Ontario's Energy Plan Projects Modest Fiscal Drag (March 3, 2017)

Credit Implications: Neutral

Credit Ratings: DBRS AA(Low), Moody's Aa2, S&P A+, Fitch AA-, All outlooks stable

Yesterday, the Province of Ontario unveiled its plan to reduce electricity costs for Ontarians. There are two principal aspects of the plan. The first one relates to subsidizing energy costs for vulnerable consumers and communities — a "social energy" policy aimed at low-income earners, rural communities, and First Nations' On-Reserve communities. The Province projects that this program will cost $2.5bln over three years or roughly $833mln dollars per year. This initiative will present a modest fiscal drag, but Ontario is firmly committed to achieving balance in Fiscal 2017/18 and will offset these additional costs through a combination of incremental revenues and/or cost savings.

The second aspect of the plan is confined to the Ontario electricity rate base and involves reducing electricity bills by decreasing the charges for the amortization of the capital costs incurred to upgrade and transform Ontario's electricity system. These costs addressed reliability as well as environmental objectives, including a shift in the fuel mix away from coal and towards clean energy sources. The reduction in costs for ratepayers will come from extending the amortization of these costs from 20 to 30 years. This aspect of the plan is fiscally neutral for the Province.

Province of Ontario: "Ontario is lowering electricity bills by 25 per cent for the typical residential customer and holding rate increases to the rate of inflation for four years."

Electricity Production

Ontario electricity production in 2005 and 2015		
Source	2005	2015
Nuclear	51%	58%
Natural Gas	8%	10%
Water	22%	23%
Solar/Wind/Bioenergy	<1%	9%
Coal	19%	0%

Includes electricity produced to meet Ontario demand, including embedded generation (which brings the total to 143 TWh in 2015), and exports (17 TWh in 2015).

Source: Ontario Ministry of Energy – Planning Ontario's Energy Future

Highlights:

- Between 2005 and 2015, Ontario invested more than $50bln in the electricity system, including $35bln in electricity generation to restore reliability, replace coal and meet environmental objectives. In 2015, generation accounted for 64% of total electricity system costs of $20bln.
- A significant portion of the clean power procurement initiatives supporting the system involved entering into 20-year power purchase agreements (PPAs) with independent power producers. As the purchase cost for the power under these arrangements was above the target threshold for electricity prices, a Global Adjustment that amortized these costs over the term of the contracts was created and a portion of this adjustment was financed upfront over the 20-year contract terms to reduce pressure on electricity rates. The amortization of the financed portion of the Global Adjustment (GA) is a pass-through cost to ratepayers. The Province now believes that, because the average life of these assets extends beyond

the contract terms, this cost could be refinanced and extended over a longer period of time (i.e. 30 years), thus further reducing costs to ratepayers.

- Under current forecasts, the Province projects that the immediate reduction in the GA (financed portion) would be about $2.5bln per year on average over the first ten years, inclusive of a maximum annual interest cost of $1.4bln. The Province believes that because future ratepayers will be able to benefit from these assets, it is a more equitable framework to spread these costs over a longer period of time rather than to front-load them to current ratepayers. Although extending the financing will increase total interest costs incurred, the Province believes that, in the later years, some system costs will be reduced due to continued operation of existing assets and, during this period, the incremental financing costs will be gradually recovered from ratepayers.
- Since 2010, the Province has been engaged in ongoing measures to bend the cost curve of Ontario's electricity system to reduce the pressure of rising electricity costs on ratepayers. To further this process, Ontario announced yesterday the establishment of a new Affordability Fund. The special purpose trust will be administered by crown-energy corporation, Ontario Power Generation Inc. (OPG) on behalf of the Province of Ontario and in conjunction with the Independent Electricity System Operator (IESO). The trust will raise funds in the debt and possibly equity markets. The proceeds will be invested….and (explain how it works to bend the cost curve)?
- More information on yesterday's announcement can be found on the Province of Ontario web-site. Click Here

For additional perspectives on Ontario, see Macro Strategy's Research Note "Talking Points on Ontario", January 27, 2017 Click Here

Maria Berlettano, CFA
416 594-8041
maria.berlettano@cibc.com
www.cibcmacro.com

Tom Bognar, CFA
416 956-6032
tom.bognar@cibc.com
www.cibcmacro.com