

Sector Overview: Fiscal Trends

Prepared for Cabinet Office

**Ministry of Finance, Treasury Board Secretariat
and the Ontario Financing Authority**

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INTRODUCTION

With a population of 14.2 million, Ontario is home to about 2 in 5 Canadians and generates approximately 39% of the national GDP. As of 2016-17, Ontario's fiscal plan was almost half the size of the federal fiscal plan (\$142 billion vs. \$311 billion in total expenses). It also comes close in size to the next two largest Canadian jurisdictions combined, Quebec (\$99 billion) and British Columbia (\$49 billion).

This report provides a snapshot of the current fiscal environment in Ontario, including the legislative framework governing fiscal planning; sources of government revenue and expense, historical trends and a discussion on fiscal sustainability.

SECTION 1: LEGISLATIVE FRAMEWORK

Ontario's fiscal decision-making and financial reporting framework is governed by two core pieces of legislation:

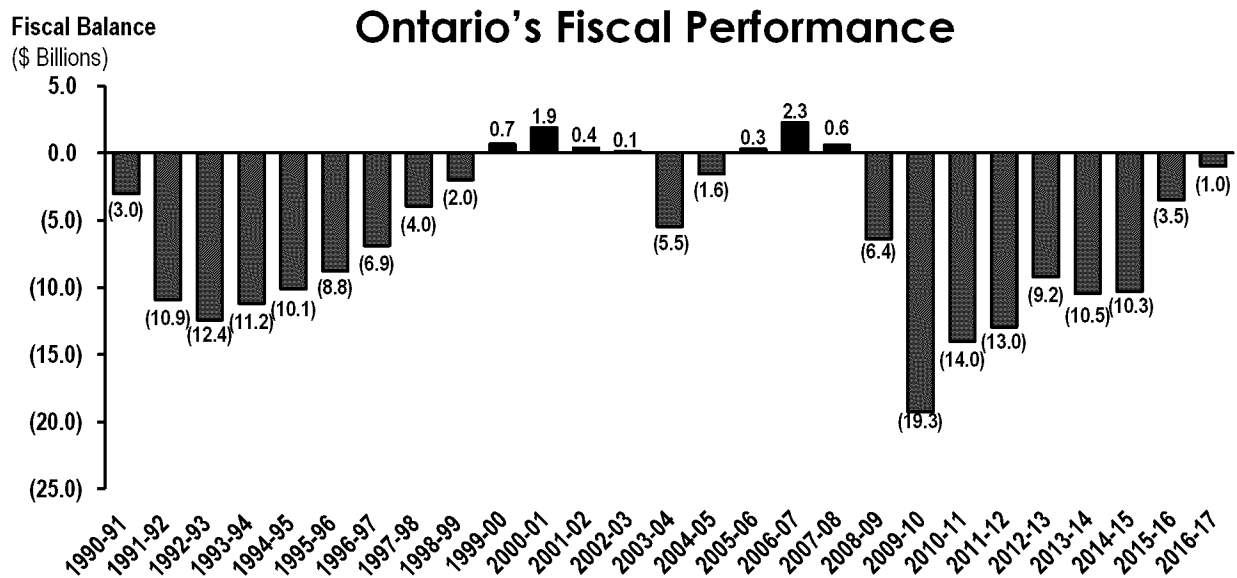
- *The Financial Administration Act (FAA)*: The FAA stipulates requirements for financial management, disbursement of public money, public debt and civil liability. It also outlines the roles and responsibilities of the Treasury Board/Management Board of Cabinet and Ministry of Finance.
- *The Fiscal Transparency and Accountability Act (FTAA)*: Enacted in 2004, the FTAA sets out the requirements for public reporting of the fiscal plan and provides guidelines for preparing the Budget, Quarterly Finances, Ontario Economic and Fiscal Review (mid-year review), Long-Term Report and Pre-Election Report.

SECTION 2: OVERVIEW OF THE FISCAL PLAN - KEY FACTS AND TRENDS

Historical Trends

Longer Term Trends: 1990-91 to 2016-17

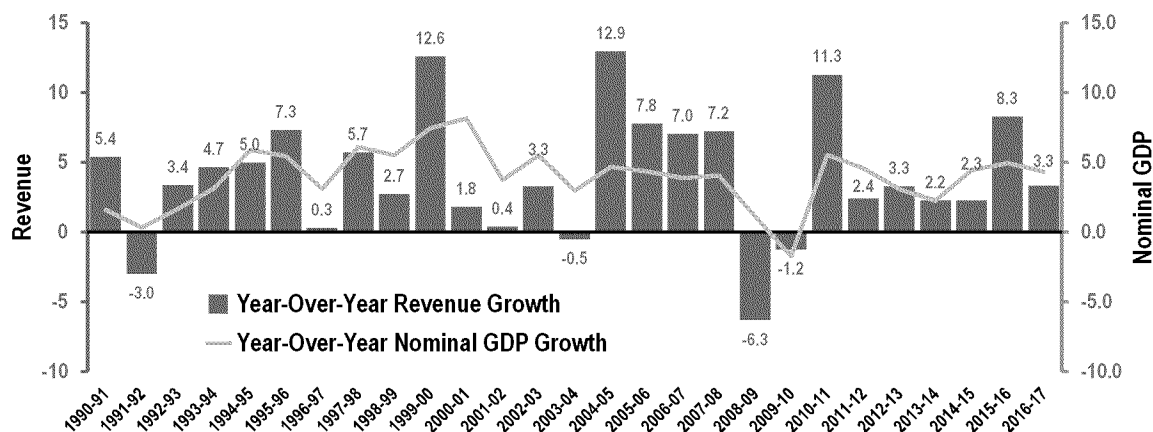
Since 1990-91, Ontario has been in deficit about three quarters of the time with cumulative deficits of \$164 billion and cumulative surpluses of \$6 billion.



Source: Ontario Ministry of Finance.

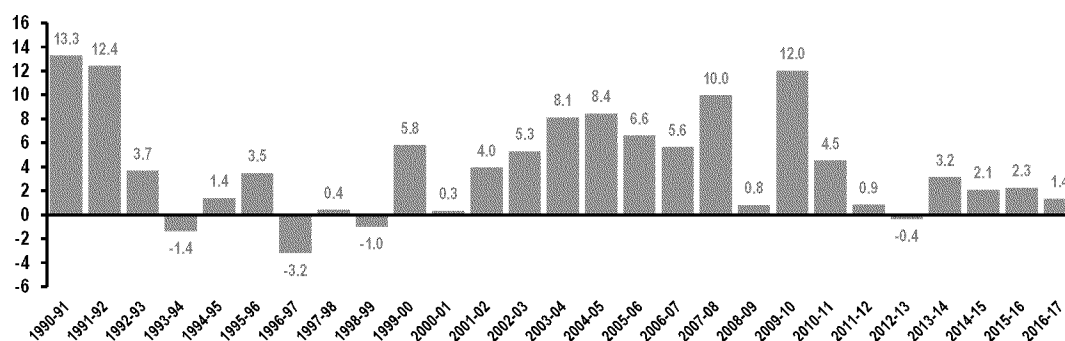
Average annual growth in revenue and program expense from 1990-91 to 2016-17 was 3.9 per cent and 3.7 per cent, respectively. Large variations in year-over-year revenue and program expense growth have been mainly due to recessions and recoveries.

Year-Over-Year Growth: Revenue and GDP



Note: Amounts have not been restated for BPS line-by-line consolidations.

