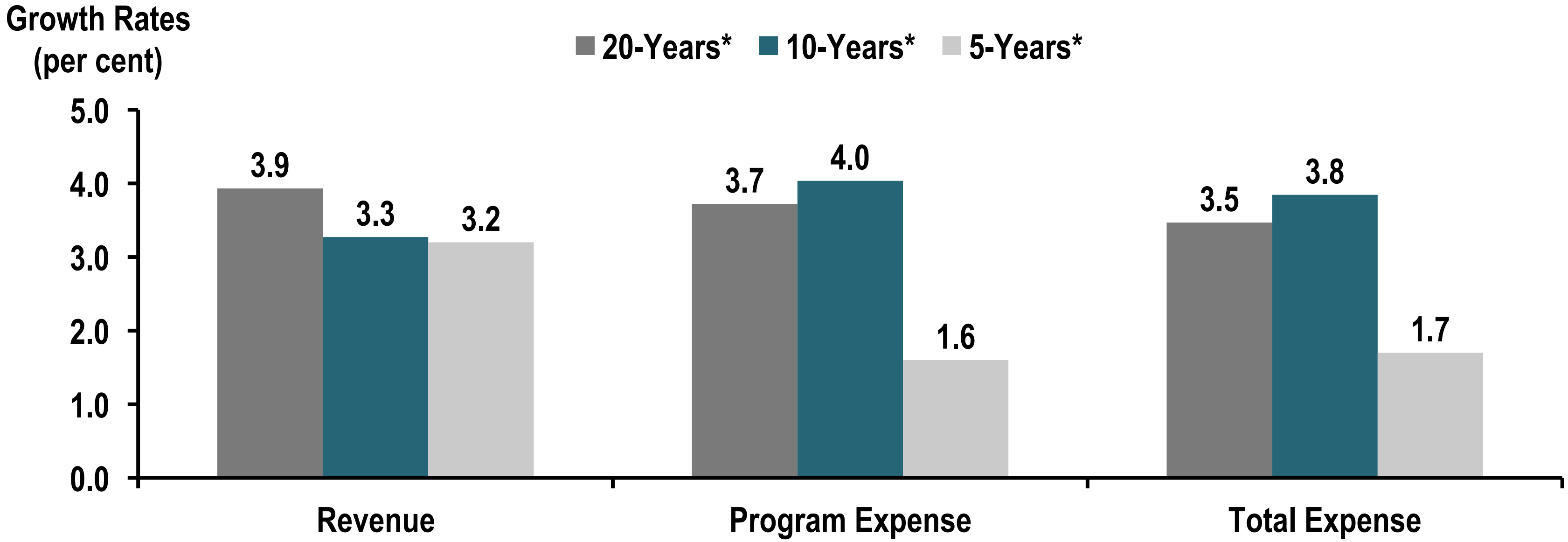
- **PRRT plans coming in above preliminary allocations** and the revised impact of **potential priority investments.** Additional electricity cost relief further widens the gap.
- The **pension adjustment beyond 2018-19 not being fully offset by revenue/expense tools.**
- **Other changes to revenue**, including a downward revision in Ontario's Equalization entitlement and asset optimization forecasts.

As a result, in the absence of further actions, the projected gap tracking against the government's fiscal targets is currently as much as $5.2 billion in 2017-18, $9.1 billion in 2018-19, and $10.6 billion in 2019-20.



Historic Revenue and Expense Growth

- While over 20 years, revenue has exceeded total expense, over the past 10 years, the opposite has been true.
  - Should the 10-year trend continue, achieving balance and long-term fiscal sustainability could be challenging.
- To support the government's commitment to balancing the budget, total expense has been held to 1.7 per cent over the past five years, reflecting significant efforts to manage spending – which may be creating pressures in future years.



* 20-years growth rate is calculated from 1995-96 until 2015-16, the10-years growth rate is calculated from 2005-06 until 2015-16, and the 5-year growth rate is calculated from 2010-11 to 2015-16.

Note: *Average annual revenue growth excludes the net impact of a significantone-time increase of $3.2 billion, resulting from the sale of Hydro One in 2015-16. Average annual expense growth excludes $1.5 billion in Pension Adjustments for 2015-16.*

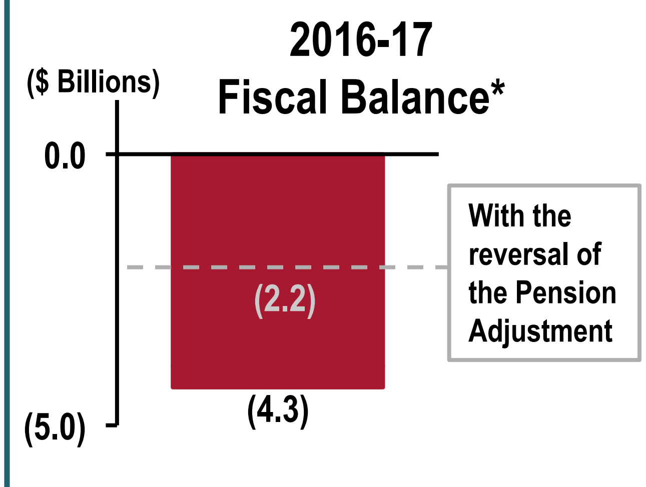
2016-17 Update

The **FES projected a deficit of $4.3 billion in 2016-17**, consistent with the 2016 Budget – however, despite a stronger revenue outlook and lower interest on debt expense, the **reserve (now at $0.4 billion) and contingency funds were reduced in order to accommodate the pension adjustment and new investments**.

