Fiscal Overview

Draft – August 14, 2017 12:00 PM

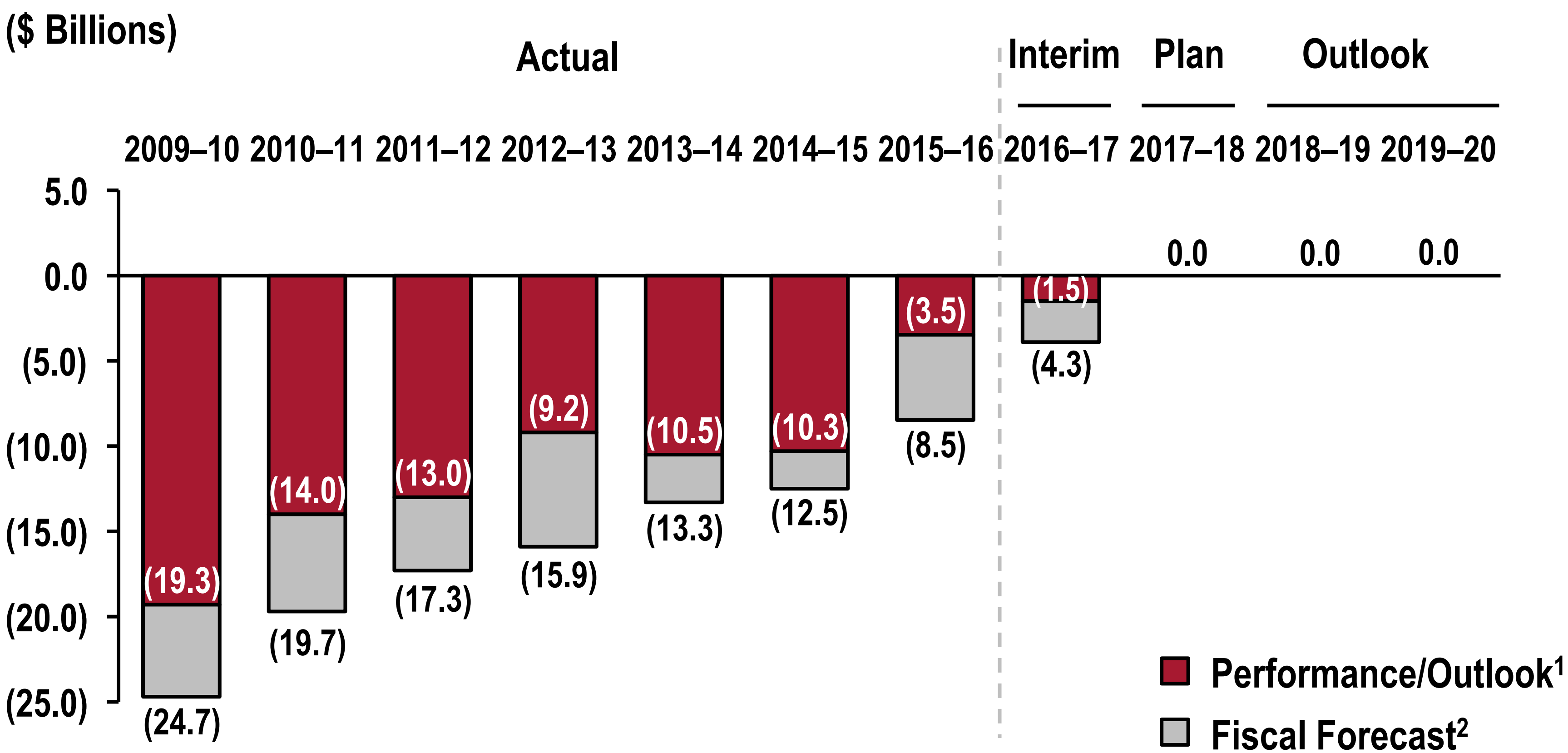
Purpose

- Overview of the 2017 Budget fiscal plan
- Highlight underlying revenue, expense, and prudence risks
- Highlight perspectives from key stakeholders on Ontario's fiscal position