Year-Over-Year Growth: Program Expense



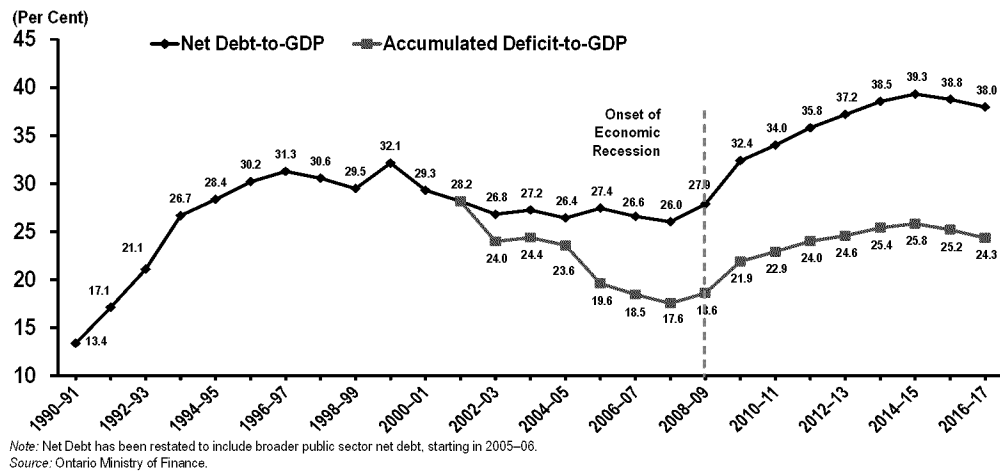
Note: Amounts have not been restated for BPS line-by-line consolidations.

Net debt is the difference between total liabilities and financial assets. Since the 1990's the net debt-to-GDP ratio has increased significantly on two occasions, both times as a result of a recessionary period. The first steep increase was in the early 1990's, the ratio then plateaued until the next recession hit in 2008-09.

Since peaking in 2014-15, the net debt-to-GDP ratio has been on a declining track as a

result of Ontario's economic growth and the government's progress towards a balanced budget.

Net Debt-to-GDP and Accumulated Deficit-to-GDP

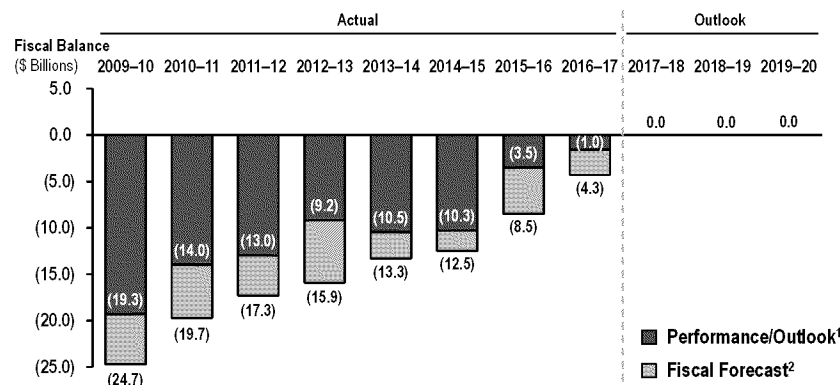


Recent Trends: 2008-09 to Present

In 2008-09, the global recession hit and the government ran deficits. During the recessionary period, real GDP in Ontario declined at a faster pace than in the rest of Canada causing significant declines in revenue, while the government increased spending through short-term stimulus investments, resulting in the deficit peaking at \$19.3 billion in 2009-10.

Under the FTAA, if the government plans for a deficit in a fiscal year it must also develop a recovery plan for achieving a balanced budget in the future. For example, in the 2010 Budget, the government made a decision to balance the budget by 2017-18 and has steadily reduced its deficits since then, with a deficit of \$1.0 billion recorded for the 2016-17 fiscal year.

Ontario's Return to Balance



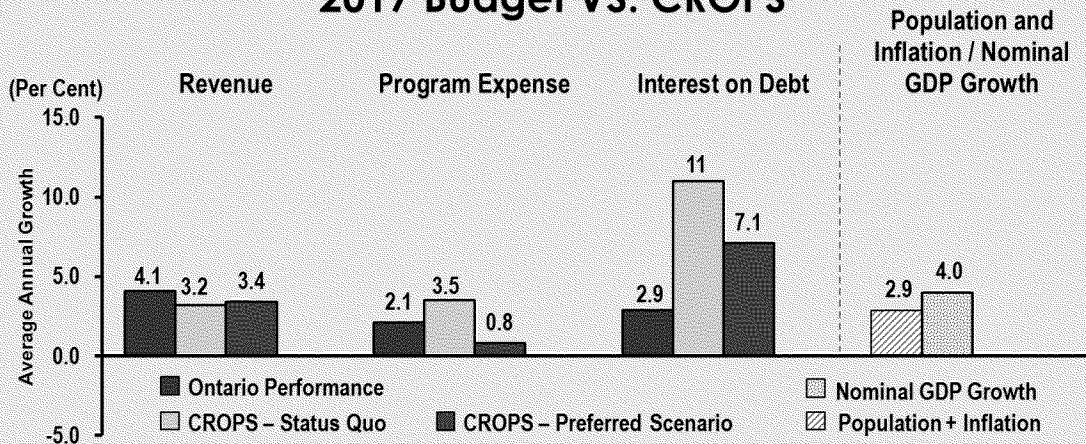
¹ Represents the 2017 Ontario Economic Outlook and Fiscal Review outlook for 2017-18 to 2019-20. For 2009-10 to 2016-17, actual results are presented.

² Forecast for 2009-10 is based on the 2009 Ontario Economic Outlook and Fiscal Review; forecasts for 2010-11 to 2013-14 are based on the 2010 Budget; forecast for 2014-15 is based on the 2014 Budget; forecast for 2015-16 is based on the 2015 Budget; and forecast for 2016-17 is based on the 2016 Budget.

OPTIONAL CONTENT:

In 2012, the government established the Commission on the Reform of Ontario's Public Services (CROPS - chaired by Don Drummond). The Commission's report had more than 360 recommendations and indicated that slowing the rate of growth in program spending to 0.8 per cent was essential to balance the budget by 2017-18. The report also projected that in the absence of measures to slow growth in spending, program expense would grow at an average annual rate of 3.5 per cent.

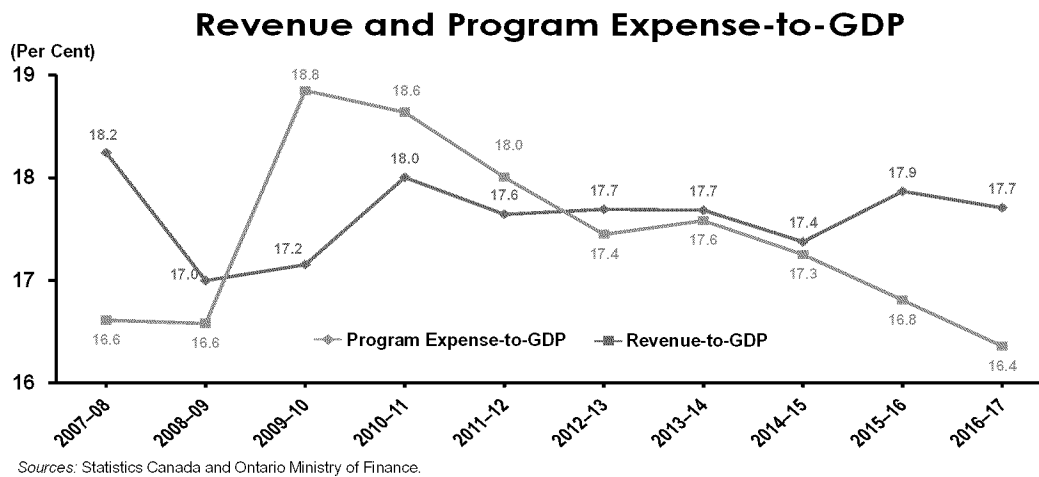
2010-11 to 2017-18 2017 Budget VS. CROPS



Note: Ontario amounts based on the published 2017 Budget, and are not restated for BPS line-by-line consolidations for comparability.
Source: Ontario Ministry of Finance.

