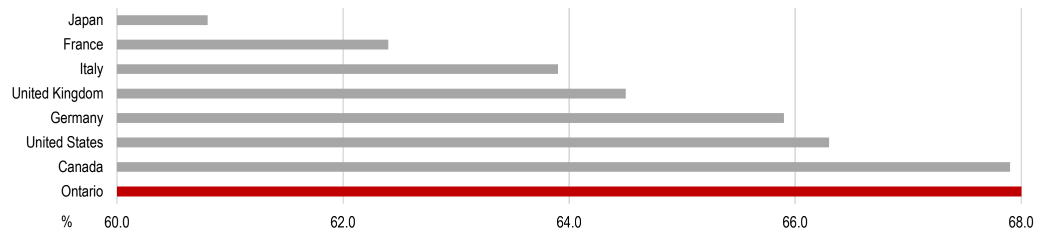
Ontario Talking Points (January 4, 2017)

Insights from our meeting last month with officials from the province.

- How is Ontario positioned with respect to the quality and rising cost of healthcare?
    - Ontario is building and/or upgrading 44 hospitals with state-of-the-art facilities.
    - As the population grows and ages, healthcare costs will rise, but the healthcare cost curve is flattening, which is consistent with the experience in advanced economies.
    - Ontario has been successful at containing health care expense growth at less than 5% annually over the past 6 years. In the last three years, the annual average increase was only 2.1%. In Fiscal 2015-16, health care expense growth was only 1.1% versus overall program spending growth of 4.2%. [Ontario 2015-16 Annual Report Click Here]
    - The aging population adds about 1% to annual expense growth.
    - Experience has shown that healthcare costs for individuals is the highest in the first two years and last two years of life.
    - While the population is aging and people are living longer, they are "healthier and wealthier". Moreover, since the 2006 amendment to the Ontario Human Rights Code which effectively eliminated the 65 mandatory retirement age, people are working and contributing longer to the economy. In 2006, the Ontario participation rate (55+) was **33.3%. In 2015, it was almost 38%.**
    - Ontario has the largest working-age (15-64) population share compared to the G7 countries and has enjoyed strong employment gains in above-average wage industries since the Global Recession.

Working Age (15-64) Population Share (G7 Countries, 2015)



Source: Statistics Canada and The World Bank

- What agreement does the province expect with the Federal government under the federal/provincial Health Accord?
    - We don't expect to get back to when the federal government paid for around 50% of provincial health spending. The federal share of health funding is currently between 20-25%.
    - The minimum escalator is set to drop to 3% in 2017 from 6% previously, and this is not acceptable.
    - Background Note: At the December "health talk" meetings between the Federal Government, provinces, and territories, the collective ask of the federal government was for a 5.2% annual escalator. The federal government raised its offer from 3% to 3.5% plus $11bln over 10 years for home care and mental health as well as another $544mln over 5 years for initiatives on prescription drugs and health innovation. An agreement was not reached. A few days following the meetings, the Province of New Brunswick announced that it had reached a separate bilateral agreement securing an additional $230mln more for health care which it assesses is equivalent to an effective 4.1% annual escalator. The provinces of Nova Scotia and Newfoundland and Labrador reached similar agreements.

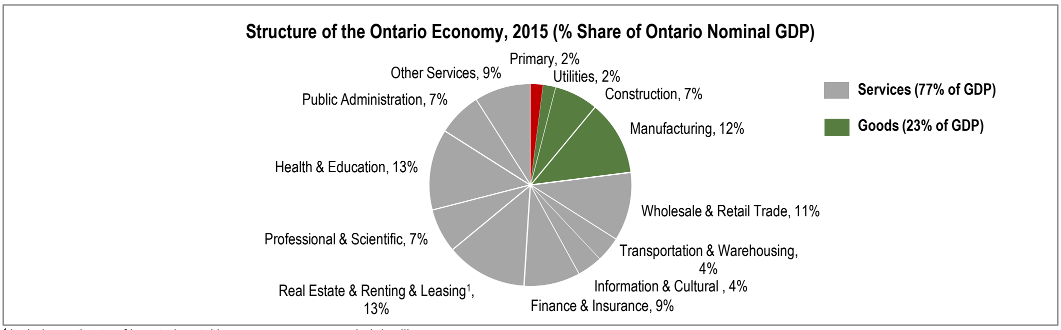
- How will Federal infrastructure funding affect borrowing and capital plans?
  - It is not clear at this stage how the federal infrastructure spending program will work into the $137bln 10-year capital plan, but it will be factored into the spring budget along with implications of both federal and provincial climate change plans.

- Will Ontario consider using its fiscal capacity to raise taxes/fees to ensure meeting its balanced budget target in Fiscal 2017-18?
  - Ontario is committed to returning to balance next year and is pursuing several options laid-out in the recommendations of the "Commission on the Reform of Ontario's Public Services, Public Services for Ontarians: A Path to Sustainability and Excellence" by Chair Don Drummond, an economist (The Drummond Report is a deficit-reduction report released in February 2012 to advise the Ontario government on how to reduce its debt levels). Click Here
  - Budget 2016 has identified a $500mln Program Review Savings Target for Fiscal 2016-17 that entails Review, Renewal and Transformation. Click Here
  - The 2016 savings target follows the $250mln target that was set and achieved in Fiscal 2015-16.
  - Fiscal capacity is not seen as the best option at this time due to the importance of remaining competitive with the United States and other countries in the competitive global landscape. The United States is articulating plans to reduce both corporate and income taxes. The United States is also potentially changing its stance on environmental issues. These factors must be taken into consideration for Ontario to remain competitive.
  - External factors are supportive of Ontario's growth. These include a recovering US economy, still low energy prices and accommodative financial conditions, and a weak Canadian currency.