The 2017 Budget Fiscal Plan

2017 Budget

The 2017 Budget projected a balanced budget in 2017–18 and continued balance in 2018–19 and 2019–20



[1] Represents the *2017 Budget* outlook for 2016–17 to 2019–20. For 2009–10 to 2015–16, actual results are presented. The 2015–16 actuals have been restated to reflect recognizing jointly sponsored net pension assets for the Ontario Public Service Employees' Union Pension Plan and the Ontario Teachers' Pension Plan on the Province's financial statements, consistent with the *2016 Budget* and as described in the *2016–17 Third Quarter Finances*.

[2] Forecast for 2009–10 is based on the *2009 Ontario Economic Outlook and Fiscal Review*, 2010–11 to 2013–14 is based on the *2010 Budget*; 2014–15 is based on the *2014 Budget*; 2015–16 is based on the *2015 Budget;* 2016–17 is based on the *2016 Budget*.

Source: Ontario Ministry of Finance.

2017 Budget – Medium-Term Fiscal Plan

Ontario's Fiscal Plan and Outlook
($ Billions)

	Actual	Interim	Plan	Outlook	
	2015–16	2016–17	2017–18	2018–19	2019–20
Revenue	**128.4**	**133.2**	**141.7**	**144.9**	**149.3**
y-o-y growth	*8.3%*	*3.8%*	*6.3%*	*2.3%*	*3.1%*
Expense					
Programs	120.9	123.5	129.5	132.3	135.8
y-o-y growth	*2.3%*	*2.1%*	*4.8%*	*2.2%*	*2.7%*
Interest on Debt[1]	11.0	11.3	11.6	12.0	12.6
y-o-y growth	*3.1%*	*2.6%*	*2.9%*	*3.9%*	*5.0%*
Total Expense	**131.9**	**134.8**	**141.1**	**144.3**	**148.4**
y-o-y growth	*2.4%*	*2.2%*	*4.7%*	*2.3%*	*2.9%*
Surplus/(Deficit) Before Reserve	**(3.5)**	**(1.5)**	**0.6**	**0.6**	**0.9**
Reserve	–	–	0.6	0.6	0.9
Surplus/(Deficit)	**(3.5)**	**(1.5)**	**0.0**	**0.0**	**0.0**
Net Debt as a Per Cent of GDP	38.6	37.8	37.5	37.3	37.2
Accumulated Deficit as a Per Cent of GDP	25.2	24.2	23.2	22.3	21.4

[1] Interest on debt expense is net of interest capitalized during construction of tangible capital assets of $0.2 billion in 2014–15, $0.2 billion in 2015–16, $0.1 billion in 2016–17, $0.3 billion in 2017–18.
Note: Numbers may not add due to rounding.

Supported by the outlook for continued economic growth, revenue is projected to grow by an average annual rate of **3.9%**.