The chart above compares the CROPS status quo projections and its "preferred" return to balance scenario, with Ontario's actual performance. From 2010-11 to 2017-18, the government constrained growth in program spending to 2.1 per cent, well below inflation and population growth through program efficiencies and compensation restraint. Stronger revenue growth and lower interest rates – resulting in lower interest on debt costs – over this period helped the government achieve its fiscal targets, while program spending grew at a faster rate than the Commission recommended.

Measuring fiscal performance relative to GDP allows for comparisons over time against the size of Ontario's economy. Efforts to manage growth in program spending have resulted in the program expense-to-GDP ratio declining to its pre-recession level. Over the past ten years, the share of revenue to GDP has been fairly stable, with revenues growing at a rate consistent with the capacity of the economy. This suggests that overall taxation has not become increasingly burdensome on the economy.



Details of Revenue

Key Drivers of Revenues Growth Over the Past 10 years

Taxation Revenue

Taxation revenues grew at an annual average rate of 2.9 per cent over the past ten years compared to nominal GDP growth of 3.6 per cent. Slow growth in taxation revenue over this period was largely due to the global recession. Excluding the recession from this period, taxation revenues grew an annual average of 5.4 per cent compared to nominal GDP growth of 4.2 per cent.

Government of Canada

Government of Canada transfers grew at an annual average rate of 5.7 per cent over the past ten years largely driven by higher transfers for major federal funding programs as well as funding for labour market programs, infrastructure projects, and direct transfers to the Broader Public Sector (e.g. hospitals, school boards and colleges).

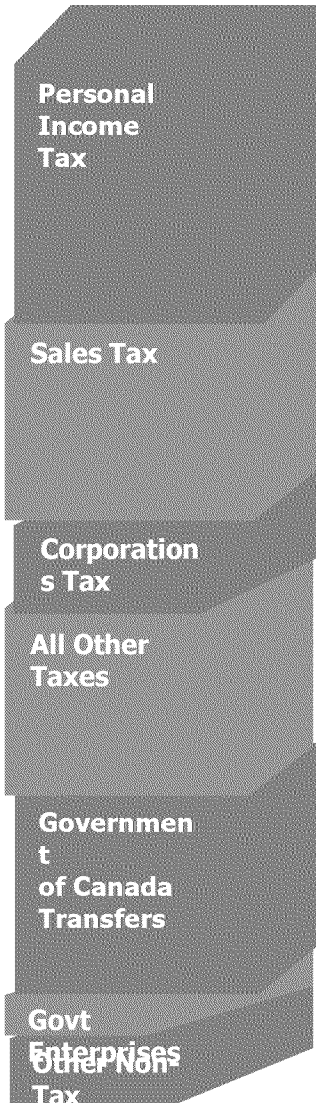
Income from Government Business Enterprises (GBEs)

Net income from GBEs grew at annual average rate of 2.9 percent over the past ten years mainly due to higher net income of Ontario Lottery and Gaming Corporation and the Liquor Control Board of Ontario, partially offset by lower net income of Hydro One.

Other Non-Tax Revenue (NTR)

Revenue from other NTR grew at an annual average rate of 2.0 per cent over the past ten years. This increase was driven by Ontario's asset optimization strategy, revenues from fees, licenses and permits including fees, donation and other revenues from the Broader Public Sector. Revenues from Ontario's initial five carbon allowance auctions will be booked in 2017-18 as other Non-Tax Revenue and are legislated to be spent on greenhouse gas reduction initiatives.

2016-17 Composition of Revenue



Personal Income Tax is income tax collected from individuals. Changes in the government's personal income tax revenue are mainly attributable to changes in employment and wages.

\$2,194 per capita | 22 per cent of total revenue

Sales Tax includes the provincial portion of the Harmonized Sales Tax and continuing Retail Sales Tax. Changes in the government's revenues from sales tax are mainly attributable to changes in consumer spending.

\$1,771 per capita | 18 per cent of total revenue

Corporations Tax includes revenue collected through corporate income taxes and the insurance premiums tax. Changes in the government's corporations tax revenue are mainly attributable to changes in corporate profits.

\$1,064 per capita | 11 per cent of total revenue

All Other Taxes includes taxes such as Education Property Tax, Ontario Health Premium, Employer Health Tax, Gasoline Tax, Land Transfer Tax and Tobacco Tax. Changes in these taxes come from a variety of sources including changes in the compensation of employees, nominal GDP and sales in the real estate market.

\$1,721 per capita | 17 per cent of total revenue

Government of Canada Transfers includes payments transferred from the federal government such as the Canada Health Transfer, the Canada Social Transfer, Equalization payments, transfers for infrastructure, labour market and various other programs.

\$1,756 per capita | 17 per cent of total revenue

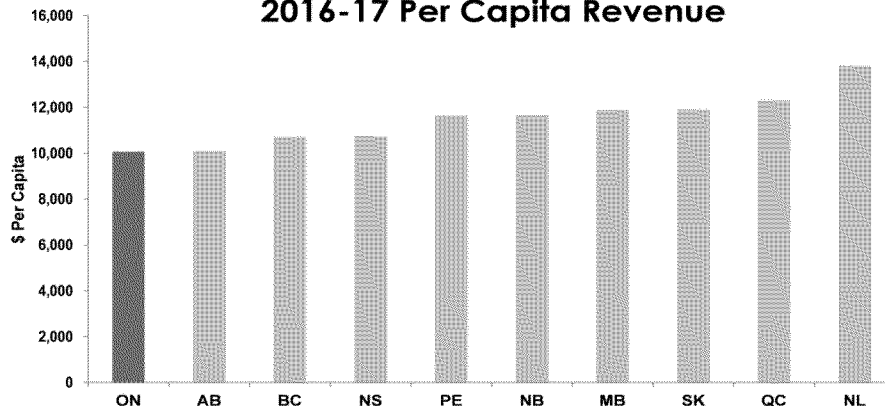
Government Business Enterprises revenue includes net income from crown corporations, mainly, the Ontario Lottery and Gaming Corporation, Liquor Control Board of Ontario, Ontario Power Generation and Hydro One.

\$398 per capita | 4 per cent of total revenue

Other Non-Tax Revenue includes carbon allowance proceeds, asset, sale or rental of Crown property, provincial fees, licences and permits etc.

\$1,165 per capita | 12 per cent of total revenue

2016-17 Per Capita Revenue



On a per-capita basis, revenues for the province were \$10,069 in 2016-17, the lowest of all other Canadian provinces.

Selected Economic and Revenue Risks and Sensitivities

While Ontario's revenue outlook is based on reasonable growth and economic assumptions, positive and negative risks remain.

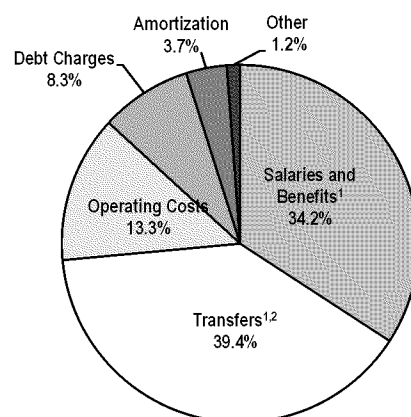
The following table highlights some of the key risks and sensitivities to the fiscal plan that could arise from unexpected changes in economic conditions. The risks included are those that could have the most material impact on Ontario's largest revenue sources.