2016-17 Update

Current information suggests that beating the $4.3 billion deficit target for 2016-17 is within reach. However, key outstanding information/decisions (and associated risks) could impact the outlook:

- Treatment of Pension Assets (plus any valuation impacts)
- Accounting Framework for OPG and Hydro One (IFRS)
- What fiscal year to book proceeds from the first cap and trade auction in March 2017 (i.e. 2016-17 or 2017-18)
- Updates to revenue and expense (based on ministry interim actual projections)
- Contaminated sites liabilities



* Includes reserve of $0.4 billion

Third Quarter Finances

Ontario's Third Quarter Finances is a public fiscal update. Under the *Fiscal Transparency and Accountability Act, 2004* (FTAA), the Third Quarter Finances is required to:

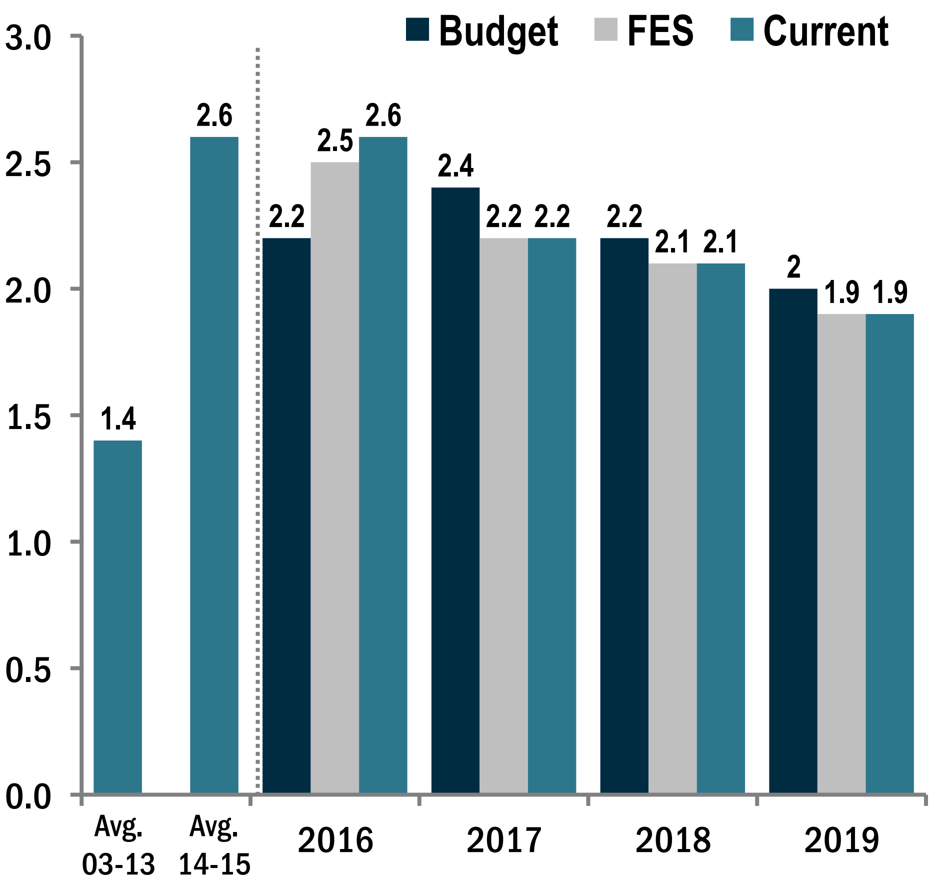
- **Be released by February 15th** (publication can be delayed if a letter is sent to the Clerk).
- Include updated information about the major components of revenue and expense for the current year (16-17).

It also provides an opportunity for the government to reiterate key fiscal messages from the Budget and Fall Economic Statement or pre-condition for the 2017 Budget.

Of note, recommendations from the Pension Panel may be released in close proximity to the Third Quarter Finances and could impact the outlook the government chooses to publish.

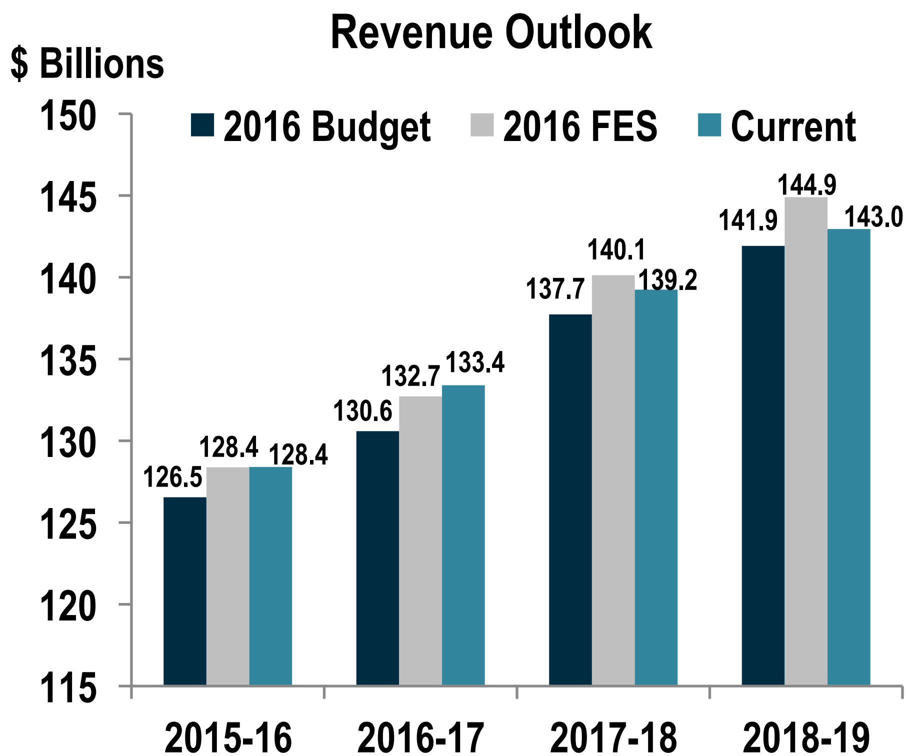
Current Economic Growth Outlook

Real GDP – Planning Assumption
Per cent change



- Ontario's economy continues to grow at an above normal pace. Job creation has been relatively robust in recent months, and the unemployment rate has been edging down.
- Ontario has been one of the strongest growing provincial economies in Canada over the past three years and is expected remain so in 2017.
- Current economic growth outlook for 2017 to 2019 remains largely consistent with the 2016 FES.
- Emerging risks to the outlook are rising interest rates and uncertainty around the future path of US economic policy.