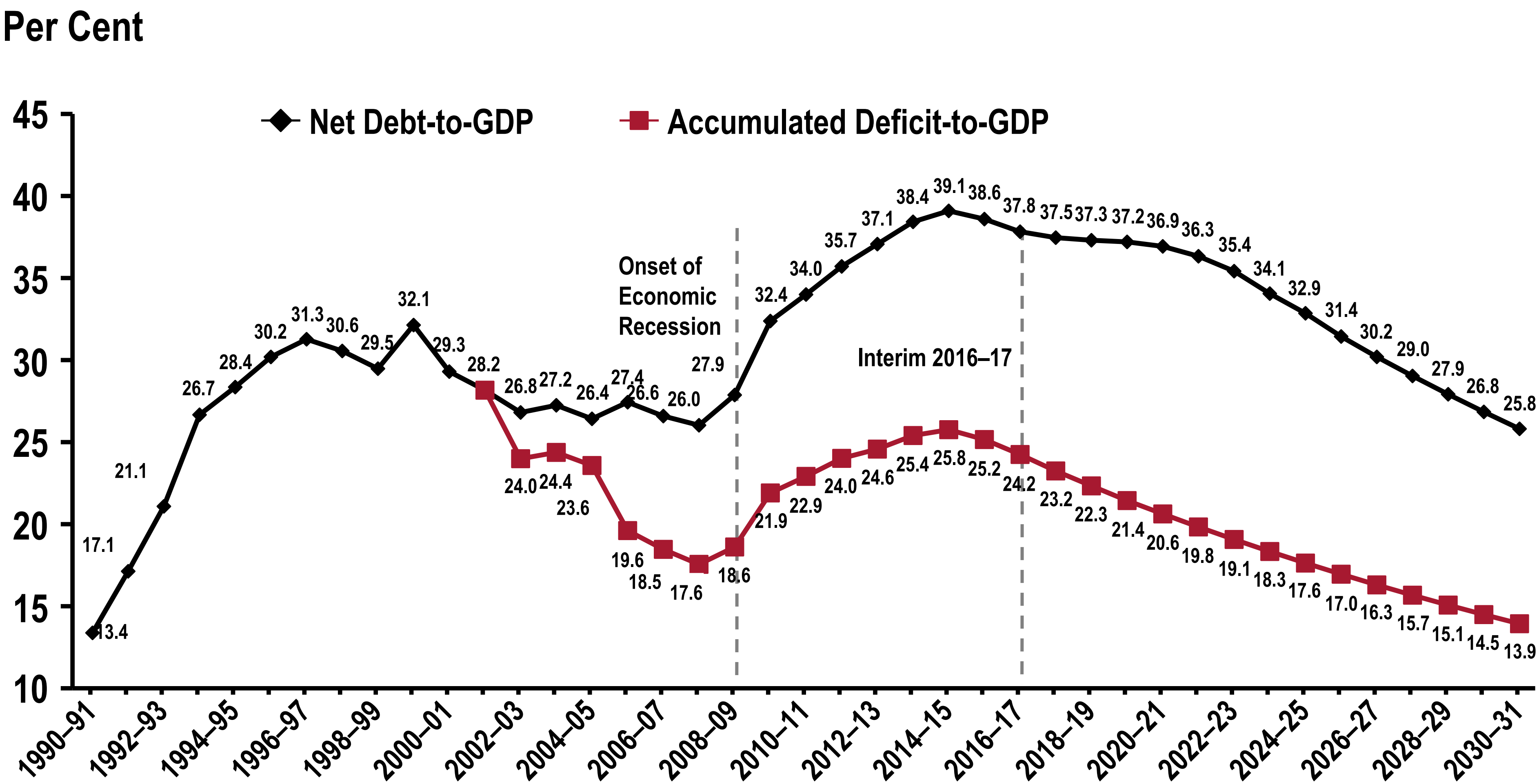
Program expense is projected to grow at an average annual rate of **2.9%.**

To protect the fiscal outlook against unforeseen adverse changes in revenue and expense the reserve has been set at $0.6 billion in 2017–18 and 2018–19 and $0.9 billion in 2019–20.

2017 Budget – Ontario's Economic Outlook

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

Both Net Debt-to-GDP and Accumulated Deficit-to-GDP peaked in 2014-15 and have been on a declining track.