Selected Economic and Revenue Risks and Sensitivities¹		
Economic Factors	Revenue Sources	2017-18 Sensitivities*
Nominal GDP	Total Taxation Revenue	\$690 million revenue change for each percentage point change in Nominal GDP Growth
Compensation of Employees	Personal Income Tax, Ontario Health Premium and Employer Health Tax	\$425 million revenue change for each percentage point change in growth in Compensation of Employees
Household Consumption Expenditures	Harmonized Sales Tax	\$190 million for each percentage point change in growth of Household Consumption Expenditures
Net Corporations Operating Surplus	Corporations Tax	\$145 million revenue change for each percentage point change in growth of Net Corporations Operating Surplus
Housing Resales and Resale Prices	Land Transfer Tax	\$26 million for each percentage point change in growth of either the number or prices of Housing Resales
*Can vary significantly, depending on composition and source of changes in the underlying economic driver. ¹ As published in the 2017 Budget (adjustments for line-by-line presentation may have marginal impacts on some of the sensitivities).		

Details of Expense

The government's total spending is made up of operating and capital expenses, and interest on debt. Operating costs pertain to service, supplies, non-depreciable equipment and other sundry expenses incurred in the year relating to direct delivery of services by the government. Salaries and benefits for provincial employees and organizations consolidated as part of the government's financial statements, including hospitals, school boards and colleges. Transfers include payments to a variety of non-consolidated service providers, such as universities and municipalities, to support their activities in supporting the delivery of public services on behalf of government, as well as transfers to support infrastructure investments. Capital expense also includes amortization expense of tangible capital assets owned by the Province and its consolidated organizations. Other expenses include various items, including losses on disposal of capital assets and loan forgiveness.

2016-17 Spending by Type of Expense (\$141.7 billion)



¹Compensation related costs for non-consolidated entities (e.g., municipalities, long-term care homes, universities) and payments to doctors for physician services are included in Transfers.

²Transfers includes operating and capital transfer payments to non-consolidated organizations

Note: Percentages may not add to 100 per cent due to rounding

Key Drivers of Total Expenses Growth Over the Past 10 Years

Health Sector

A number of key drivers have affected the demand for, and cost of, health care services over the years, such as demographics (population growth and aging), population health status, and technology.

Public expectations and societal influences are other factors that have affected demand for health care. Support for technologies that allow people to live more active lives may have driven up system costs, while the reduced social acceptability of smoking may have lowered costs.

Employment in this sector has seen regular consistent growth since the end of the 1990's, with salaries and wages accounting for 27 per cent of spending in 2016-17 (not including payments to doctors for physician services through OHIP).

From 2011-12 to 2016-17, Ontario's overall health care budget was held to an average annual growth rate of 2.3 per cent, down from an annual average of 6 per cent in the preceding decade, the lowest since 1997. This slowing of growth was driven by a shift towards care provided in the home and community while stabilizing the hospital system. Major cost drivers noted above, such as a growing and aging population, as well as increases in the cost of services due to inflation and compensation increases, will increase pressure on health care spending.

Education Sector

Enrolment in elementary and secondary schools has been declining recently as the large cohorts of the baby boom echo move out of this age group. Nevertheless, expansion of childcare and full-day junior kindergarten has also driven growth in this sector.

Salaries and wages account for 66 per cent of spending in the education sector. Compensation of public sector workers in the education sector saw modest increases during the 1990s, before increasing rapidly after 2005.

Post-Secondary Sector

Post-secondary institutions have seen increases in enrolment since 2000, in part because of demographics, but also as a result of a government-led strategy aimed at raising Ontario's post-secondary attainment rate.

Salaries and wages account for 22 per cent of spending in the post-secondary sector.

Children and Social Services Sector

Expenditures in this sector have been driven mainly by economic conditions (in particular labour market conditions) and social and demographic factors. For example, during the 2008-09 recession, people who became unemployed required increased financial supports and other services. Other factors, such as increased diagnosis of mental illness, have driven the demand for social programs that support Ontarians with disabilities. As committed in 2008, the province will have uploaded the cost of all social assistance benefits by January 2018, as part of the Provincial-Municipal Fiscal and Service Delivery Review. Municipalities continue to play a key role in delivering Ontario Works (OW) in their communities and share the OW administration costs with the Province.

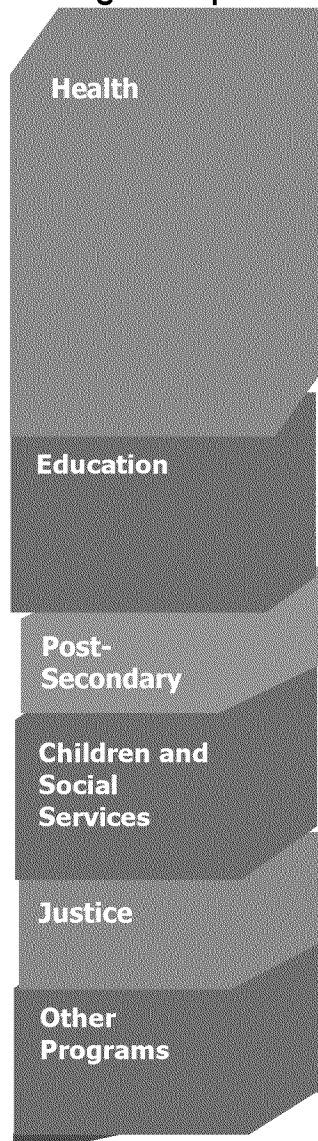
95 per cent of expense in this sector can be accounted for as transfer payments to non-consolidated entities that deliver services on behalf of the government, including salaries and benefits for employees of these service providers.

Other Government Expenses

This sector includes investments in economic development, transportation, transit, justice, environment and natural resources and other government programs. Some of these programs were demand driven, whereas others have been mandated by statutory or regulatory requirements. Demographic changes and the performance of the Ontario economy have continued to be key drivers of demand for government programs. Ontario's recently established Greenhouse Gas Investment Plan – designed to spend carbon allowance proceeds on greenhouse gas reduction initiatives – will also drive growth in this sector.

Salaries and wages account for 24 per cent of spending in the other government expenses sector.

2016-17 Composition of Program Expense



Health Sector programs include payments to physicians, the operation of hospitals, provincial drug programs and funding for long-term care homes. Government spending in this sector is driven by increased demand for spending on hospitals and drug programs.

\$4,005 per capita | 43 per cent of program expense

Education Sector expense primarily consists of funding for Ontario's publicly funded elementary and secondary schools, including full-day kindergarten. Changes in program expense in the education sector are mainly driven by changes in enrolment rates in elementary and secondary schools.

\$1,902 per capita | 20 per cent of program expense

Post-Secondary Sector expense includes support for Ontario's public universities and colleges, student financial assistance and employment and training programs. Changes in program expense in the post-secondary sector are mainly attributable to changes in post-secondary enrollment.

\$725 per capita | 8 per cent of program expense

Children and Social Services Sector programs include payments through Ontario Works, the Ontario Disability Support Program, Child Protection Services, Developmental Services and the Ontario Child Benefit. Changes in program expense in the children and social services sector are mainly due to changes in the case load of the Ontario Works and Ontario Disability Support programs.