- Could you clarify Ontario's course of action given the Auditor General of Ontario's qualified opinion on Pension Accounting?
  - Although the pension expense is a non-cash charge, it is still very important to achieving the balanced budget target in Fiscal 2017-18.
  - The Province has engaged an expert panel of accountants to assess the issue.
  - The core matter is whether the pension plan is in a positive funding position given the assumptions used, which we believe to be the case.
  - Effectively, two fundamental questions need to be answered in the affirmative: "Is there an asset and does the province own it?" The answers will depend on a number of factors related to both the underlying assumptions and the contractual arrangements.
  - The calculation is sensitive to the discount rate used which is currently at 6.25%.
  - Background – Ontario Public Accounts 2015-16: In Ontario's fall fiscal and economic update, the government adopted the Auditor General's accounting interpretation for the treatment of net pension assets for 2015–16 through a time-limited regulatory amendment (the "Pension Adjustment"). The impact of the change resulted in an additional $10.7bln being added to the net debt and accumulated deficit and an increase of $1.5bln to the annual deficit for 2015–16. Consistent with the accounting treatment adopted in the Public Accounts of Ontario 2015–2016, the medium-term fiscal outlook provided reflects a cautious approach to forecasting the projected annual Pension Adjustment. This cautious approach results in an estimated potential impact of $2.2bln in 2016–17, $2.8bln in 2017–18, and $3.7bln in 2018–19 to the annual Pension Adjustment.

- What is the future of Ontario's automotive sector?
  - Ontario's auto industry is very important, but just one component of Ontario's diversified economy.

- Overall, the auto industry represents only 2.5% of GDP, but it is the largest manufacturing sector accounting for almost 20% of total manufacturing.
- Ontario is the largest single auto jurisdiction in North America, ranking ahead of Michigan.
- Ontario cannot compete with low-wage assembly jobs, but needs to remain competitive on the basis of technological leadership.



[1] Includes estimate of imputed rental income on owner occupied dwellings
Source: Statistics Canada and Ontario Ministry of Finance

- What trends do you see with respect to immigration?
  - Ontario attracts about 40% of new immigrants to Canada based on long-term averages. This level is above the provincial average.
  - The percentage of new immigrants fluctuates from quarter-to-quarter and has been as low as 30%.
  - Ontario anticipates that its share of immigration will increase to 45-50% in the coming years.
  - Inter-provincial migration has been historically very low, near 0%.

- What is Ontario's housing market outlook?
  - The range of forecasts is quite wide. We expect some moderation, but this will be mitigated by continuing population growth and financial conditions that are still financial stimulative, although borrowing rates and mortgage underwriting conditions have moved tighter.

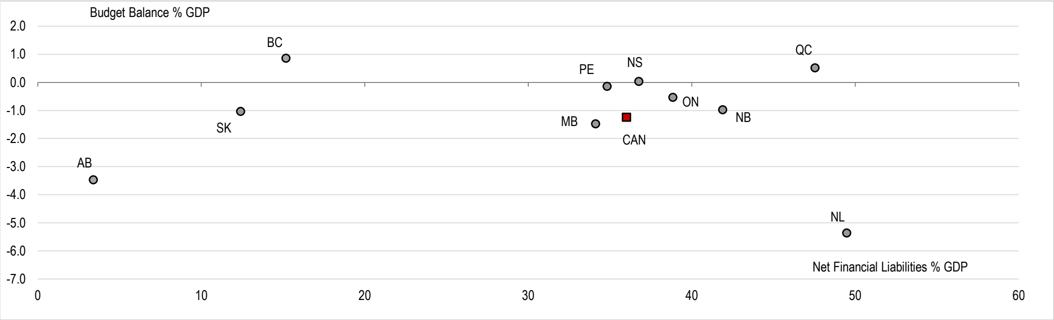
- Why is the province's debt risk-weighted 20% instead of 0% in some international jurisdictions?
  - Each country has its own financial institutions regulator.
  - We continue to dedicate time and resources to educate international regulators about the creditworthiness of the province and have been successful in many jurisdictions to have the risk-weighting reduced to 0%. This work is ongoing work.
  - In at least 15 countries, including where our major international borrowers are located such as the United States, United Kingdom, and Germany, the risk-weighting is 0%.

- What is the expectation for changes in Equalization payments from the Federal government?
  - Ontario began collecting equalization in 2009-2010. Click Here
  - Given Ontario's leading economic growth, we expect equalization to gradually diminish. This was confirmed in the recent announcement by the federal government in regards to major federal transfers. Ontario's Fiscal 2017-18 Equalization Transfer will be $1,424mln. This is down from $2,304mln in 2016-17. The Equalization Framework is a system of a three-year weighted moving average with a two-year lag of measured fiscal capacities which takes into account the variation in the revenue generating capacity of the provinces~~. with a two-year lag~~. The weightings allocate more weight to the last year (50%) and less weight to the first two years (25% each). There is a two-year lag in the calculation.

- When is the next ~~and final~~ IPO planned for Hydro One?
  - The Province is continuing to move forward with its plan to broaden Hydro One ownership. Ontario successfully completed a secondary

offering of 14 per cent of common shares in April [2016] and raised approximately $2.0 billion in total gross proceeds. The Province now holds approximately 70 per cent of Hydro One common shares and will reduce its stake to 40 per cent over time.

Provincial Fiscal Positioning (Fiscal 2016-17 Forecast)



Source: Government Public Accounts, CIBC Macro Strategy (Quebec budget balance before deposits to the Generations Fund)

Province of Ontario Credit Ratings:

DBRS AA(low)
Fitch AA-
Moody's Aa2
S&P A+

All Outlooks Stable

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