Current Revenue Outlook

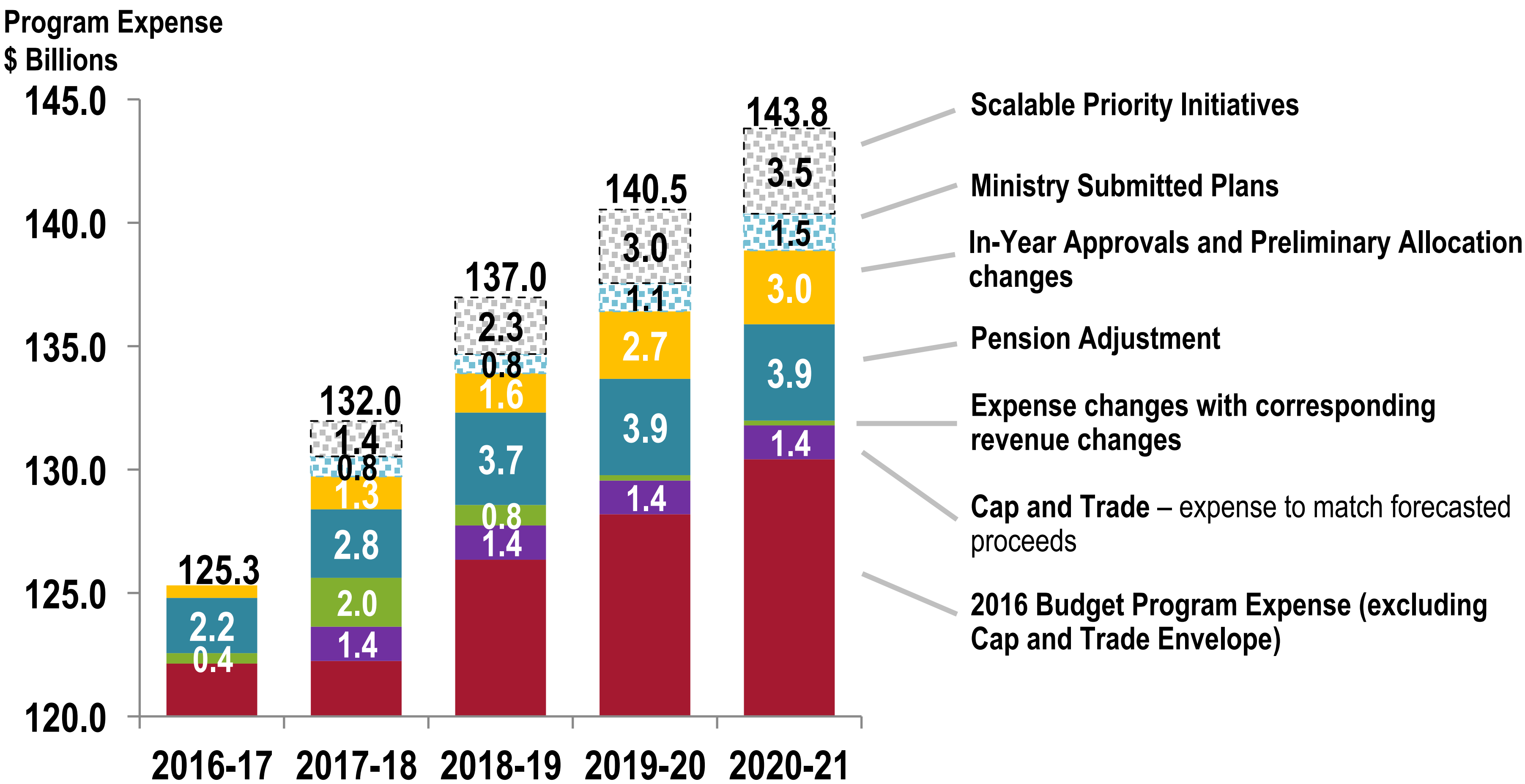


Change in the Revenue Outlook

$ Billions	2016-17	2017-18	2018-19
Since Budget	2.8	1.5	1.0
Since FES	0.7	(0.9)	(1.9)

- The current outlook calls for revenues to increase to $143.0 billion in 2018-19, an average annual increase of 3.6% over three years.
- The outlook maintains key revenue assumptions included in the FES such as those regarding federal funding for infrastructure and home care.
- The improvement in the revenue outlook since the *2016 Budget* is mainly due to higher taxation revenues reflecting a stronger economy in 2015 and 2016. Revenue gains are mitigated by lower non-tax revenues outlined below.
- Higher 2016-17 revenues since the FES are mainly due to higher HST revenues. This is offset in 2017-18 and 2018-19 by lower projected non-tax revenues from Equalization, Asset Optimization and Cap & Trade proceeds.
- Information forthcoming over the next month could result in modest adjustments to the revenue outlook.
- Key revenue risks are the economic growth outlook, the housing market, federal transfers and cap and trade proceeds.

Program Requests



- Program Expense growth at 2016 Budget averaged 1.9% per year between 2014-15 and 2018-19.
- Including ministry requests, average program expense growth is 3.3% between 2014-15 and 2020-21. Adding in interest on debt, the total expense grows at 3.3% over the same period.
- Additional electricity relief could increase the program expense growth rate to 3.6% between 2014-15 and 2020-21.