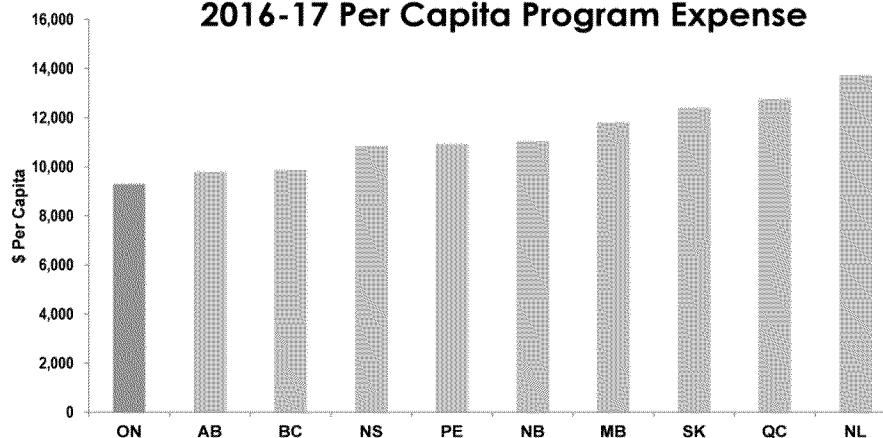
\$1,150 per capita | 12 per cent of program expense

Justice Sector programs include various expenses such as criminal, civil and family court services, justice sector agencies (e.g. Legal Aid Ontario), the operation of provincial correctional facilities, funding for the Ontario Provincial Police and community safety initiatives. Changes in the program expense of the justice sector are driven by changes in the complexity of cases and demand for legal services.

Other Programs Sector include agriculture programs, various funding to municipalities, environmental programs, funding for natural resources and northern development, along with transportation programs such as the maintenance of provincial highways and support for public transit.

\$1,191 per capita | 13 per cent of program expense

2016-17 Per Capita Program Expense



On a per-capita basis, program expense for the province was \$9,303 in 2016-17, the lowest of all other Canadian provinces.

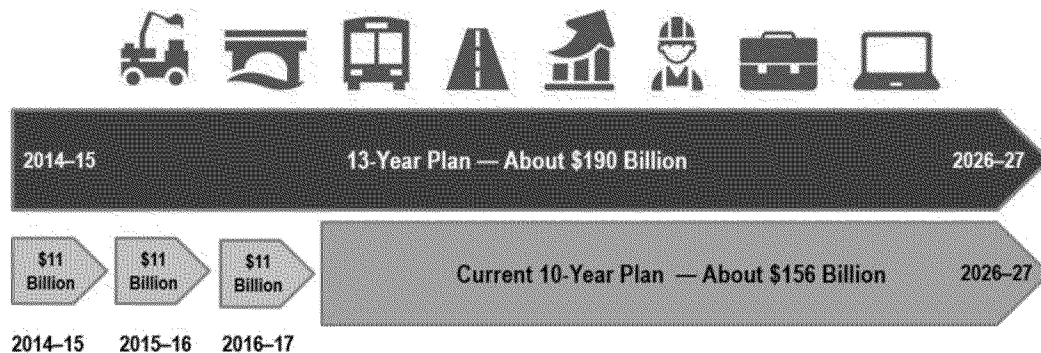
Selected Expense Sensitivities

The following table provides a summary of key expense risks and sensitivities that could result from unexpected changes in economic conditions and program demands.

Selected Expense Sensitivities¹		
Program/Sector	2017-18 Assumptions	2017-18 Sensitivities
Health Sector	Average annual growth of 3.3 per cent	One per cent change in health spending: \$538 million
Hospitals Sector Expense	Annual growth of 3.1 per cent	One per cent change in hospitals sector expense: \$237 million
Drug Programs	Annual growth of 8.4 per cent	One per cent change in program expenditure of drug programs: \$42 million
Long-Term Care Homes	78,229 long-term care home beds. Average Provincial annual operating cost per bed in a long-term care home: \$52,861	One per cent change in number of beds: approximately \$41 million
Home Care	Approximately 29 million hours of personal support services Approximately 8.7 million nursing and therapy visits and 2.1 million nursing shifts	One per cent change in hours of personal support services: approximately \$9.7 million One per cent change in all nursing and therapy visits: approximately \$8.4 million
Elementary and Secondary Schools	Approximately 1,969,000 average daily pupil enrolment	One per cent enrolment change: approximately \$165 million
Ontario Works	248,877 average annual caseload	One per cent caseload change: \$27 million
Ontario Disability Support Program	358,079 average annual caseload	One per cent caseload change: \$51 million
Interest on Debt	Average cost of 10-year borrowing in 2017-18 forecast to be approximately 3.0 per cent	The impact of a 100 basis-point change in borrowing rates is forecast to be approximately \$300 million
¹ As published in the 2017 Budget. Adjustments for line-by-line presentation may have marginal impacts on some of the sensitivities.		

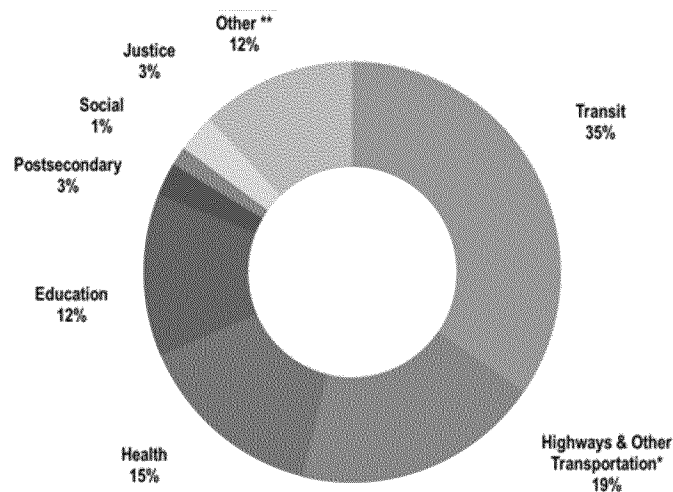
Capital Commitments

Ontario's public infrastructure portfolio is funded by various levels of government. The government develops its long-term capital plan over a 10-year period, as mandated by the *Infrastructure for Jobs and Prosperity Act, 2015*.



Capital spending has been taking place and projected to take place primarily in the Transit, Highways, Health and Education sectors respectively.

The following pie chart provides a high level sectoral breakdown of the 13-year capital plan, on an expenditure basis, starting in 2014-15 and totaling about \$190B:



*Other transportation includes highway planning activities, property acquisition and other infrastructure programs.

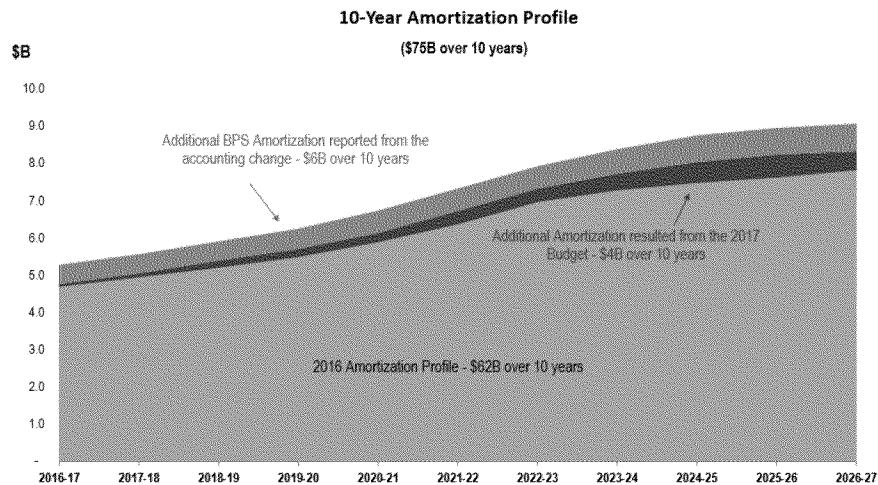
**Other sector includes government administration, natural resources, culture and tourism sectors.

Note: Figures exclude third-party investments in hospitals, colleges and schools

A study by the Centre for Spatial Economics found that over the long-term, real GDP in Ontario rises up to \$6 on average per dollar of public infrastructure spending.

Accordingly, infrastructure investments reflect the amount of activity the economy feels.

