

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

If you no longer wish to receive these emails, please email us at unsubscribe-macro-strategy@cibc.com and request to be removed from this distribution list. Note that you will be permanently removed from the distribution list within 10 days of your request.

This communication, including any attachment(s), is confidential and has been prepared by the Macro Strategy Desk within the Global Markets group at CIBC Capital Markets.

CIBC World Markets Inc. is a legal entity name. CIBC Capital Markets is a trademark brand name under which different legal entities provide different services under this umbrella brand. Products and/or services offered through CIBC Capital Markets include products and/or services offered by the Canadian Imperial Bank of Commerce, the parent bank of CIBC World Markets Inc. and various other subsidiaries of the Canadian Imperial Bank of Commerce. Services offered by the Canadian Imperial Bank of Commerce include corporate lending services, foreign exchange, money market instruments, structured notes, interest rate products and commodities, equity options and OTC derivatives. Canadian exchange-traded equity options are executed through CIBC World Markets Inc. Equity and fixed income securities are executed through CIBC World Markets Inc. and other directly or indirectly held subsidiaries of CIBC.

The contents of this communication are based on macro and issuer-specific analysis, issuer news, market events and general institutional desk discussion. The author(s) of this communication is not a Research Analyst and this communication is not the product of any CIBC World Markets Inc. research department nor should it be construed as a research report. The author(s) of this communication is not a person or company with actual, implied or apparent authority to act on behalf of any issuer mentioned in the communication. The commentary and any attachments (other than any attached CIBC World Markets Inc. branded Research Reports) and opinions expressed herein are solely those of the individual author(s), except where the author expressly states them to be the opinions of CIBC World Markets Inc. The author(s) may provide short-term trading views or ideas on issuers, securities, commodities, currencies or other financial instruments but investors should not expect continuing analysis, views or discussion relating to the securities, securities, commodities, currencies or other financial instruments discussed herein. Any information provided herein is not intended to represent an adequate basis for investors to make an informed investment decision and is subject to change without notice. CIBC World Markets Inc. or its affiliates may engage in trading strategies or hold positions in the issuers, securities, commodities, currencies or other financial instruments discussed in this communication and may abandon such trading strategies or unwind such positions at any time without notice.

The contents of this message are tailored for particular client needs and accordingly, this message is intended for the specific recipient only. Any dissemination, re-distribution or other use of this message or the market commentary contained herein by any recipient is unauthorized. If you are not the intended recipient, please reply to this e-mail and delete this communication and any copies without forwarding them.

Distribution in Hong Kong: This communication has been approved and is issued in Hong Kong by Canadian Imperial Bank of Commerce, Hong Kong Branch, a registered institution under the Securities and Futures Ordinance (the “SFO”) to “professional investors” as defined in clauses (a) to (h) of the definition thereof set out in Schedule 1 of the SFO. Any recipient in Hong Kong who has any questions or requires further information on any matter arising from or relating to this communication should contact Canadian Imperial Bank of Commerce, Hong Kong Branch at Suite 3602, Cheung Kong Centre, 2 Queen’s Road Central, Hong Kong (telephone number: +852 2841 6111).

Distribution in Singapore: This communication is intended solely for distribution to accredited investors, expert investors and institutional investors (each, an “eligible recipients”). Eligible recipients should contact Danny Tan at Canadian Imperial Bank of Commerce, Singapore Branch at 16 Collyer Quay #04-02 Singapore 049318 (telephone number + 65-6423 3806) in respect of any matter arising from or in connection with this report.

Distribution in Japan: This communication is distributed in Japan by CIBC World Markets (Japan) Inc., a registered Type1 Financial Product Provider with the registration number Director General of Kanto Finance Bureau #218.

Distribution in Australia: Communications concerning derivatives and foreign exchange contracts are distributed in Australia to “professional investors” within the meaning of the Corporations Act 2001 by CIBC World Markets Inc. Communications concerning securities are distributed in Australia by CIBC Australia Ltd (License no. 240603; ACN 000 067 256) to CIBC Capital Markets clients.

CIBC World Markets Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. CIBC World Markets Corp. is a member of the Financial Industry Regulatory Authority. CIBC World Markets plc is regulated by the Prudential Regulation Authority and Financial Conduct Authority. CIBC World Markets Securities Ireland Limited is regulated by the Central Bank of Ireland. CIBC Australia Ltd is regulated by the Australia Securities and Investment Commission. CIBC World Markets (Japan) Inc. is a member of the Japanese Securities Dealer Association. Canadian Imperial Bank of Commerce, Hong Kong Branch, is a registered institution under the Securities and Futures Ordinance, Cap 571. Canadian Imperial Bank of Commerce, Singapore Branch, is an offshore bank licensed and regulated by the Monetary Authority of Singapore.

Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited and may result in prosecution.