Ministry Submitted Plans

Need to do Items … $0.2B in 2017-18

Legislative and contractual obligations, and Health expense growing at 3%. Also includes project, amortization and consolidation updates along with TB decisions made after November 1.

For example, justice and corrections announcements; child welfare adjustments; capital and operating re-profiling (primarily MTO).

Continue to manage items … $0.2B in 2017-18

Ministries previously directed by TB/MBC to manage or have demonstrated ability to manage from within existing allocations. Also includes additional requests for relief from savings targets.

For example, MEDG pressures; Provincial contribution to Clean Water and Wastewater program; boulder savings targets.

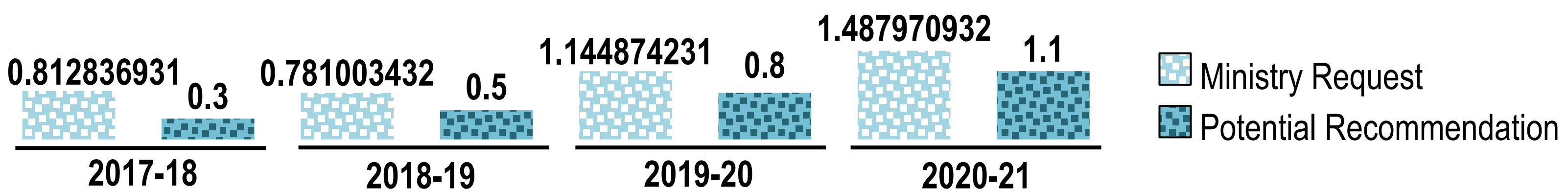
To Consider items … $0.2B in 2017-18

Discretionary requests from ministries that may be difficult to avoid.

For example, investments in OPS buildings; pressures in ministries (primarily MCSCS, MOECC, MNDM); additional capacity in ministries; and new capital (e.g., Halton Courthouse, correctional facilities, resources road lab).

Track as Risks Items … $0.2B in 2017-18

As in prior years, monitor forecasts for demand driven programs including Social Assistance payments and the 8% Electricity rebate.



Scalable Initiatives

- Initiatives under discussion need to be evaluated and scaled based on mandate commitments, timing and resources

Fund Now

Highly Skilled Workforce
Youth Jobs Strategy
Child Care Expansion
Black Youth Action Plan
Transitioning Adults with Special Needs
Advancing Transformation in Dev. Services
GO Transit Operating Subsidy
Going Global Export Strategy
Business Growth Initiative
Retirement home sprinklers
Improving Refugee Outcomes
Budget Talks

Consider Not Funding

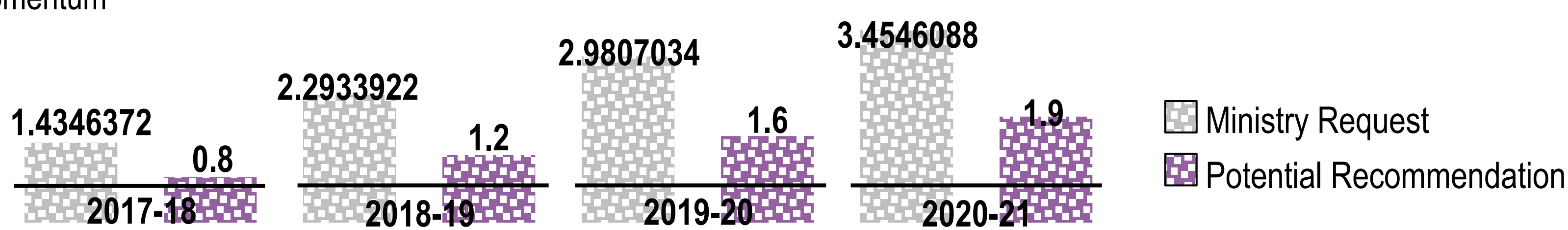
Health at an additional 0.2% to total 3.2%
JPF Enhancement
Ontario Place
Ontario 150 – additional funding

Consider Funding

Senior Comm. Grants/Elderly Person Centres
Additional OSAP support
Income Security Reform
Basic Income
Additional Corrections Reform funding
Project Momentum

Do Not Fund

Serious Fraud Office



Accounting Issues – Fiscal Impact Overview

Net Pension Assets	Fiscal impact to FES				
	2016-17	2017-18	2018-19	2019-20	2020-21*
Current AG's position **Expert Panel Position (reverse write off of OTPP and OPSEUPP; HOOPP and CAATPP TBD)** (Estimates to be updated in mid-February,2017)	**-** **($ 2.2B)**	**-** **($2.7B)**	**-** **($3.1B)**	**-** **($3.1B)**	**-** **($3.1B)**

- Panel has completed its work on OTPP and OPSEUPP; work on HOOPP and CAATPP is ongoing
- OTPP/OPSEUPP Panel Recommendations (to be followed by Province)
    - Panel agrees with recognition of the net assets on the basis that (a) net assets are economic resources available to the sponsors to reduce future contributions or improve benefits; (b) unilateral control is not necessary for asset recognition; (c) recognition of the assets faithfully represents the financial position of the Province and the substance of the sponsors' deal
    - Panel believes that no valuation allowance is required for either asset