However, these capital commitments will have a deferred fiscal impact (amortization) over the useful life of acquired assets. As new projects come into service, they contribute to the growth in amortization. The Amortization profile is \$75 billion over the next 10 years.



Federal Funding

Major Federal Transfers: Unconditional Block Transfers (2016-17 share)

Canada Health Transfer (CHT)

CHT is the largest federal transfer. It is largely an unconditional block transfer allocated to provinces and territories on an equal per capita basis to help fund the costs of provincial and territorial health care. Since 2005-06, total national CHT funding grew at 6 per cent per year, however, beginning in 2017-18, growth in CHT funding moved to an escalator based on a three-year moving average of national nominal GDP growth, with funding guaranteed to increase by at least 3 per cent per year.

\$13.9 billion | 57 per cent of the total revenues from the federal government

Beginning in 2017-18, the Government of Canada will provide additional, time-limited health funding outside of the CHT, which will be targeted towards home care services and mental health services. Ontario will receive \$4.2 billion over 10 years.

Canada Social Transfer (CST)

CST is a federal block transfer that grows at 3 per cent per year, allocated to provinces and territories on an equal per capita basis. It supports provincial and territorial expenditure on post-secondary education, social assistance and social services, including early childhood development, and early learning and child care services.

\$5.1 billion | 21 per cent of the total revenues from the federal government

Equalization

Equalization is the Government of Canada's transfer program for addressing fiscal disparities between provinces. The purpose of the program is entrenched in the Constitution Act, 1982. Ontario has qualified for Equalization payments since 2009-10.

\$2.3 billion | 9 per cent of the total revenues from the federal government

Specific Purpose and Conditional Transfers

The federal government funds a number of joint programs operated by provincial governments, usually according to federal guidelines and standards. In return, the federal government provides funding that covers a portion of provincial costs.

Labour Market Transfers Agreements (LMTAs)

Under the LMTAs the federal government provides Ontario with funding for employment and skills training programs and services. Historically providing over \$900 million annually, Ontario uses these federal funding to cover over 70 per cent of its expenditures on skills and training programming.

Early Learning and Childcare (ELCC)

The ELCC transfer provides support for early learning and child care including investments in regulated early learning and child care programs and services for children under age six. The Canada-Ontario ELCC Agreement allocates \$439 million over the next three years.

Infrastructure Funding

Infrastructure funding to Ontario supports the construction, renewal, improvement and expansion of the Province's physical capital. In the 2016, the federal government introduced an infrastructure funding plan that was to be implemented in two phases.

The Phase 1 infrastructure funding agreements includes Public Transit Infrastructure Fund; Clean Water Wastewater Fund; Social Infrastructure Fund; and Post-Secondary Strategic Investment Fund.

The Phase 2 funding commits \$81.2 billion over 11 years, beginning 2017-18 nationally where \$33 billion will be allocated to provinces and territories to support five key areas: Public transit; Rural and northern communities; Green infrastructure (includes the Canada Infrastructure Bank); Trade and transportation; and Social infrastructure (which includes community, culture and recreation bilateral agreement, the National Housing Strategy and the ELCC).

Housing

Currently, Ontario receives federal funding for housing largely through two main transfers: (1) The **Social Housing Agreement** transferred administration and responsibility of the previously federally administered social housing to Ontario and funding currently supports operating costs related to existing social housing stock; and (2) The **Investment in Affordable Housing** provides funding for capital related investments, and funding is provided to each province on an equal cost-matching basis.

Recently the federal government has announced a new National Housing Strategy that proposes to build on the Social Housing Agreement, and replace the Investment in Affordable Housing agreements, in addition to a number of federal direct investments.

Low Carbon Economy Fund (LCEF)

Starting in 2017-18, a new \$2 billion Low Carbon Economy Fund over 5 years will be delivered in two parts: (1) a '**leadership**' fund of \$1.4 billion nationally to support new or expanded provincial projects that materially lower greenhouse gas (GHG) emissions where Ontario's share of this funding is \$420 million, with an Ontario cost-share of \$420 million required; and (2) a '**challenge**' fund of \$600 million nationally, where Ontario's eligibility for funding is unknown at this point and is based on projects submitted by Ontario which are currently under review.

Key Characteristics of the Fiscal Plan

Cautious Planning Assumptions

Ontario's revenue outlook is based on reasonable assumptions about the pace and composition of growth in Ontario's economy. The Ministry of Finance consults with

private-sector economists and tracks their forecasts to inform its planning assumptions.

The Ministry of Finance real GDP forecast – a key driver of the revenue forecast – is pegged one-tenth of a percentage point below the private sector average.

The expense outlook is based on detailed ministry-submitted business plans that take into account demand for existing programs, which are then reviewed through the government's annual planning process.

Interest on debt is forecasted based on a debt management strategy that accounts for a potential rise in interest rates.

Prudence

The reserve and contingency funds are included in the fiscal plan to help the Province meet its fiscal targets.

- Reserve: the FTAA, requires Ontario's fiscal plan to incorporate a reserve to protect the fiscal outlook against adverse changes in the Province's revenue and expense. Since the requirement was introduced in 2004, the reserve published in the Budget has averaged \$0.9 billion in the plan year and \$1.2 billion in the two out years.
- Contingency Funds: help to offset new expenses that would otherwise impact Ontario's fiscal performance. The fiscal plan has both a capital and operating contingency fund.

Accounting Standards

The government prepares its financial statements in accordance with the accounting standards issued by the Public Sector Accounting Board (PSAB).

In the Public Accounts, the government reflects the assets, liabilities, revenues and expenses of all of the entities which it controls for accounting purposes. Through its consolidation of these organizations, the amounts reported as transfer payments to these entities are eliminated and the actual expenses of these entities are reported as provincial expenses. Such organizations include hospitals, colleges and school boards, as well as crown agencies and other organizations that have balances significant enough to meet the Province's threshold of materiality.

As of the 2016-17 Public Accounts, a line-by-line presentation of the annual operating results for hospitals, school boards and colleges on the Statement of Operations was introduced. This recent change increases transparency and is consistent with PSAB

standards and reporting practices of other Canadian governments. While this shift in presentation increases both revenues and expenses, it does not affect the annual deficit, net debt or accumulated deficit.

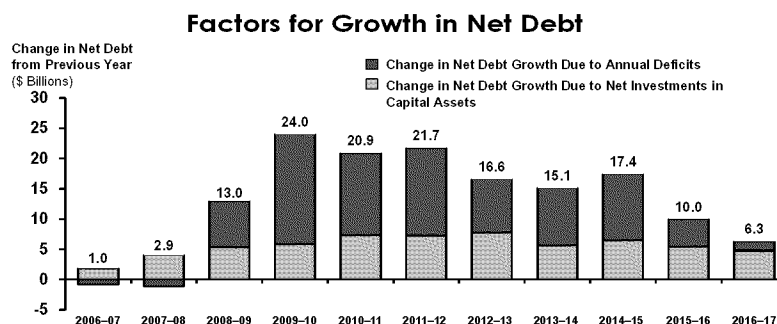
All other transfer payments to non-consolidated entities, such as municipalities and universities, as well as other government direct spending (e.g. salaries and benefits) are reported in the financial statements on an accrual basis of accounting under public sector accounting standards.

Debt

Debt Profile and Financing

The government conducts its borrowing program with the objectives of minimizing interest on debt costs and providing the necessary funding for strategic investments that contribute to economic growth.

Even during years of fiscal balance or surplus, the government has continued to borrow, as is illustrated by the chart below. From 2005-06 to 2007-08, the province's books were either balanced or in surplus, yet the government continued to borrow for investments in capital assets.



Source: Ontario Financing Authority.