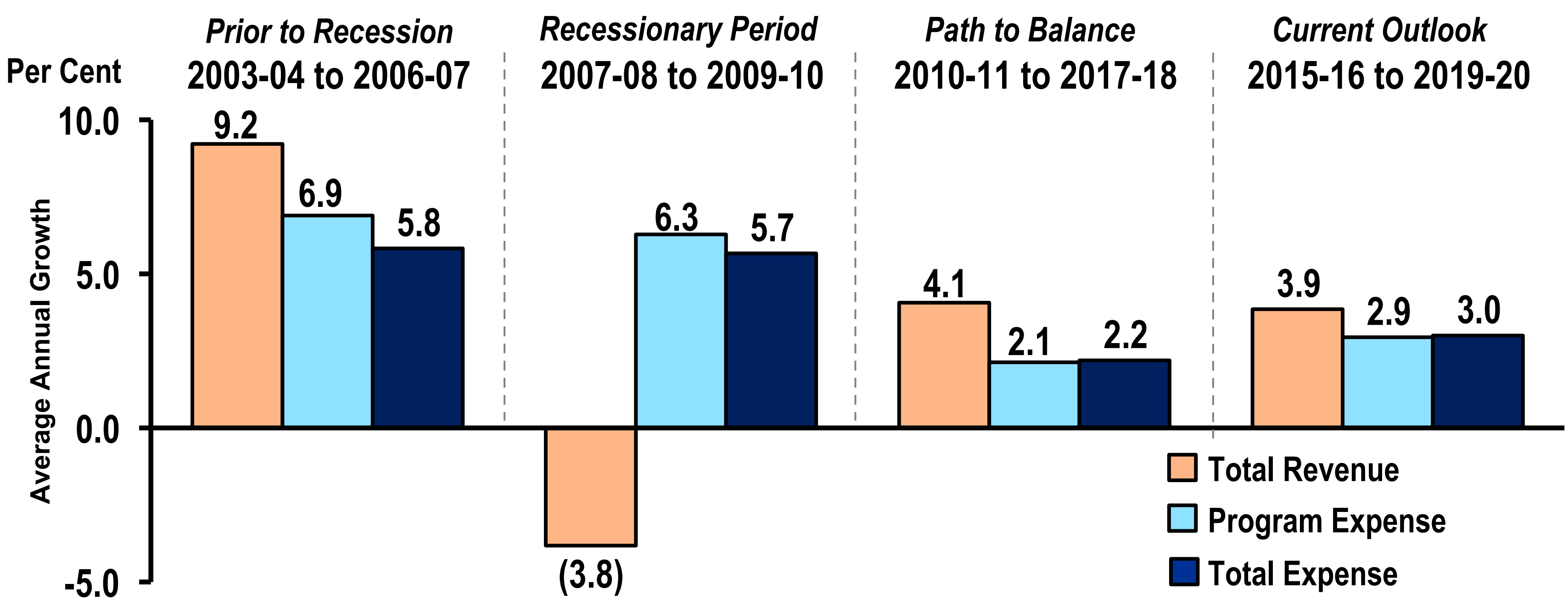


Notes: Net Debt has been restated to include Broader Public Sector Net Debt, starting in 2005–06.
Source: Ontario Ministry of Finance.