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

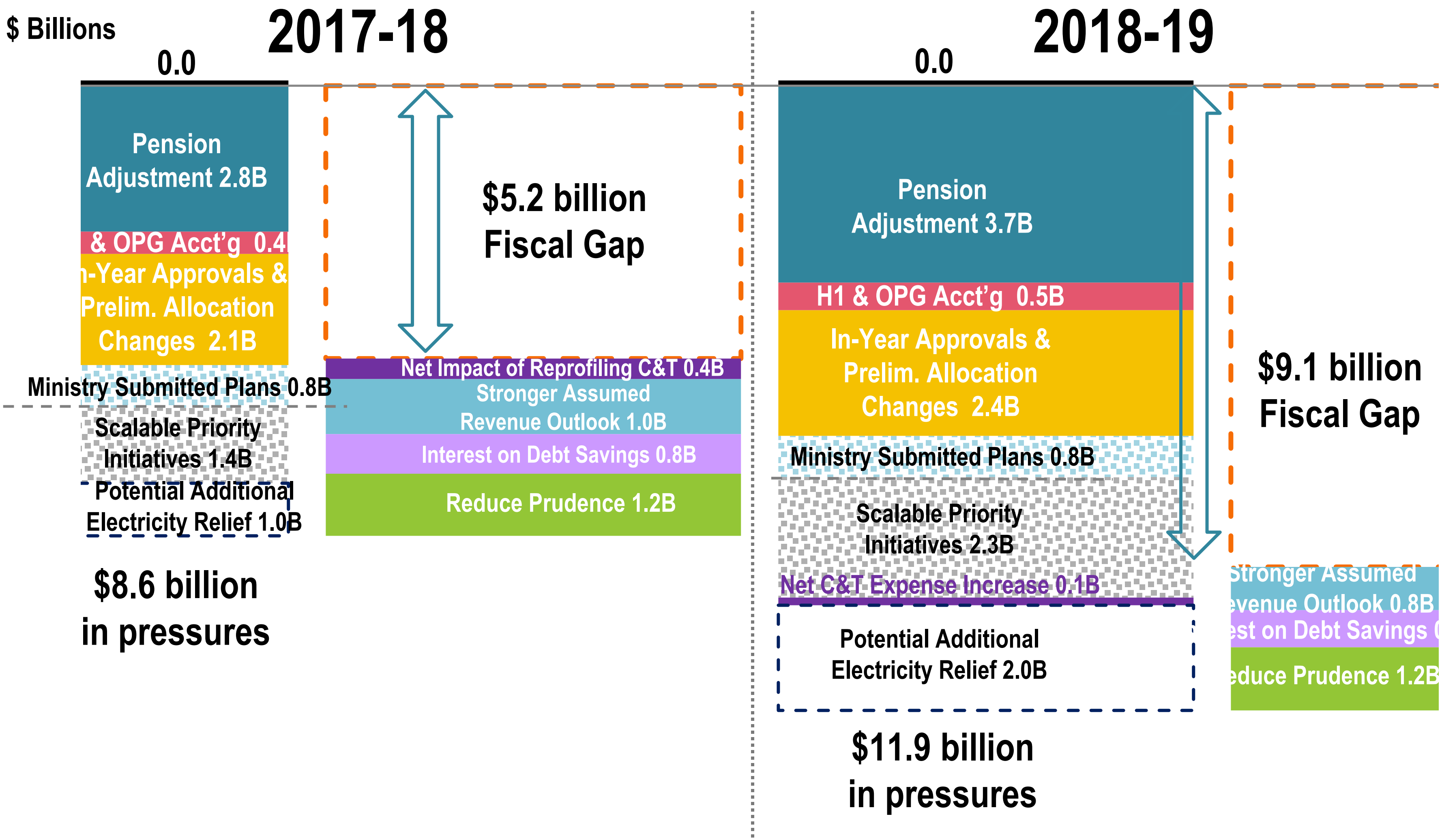
- In 2015-16, the Province consolidated H1 & OPG using US GAAP; differences between US GAAP and IFRS were immaterial.
- Public Sector Accounting Standards (PSAS) directs consolidation of these entities using IFRS; in 2016 Public Sector Accounting Board (PSAB) declined a request from the Province to expand the guidance to permit use of US GAAP for consolidation; AG agrees that IFRS is required for consolidation
- IFRS-US GAAP differences will become material as early as 2016-17, therefore continuing to consolidate using US GAAP is no longer appropriate
- Potential IFRS-US GAAP differences could increase materially if rate regulated accounting is rejected under IFRS (decision expected to take several years).

Note – The amounts presented for both issues are based on prior year/preliminary estimates – estimates will be updated by end of February. Other relevant accounting issues are outlined in the appendix.

Update on the Fiscal Challenge

In order to accommodate fiscal pressures in 2017-18 and 2018-19, tools were taken on in the 2016 FES and the 2016 Budget.

The remaining fiscal gap will need to be addressed through additional tools.



Other Factors That Could Further Impact the Gap

Revenue

- Revisions to economic outlook
- Potential revisions to cap-and-trade proceeds based on auction results in 2017.
- Adjustments to the government's asset optimization strategy
- Remaining 2015 CIT & PIT tax assessment information and ongoing tax receipts from provincially administered taxes
- PRRT updates (revised revenue outlooks from ministries, agencies and government business enterprises)
- Implications of Federal Budget

Expense

- 2017 Document initiatives
- Labour settlements
- Interest on debt forecast updates
- Alignment of climate change investments with available proceeds
- Impact of expense pressures that ministries have been asked to manage

<u>Accounting risks:</u>

- Treatment of Pension Assets (plus any valuation impacts)
- Further updates to accounting Framework for OPG and Hydro One (IFRS)

Prudence

- Build the reserve back up to mitigate adverse impacts to the fiscal plan
- Resetting the contingency funds to accommodate expense risks and pressures

Potential improvement to gap

Potential improvement or deterioration to gap

Potential deterioration to gap

Principles for Approaching Closing the Gap

- The government could adopt the following **principles when considering trade-offs and tools** to close the gap in the lead up to the 2017 Document:
  - Ensure the fiscal plan has a **credible plan to achieve balance:**
    - **Ensure sufficient prudence** is built into the fiscal plan to protect against unforeseen or unanticipated impacts and provide **flexibility to address risks.**
    - Identify a **clear process** by which **savings targets are achieved**.
    - **Manage any assertions that a reversal of the pension adjustment** should create even greater surplus/fiscal room for additional investments.
  - Adopt **a focused and targeted approach to funding priorities** so that any tools used to fund investments align with overall government policy.
  - Consider **strategic roll-out (e.g., backend loaded) and scaling** of priority investments and above allocation requests.