About 62 per cent of the increase in net debt from 2008-09 to 2016-17 was due to the deficit. The remaining net debt increase was a result of investments in capital assets such as roads, bridges hospitals and schools which are considered to be a key contributor to economic growth. While infrastructure investments result in an immediate increase to Net Debt, this expense is amortized, resulting in pressure on the government's fiscal plan over the amortization period.

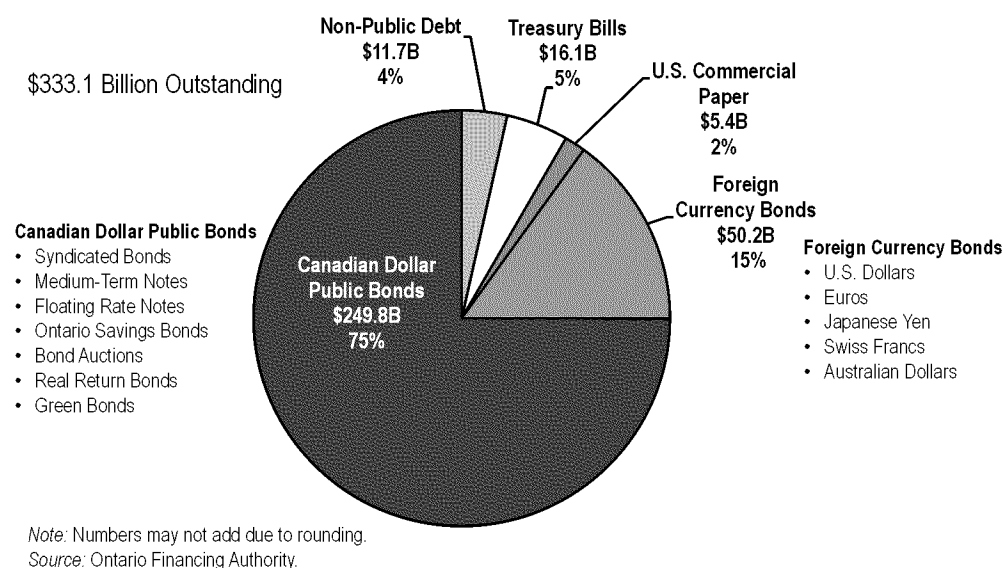
Total Debt Composition

Total debt consists of bonds issued in the public capital markets, non-public debt, treasury bills and U.S. commercial paper. Total debt, which represents all borrowing without offsetting financial assets, was \$333.1 billion as of March 31, 2017.

Public debt, as of March 31, 2017, was \$321.4 billion, primarily consisting of bonds issued in the domestic and international public markets in six currencies. Ontario also has \$11.7 billion outstanding in non-public debt issued in Canadian dollars. Non-public debt consists of debt instruments issued mainly to the Canada Pension Plan Investment Board. This debt is not marketable and cannot be traded.

Canadian-dollar denominated debt represents 84 per cent of the total debt projected as of March 31, 2017.

Total Debt Composition as of March 31, 2017

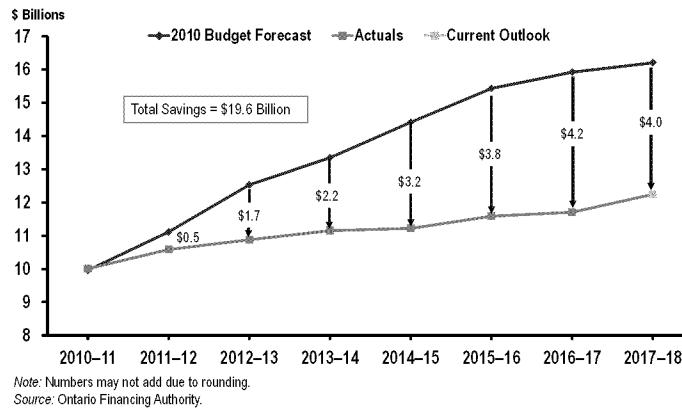


Cost of Debt

Over the past ten years, interest on debt expense has increased at an average annual rate of 2.5% and totalled \$11.7 billion in 2016-17.

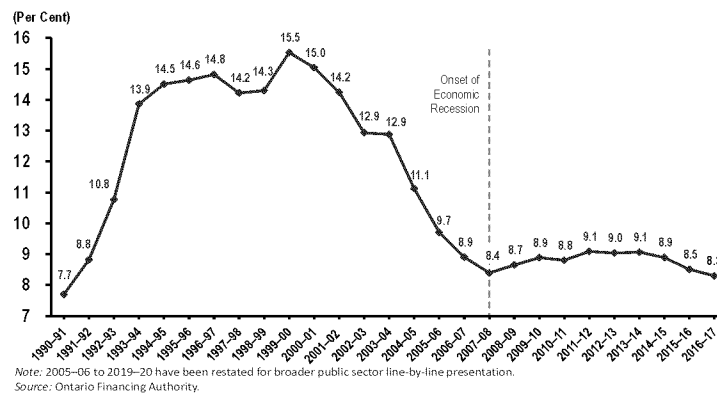
Between 2010 and 2017 a combination of lower deficits and borrowing requirements, and lower-than-forecast interest rates led to significant interest on debt savings – specifically \$19.6 billion in additional savings relative to the 2010 Budget forecast.

Interest on Debt: Current Outlook vs Actual



Interest on debt-to-revenue is considered a key measure of affordability of debt. This ratio measures how many cents of every revenue dollar received goes toward paying interest. The ratio peaked in the late 1990's and as of 2016-17 it has declined to 8.3 cents in interest for every dollar of revenue.

Interest on Debt-to-Revenue Ratio



The global decline in interest rates over the last 25 years cannot continue indefinitely. To protect the province from an increase in interest rates, the government has continued to extend the term of its debt. Going back to the beginning of the 2010-11 fiscal year, Ontario has issued \$68.6 billion of bonds longer than 30 years to lock in low rates.

As a result, the weighted-average term to maturity of long-term provincial debt issued

has been extended significantly, from 8.6 years in 2008-09 to 13.9 years in 2016-17 and 12.8 years for 2017-18 as of October 31. As interest rates begin to rise, the Province will

assess whether it remains cost-effective over the long term to continue to extend the term of its debt.

Credit Rating

Credit ratings express an agency's opinion about the ability and willingness of an issuer to meet its financial obligations in full and on time. Ontario's debt is rated by four credit rating agencies, which typically publish an annual update of their view on the credit worthiness of the Province's debt based on the budget and other financial statements.

Rating agencies have confirmed Ontario's long-term credit ratings and the outlook is stable. The rating agencies have noted that risks to Ontario's credit rating include: after-capital deficits; high debt burden; elevated household debt; correction in housing prices; higher-than-expected rise in interest rates; and, whether the debt issued under the government's plan to reduce electricity costs is self-supporting.

	Long-Term Rating	Most Recent Review
Moody's	Aa2	Confirmed August 8, 2017
DBRS	AA (low)	Confirmed June 28, 2017
Fitch	AA-	Confirmed June 20, 2017
S&P	A+	Confirmed June 15, 2017

Oversight of the Fiscal Plan

The government's fiscal performance is subject to independent review by two legislative officers:

The Financial Accountability Officer (FAO), was created in 2013 with a mandate to provide independent analysis of the Province's finances – including its Budget and FES – and respond to requests for analysis from committees or members of the Assembly related to provincial finances.

The Auditor General has a mandate to conduct value-for-money and financial audits of the government's ministries and agencies. The AG reports findings to the Legislature.

Recently, the AG has raised two issues with the Province's financial accounts:

- Accounting for assets of jointly sponsored pension plans: In Fall 2016, there was a dispute between the Province's professional accounting staff and the Auditor General's Office on the interpretation of public sector accounting standards with respect to the recognition of a proportionate share of assets of Ontario's jointly sponsored pension plans: the Ontario Teachers' Pension Plan (OTPP) and the Ontario Public Service Employees Union Pension Plan (OPSEUPP). An independent advisory panel concluded that both the OTPP and OPSEUPP should continue to be recognized as an asset in the Province's financial statements – which the government accepted. However, the Auditor General has continued to provide a qualified opinion of the Province's books based on this interpretation.