Potential Decisions to Achieve Fiscal Anchors

There are a number of revenue and expense measures that could be considered to achieve fiscal anchors.

Additional Revenue Measures	**Federal Revenue Strategy**

• Determine the scope for revenue tools, including:
  • Targeted Tax measures
  • Asset optimization (move final tranche from 2018-19 to 2017-18)
  • Non-tax revenue/use of C&T proceeds
  • Paralleling federal tax measures
	• Engagement strategy with the federal government to maximize new federal funding, including:
	  • Funding for climate change initiatives
	  × Infrastructure funding
	  • Health funding

Additional Expense Measures	**Review level of Prudence**

• Determine the scope for expense measures, including:
  • Undertaking additional transformative initiatives
  • Revisiting in year approvals
  • Timing/scaling mandate letter commitments and ministry requests
  • Additional savings targets
• Interest on Debt Savings
	• What is the appropriate level of the C-Fund and reserve that should be built into the fiscal plan?
	  × Further reductions to the reserve or C-Fund increase vulnerability to future forecast changes

× Measures have already been taken on. Achieving further fiscal effort from these measures will be challenging.

Illustrative Scenario to Balance With Other Investments

Excludes any additional factors that could impact the fiscal gap that would require additional tools to offset.

2017-18

$5.2 billion Fiscal Gap

0.0

Reduce Scalable Priorities 0.6B

Reduce PRRT Submissions 0.5B

Potential Additional Electricity Relief 1.0B

$8.6 billion in pressures

2018-19

$9.4 billion Fiscal Gap*

0.0

Reduce Scalable Priorities 1.1B

Reduce PRRT Submissions 0.3B

Potential Additional Electricity Relief 2.0B

$12.1 billion in pressures*

*Total pressures in 2018-19 increased from $11.9 billion to $12.1 billion due to the asset optimization tool assumed in 2017-18. This also results in an increased gap to fill from $9.1 billion to $9.4 billion.

Unfunded pressures

The following are unfunded initiatives. Adding any of these will require offsetting measures elsewhere (e.g., new revenues or cost savings):

- Design of further Electricity Price Mitigation (over and above HST rebate)
- Sharing additional gas tax revenues with municipalities
- Compensation agreements at a rate higher than 1.4% assumed in the fiscal plan (impact to be determined)
- Cost Matching for Phase 2 Federal Infrastructure Funding ($2.5B over four years)
- National Housing Strategy (Impact to be Determined)
- Health Sector Risks Above 3% Annual Growth (~$400M in 2017-18)
- Potential Indigenous Land Claim settlements (up to $80M in 2017-18)
- Resource Revenue Sharing ($70M annually starting in 2018-19)
- Shortfall in non-tax revenue as some ministries have requested fee reductions

Other outstanding items that could impact the fiscal plan include:

- School Board Enrolment Forecast
- Consolidations Forecast
- Health Capital

Summary of Key Decisions

- Current information suggests that **beating the government's $4.3 billion deficit target in 2016-17 is within reach** (including the reserve and pension asset).
- However, even if the pension adjustment is reversed, a smoothed approach to IFRS accounting is adopted and priority new investments are rolled-out strategically, **achieving balance in 2017-18 and beyond is not possible without new revenue measures and/or new spending constraint**

Potential Expense Tools

- **Limit funding** for ministry above-allocation PRRT requests
- **Focus new investments** on priority initiatives and consider **longer phase-in** options
- Implement additional transformation initiatives/a further **program review savings target**

Potential Revenue and Other Tools

- Increases to **tobacco, beer, and marijuana** tax revenue of up to $0.1 billion in 2017-18, and up to $0.2 billion by 2019-20*
- Increasing the **insurance premium tax** by 1 percentage point, which could generate up to $0.3 billion in 2017-18, and up to $0.4 billion by 2019-20
- Increase planned **education property tax** adjustment from 1% to 2%annually, which could generate up to $0.1 billion in 2017-18. If this was extended to 2019-20, it could generate up to $0.3 billion annually
- Use a greater proportion of **Cap and Trade proceeds** against in-plan GHG reduction expenditures

- While the above tools may be sufficient to balance in 2017-18, additional revenue tools will need to be considered to achieve balance in 2018-19 and beyond.

*Includes potential revenue associated with marijuana beginning in 2018-19.

Next Steps

- Develop approach for engagement with Auditor General regarding decisions of Province regarding key accounting issues (e.g., pensions, IFRS)
- Finalize approach to funding PRRT plans
- Develop and consider options and approaches to priority investments
- Continue to refine list of tools for consideration
- Next MM+P in February