- In the 2016-17 Public Accounts, the Auditor General also raised concerns with respect to the proposed accounting presentation of the government's plan to reduce electricity costs. The government issues its financial statements in accordance with generally accepted accounting principles for government as issued by the Public Sector Accounting Board of CPA Canada. With the support of external advisors, it has been determined that the accounting presentation for the government's plan to reduce electricity costs, under the guidance provided for rate regulated entities under US GAAP, is appropriate under Canadian public sector accounting standards (PSAS). However, the Auditor General does not agree with the assessment that rate regulated accounting is allowed under PSAS, and has indicated that the application of rate regulated accounting will result in a material misstatement of the annual surplus/deficit and net debt in the government's financial statements. As a result, the Auditor General has indicated an audit qualification is highly likely on this matter.

SECTION 3: FISCAL SUSTAINABILITY

Fiscal Sustainability is the degree to which a government can maintain its existing financial obligations—its service commitments to the public and its financial commitments to creditors, employees and others—without increasing the debt or tax burden *relative to the economy in which it operates*.

Over the longer-term, Ontario's economy is expected to be affected largely by the province's aging population and advances in technology.

- Ontario's population is projected to continue to grow but at a moderating pace. With low fertility rates and an aging population, net migration is expected to become an important factor to sustaining population growth in the near future. Slower growth in the working-age population is also expected have a moderating effect on Ontario's economic growth.
- The fiscal outlook will face the largest pressure from increased demand for health care and education.
 - With the number of seniors in the province growing (from more than two million today to 4.5 million by 2040), the government's capacity to deliver health care services will place a burden on the government's fiscal plan.
 - According to a forecast by the Conference Board of Canada, provincial health care expenditures are projected to grow in line with the demands of an ageing population and inflation – at an average annual rate of 5.2 per cent per year out to 2035. The following breaks down health spending according to the baseline scenario of the Conference Board of Canada, from 2015 to 2035:

Conference Board Projections	%
Population growth	0.9
	2
Inflation in the health care sector	2.4
	3
Impact of populating aging	1.0
	1
Increased access to the system and continued improvements in the system	0.8
	4
Annual average growth	5.2

- Additional pressures from increased enrollment in elementary and secondary schools will begin to take place as children from the baby boom echo move out of this age group and are replaced by the children of younger families.
- Key external risks to Ontario's fiscal and economic outlook relate to uncertainty about U.S. economic policies, including restrictive changes to U.S. trade and immigration policy, and potential U.S. tax reforms. Domestically, high levels of household debt have left Ontario households sensitive to rising interest rates which would lead to slowing consumer spending and housing market sales.

A key sustainability indicator is the ratio of net debt to GDP. If net debt-to-GDP continuously rises, fiscal policy is not sustainable. Ontario has been in deficit in 40 of the last 50 years, as a result, Ontario's net debt has grown to \$301.6 billion as of 2016-17. The growth of Ontario's debt has exceeded growth in the economy - leading to increasing net-debt to GDP levels, which peaked in 2014-15.

The AG has noted that Ontario's fiscal plan will become less sustainable over the coming years, as a result of high debt and potentially increasing interest on debt charges, which it contends will hinder the government's ability to be flexible and respond to changing economic circumstances.

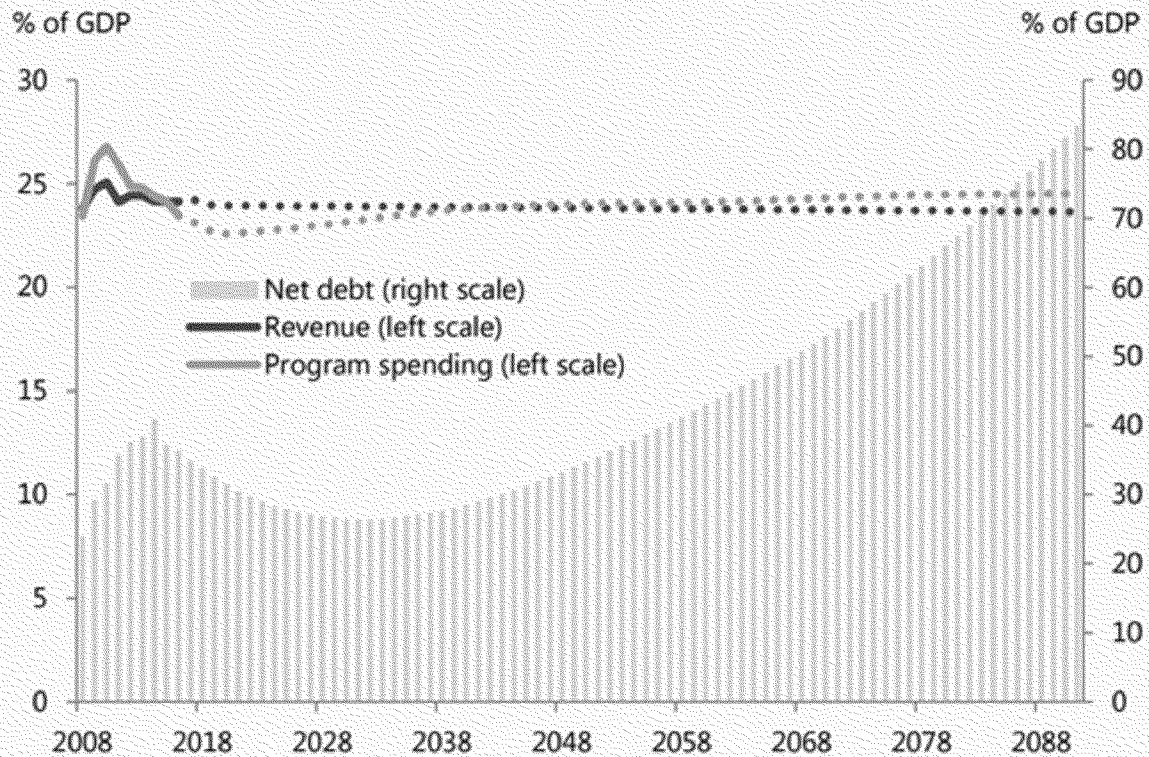
Similarly, the FAO noted in its 2017 Long-Term Budget Outlook Report that "if current trends in fiscal policies continue, demographic changes will combine to lower tax revenue growth and raise spending, leading to large and rising budget deficits." The FAO predicts that demographic pressures on the budget will intensify in the mid-2020's. The FAO cautions that higher debt, and thus higher interest on debt payments, could leave the Province with less fiscal flexibility, and decrease the Province's ability to use deficit spending to respond to unforeseen events, including recessions. The FAO recommends permanently raising revenue or lowering spending by at least 0.75 per cent of GDP, beginning in 2018-19, to avoid shifting the burden of stabilizing the province's finances to younger Ontarians.

The Parliamentary Budget Office's (PBO) 2017 Fiscal Sustainability Report includes a section on Ontario's fiscal sustainability. The PBO's assessment concludes that:

- Ontario's current fiscal policy is not sustainable over the long term.

- Achieving fiscal sustainability would require policy actions, such as permanent tax increases or spending reductions amounting to 0.4 per cent of provincial GDP (\$3.5 billion in current dollars).
- Health care spending is the key fiscal pressure.

Fiscal projection summary: Ontario



Sources: Statistics Canada and the Parliamentary Budget Officer.

Note: 2016 values are PBO estimates. The projection period covers 2017 to 2091.