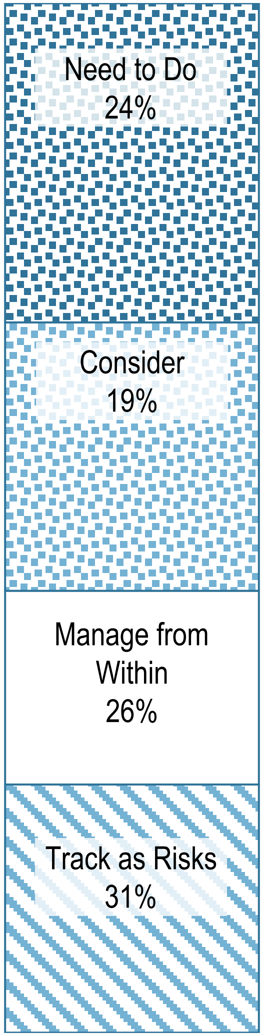
Appendix

Pressures: Ministry Submitted Plans

$ Millions	2017-18	2018-19	2019-20	2020-21
TOTAL FUZZY BLUE	**813**	**781**	**1,145**	**1,488**
Need to do items				
Health at 3%	-	242	570	927
MAG, MCSCS Annualize Justice & Corrections reforms	77	76	59	60
MCYS Child Welfare (Fetal Alcohol and legislative component)	17	16	23	42
MTO Presto funding for TTC	27	45	46	48
Capital Re-profiling (MTO Highway Expansion/Rehab, GO Transit, Municipal Projects)	112	52	10	(1)
Other changes (consolidations, re-profile operating)	(37)	(99)	(37)	(87)
Total Non-Discretionary Items	**196**	**328**	**671**	**989**
To Consider				
MOI Safe & Sustainable Buildings and demolition	45	48	34	37
MCSCS – Class Action Resource Team	16	16	11	11
MOECC initiatives (e.g. Great Lakes Science, Lab Relocations)	15	23	25	13
New Capital Requests (e.g., Halton Courthouse, Correctional Facilities)*	-	-	-	-
MNDM initiatives (e.g. ONTC)	16	17	20	21
Ministry capacity request (FTEs and associated funding)	57	58	50	45
Other changes	3	2	(29)	30
Total To Consider	**153**	**164**	**111**	**157**

*Requests with long-term fiscal obligations. Total project costs for the Halton Courthouse is $677M and the new correctional facilities is $2.7B

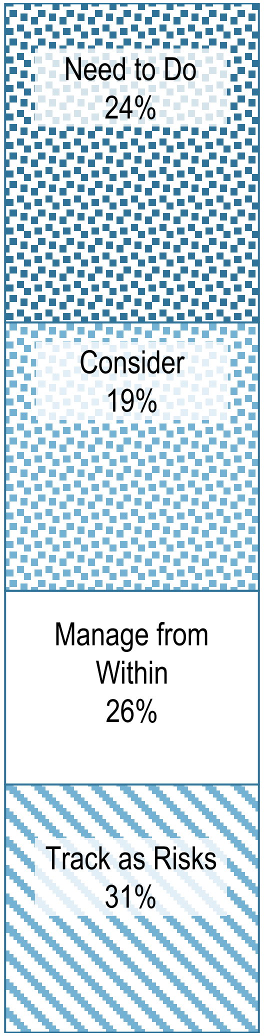
2017-18



Pressures: Ministry Submitted Plans

$ Millions	2017-18	2018-19	2019-20	2020-21
Manage from Within				
Requests for relief from boulder savings target	21	62	79	73
MEDG/MRIS pressures (e.g. Communitech, Social Enterprise Fund)	16	19	21	19
Clean Water and Wastewater Provincial contribution	135	-	-	-
Various small requests without offsets	40	38	45	32
Total Manage from Within	**212**	**119**	**145**	**124**
Track as risks				
8% Electricity Rebate forecast risk	94	96	196	196
Social Assistance forecast risk	145	52	-	-
MCYS and MCSS capital initiatives	14	22	22	22
Total Track as risks	**252**	**171**	**218**	**218**

2017-18



Pressures: Scalable Options

$ Millions	2017-18	2018-19	2019-20	2020-21
TOTAL SCALABLE OPTIONS (HIGH OPTION)	**1,385**	**2,243**	**2,931**	**3,405**
Fund Now				
Highly Skilled Workforce	232	281	313	323
Medium option (for discussion)	176	199	208	180
Youth Jobs Strategy	80	80	80	80
Low option	40	40	40	40
Child Care Expansion	232	421	610	799
Low option *(with assumptions for out-years)*	94	211	450	799
Black Youth Action Plan	6	19	19	19
Medium option	5	13	14	14
Transitioning Adults with Special Needs	66	82	91	103
Medium option	46	82	91	103
Advancing Transformation in Dev. Services	125	298	495	666
Low option (assumes policy review of program)	89	89	89	89
GO Transit Operating Subsidy	56	104	149	156
Low option	24	40	66	38
Going Global Export Strategy	14	13	22	22
Low option	9	11	16	16
Business Growth Initiative*	36	66	84	59
Low option	11	31	39	8
Retirement home sprinklers	15	22	4	-
Low option	7	10	3	-
Improving Refugee Outcomes	2	5	5	5
Fund for two years	2	5	-	-
Budget Talks	3	-	-	-
Fund at 100%	3	-	-	-
Total Fund Now	**867**	**1,391**	**1,873**	**2,232**
Total Fund Now	**506**	**730**	**1,016**	**1,316**

continued …

**The combined total of the Going Global, BGI and JPF requests is $60M in 2017-18, $89M in 2018-19, $117M in 2019-20 and $91M in 2020-21.*

Pressures: Scalable Options

$ Millions	2017-18	2018-19	2019-20	2020-21
Consider Funding				
Senior Comm. Grants/Elderly Person Centres	5	6	6	6
Low option	2	3	3	3
OSAP	64	76	80	85
Exempt RESPs, increase support for Indigenous learners	39	41	43	45
Income Security Reform	134	285	395	400
Low option (2% social assistance rate increase)	70	133	139	141
Basic Income	50	50	50	50
Low/Medium option	25	25	25	25
Additional Corrections Reform funding	47	143	155	155
Placeholder [more work required on staffing models]	32	72	76	76
Project Momentum*	89	90	77	58
placeholder in contingency fund	89	90	77	58
Total Consider Funding	**389**	**650**	**763**	**754**
Total Consider Funding	**258**	**373**	**371**	**357**
To Consider Not Funding				
Health at an additional 0.2% to total 3.2%	104	215	332	456
0.1% option	52	107	166	228
JPF Enhancement	10	10	10	10
Do not fund	-	-	-	-
Ontario Place	13	-	-	-
Do not fund	-	-	-	-
Ontario 150 – additional funding	50	25	-	-
Do not fund	-	-	-	-
Total Consider Not Funding	**177**	**250**	**342**	**466**
Total Consider Not Funding	**52**	**107**	**166**	**228**

continued …

Reflects profile for Honda ($8M in 2017-18, $10M in 2018-19, $10M in 2019-20 and $3M in 2020-21) as well as potential agreements for Ford and Toyota

Pressures: Scalable Options

$ Millions	2017-18	2018-19	2019-20	2020-21
Do Not Fund				
Serious Fraud Office	2	3	3	3
Do not fund	-	-	-	-
Total Do Not Fund	**2**	**3**	**3**	**3**
Total Do Not Fund	**-**	**-**	**-**	**-**
Total Scalable Options (High Option)	**1,435**	**2,293**	**2,981**	**3,455**
Scenario	**816**	**1,211**	**1,554**	**1,901**
Savings relative to High Options	***619***	***1,083***	***1,427***	***1,554***

Other Relevant Accounting Issues

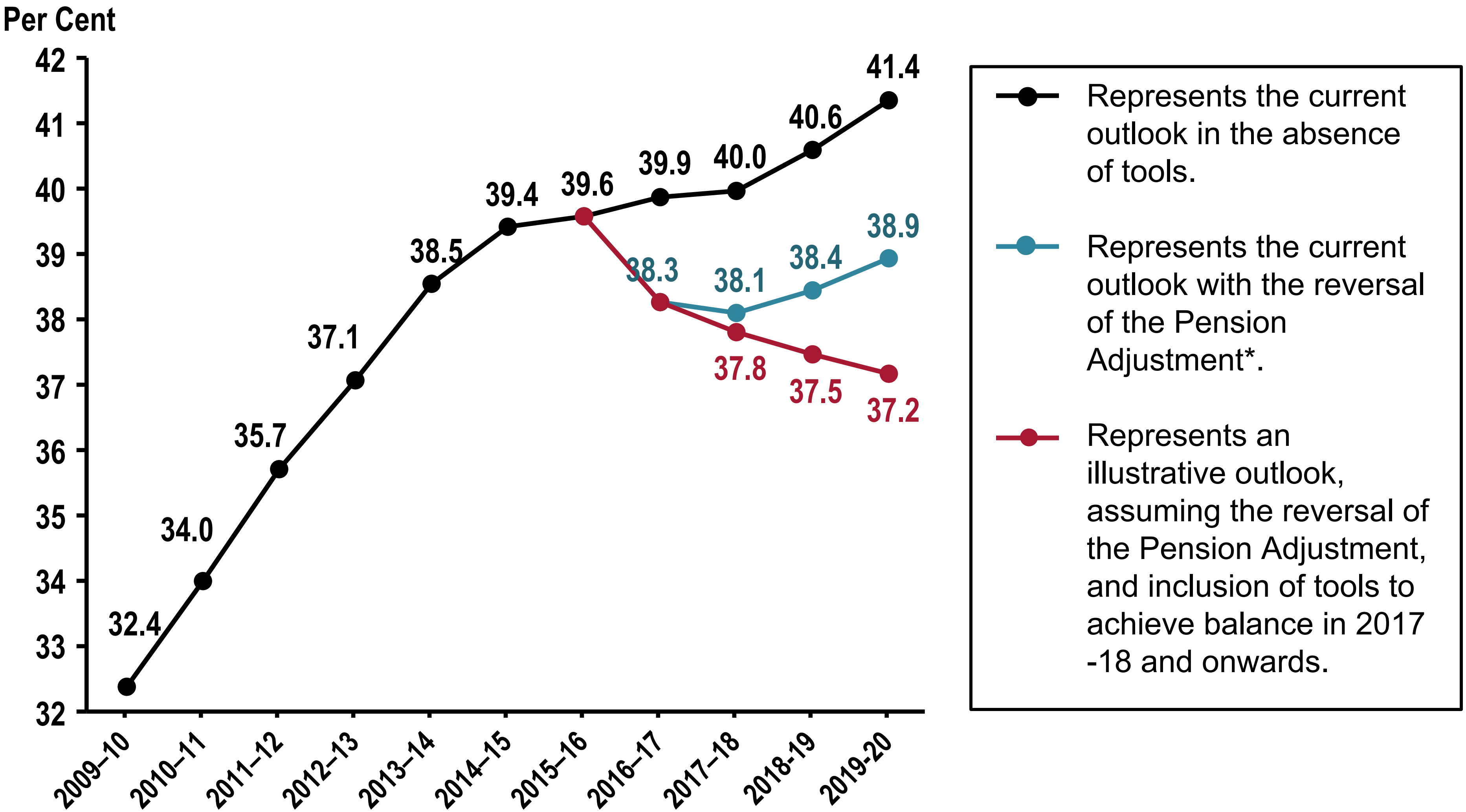
Other relevant accounting issues include:

- Accounting implications of Metrolinx agreement with the City of Toronto;
  - **Risk**: If control criteria not met for accounting purposes, the Province will have to write off capitalized costs (immediate expense impact), and future investments/transfers will be accounted for as expenses.
  - **Risk Mitigation**: working group formed to ensure binding agreement with City preserves accounting for assets by the Province

- Transfer payment expense recognition (timing).
  - **Risk**: Status of transfer payment agreements and timing of cash flows related to year-end TPs expected to impact timing of expense recognition, based on change in AG view on GIF TPs
  - **Risk Mitigation**: communication of change in AG interpretation to stakeholders

- Timing of cap & trade proceeds – previously discussed

Net Debt-to-GDP Scenarios



**Reflects the reversal of the Teachers Pension Plan and OPSEU Pension Plan adjustments, including reversal of the $10.5 billion debt adjustment made in the 2015-16 Public Accounts*