Underlying Assumptions and Risks

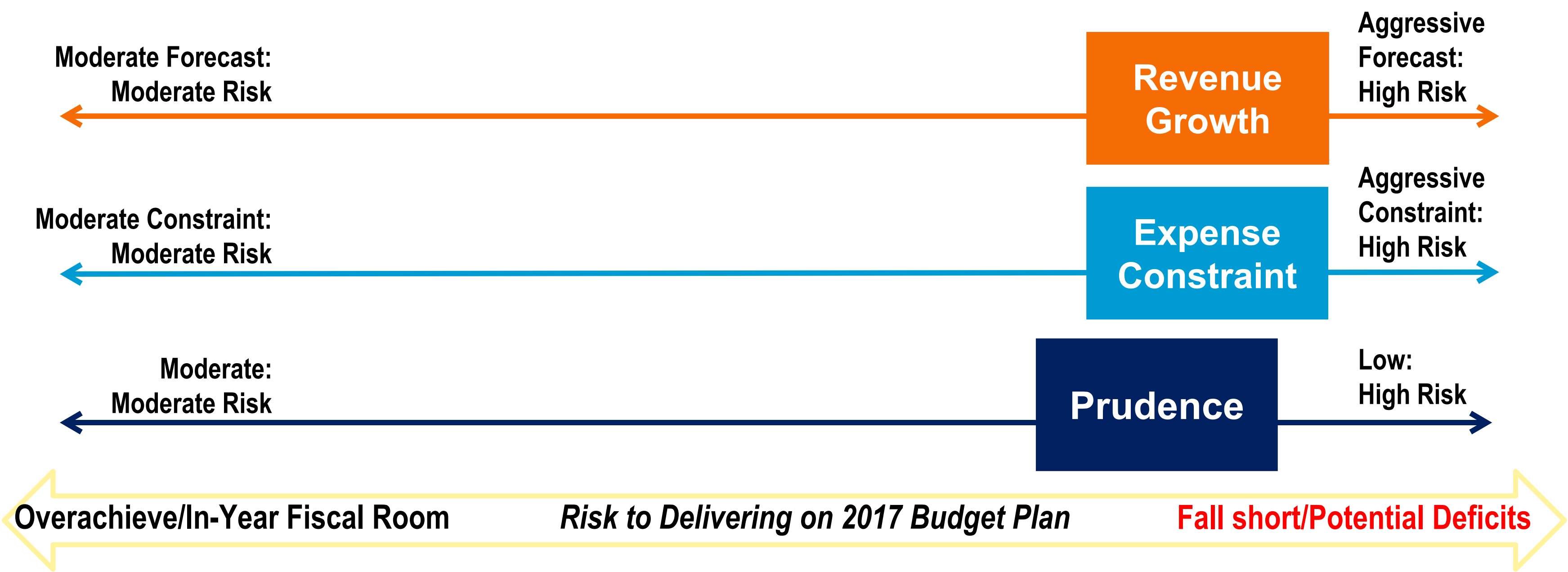
2017 Budget – Average Growth in Revenue and Expense

- Prior to the recession, revenue growth significantly exceeded program expense growth. However, during the recession, real GDP in Ontario declined at a faster pace than in the rest of Canada causing significant declines in revenue, while the pace of spending remained consistent, leading to deficits.
- Over the subsequent years, the government managed growth in program spending to an average annual rate of 2.1 per cent, through measures such as compensation restraint and improvements in program efficiency and value for money. Over this period, program expense grew at a rate below the sum of inflation and population growth. Low interest rates also helped the government achieve its fiscal targets.
- Over the medium-term, program expense is expected to grow more in line with population and inflation growth, and revenue growth is expected to be roughly in line with nominal GDP.



2017 Budget – Underlying Fiscal Architecture

- While the 2017 Budget fiscal plan delivers a published balanced budget, the underlying fiscal architecture and assumptions are strained, making the plan vulnerable to adverse events post-Budget, and providing limited room for error, reduced flexibility for unforeseen (or known downside risks) and any desire for further investment.
- A robust **post-Budget implementation plan and in-year expenditure management strategy** is required and is now being implemented.



2017 Budget – Economic Risks

Upside Potential

- US growth
- Rest of Canada growth
- Exports
- Infrastructure spending
- Household spending

Downside Risks

- Geopolitical uncertainty
- Trade protectionism
- Elevated household debt
- Rising interest rates
- Financial markets
- Housing

2017 Budget – Revenue Risks

Upside Risks

- 2016 Corporations Tax Assessments
- OLG / LCBO Net Income
- Carbon Allowance Proceeds

Balanced Risks

- Ontario GDP Performance / Growth
- Harmonized Sales Tax Update

Downside Risks

- Housing Market
- 2016 Personal Income Tax Assessments
- IFRS Consolidation Adjustment after 2017-18
- 2018-19 Equalization Entitlement
- OEB Rate Decisions (Regulatory Risk) on OPG Net Income

2017 Budget – Program Expense Risks

- The current program expense allocation provided to Ministries includes funding to address many government priority initiatives. However, some program expense pressures are being risk managed outside the fiscal plan, including:

Compensation Risks

- Potential pressures related to upcoming negotiations with the Ontario Medical Association regarding **Physician Services Payments.**

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Demand Driven Program Risks

- Demand/utilization and cost growth in **health sectors** such as, OHIP, Hospitals, Other Programs (e.g., Canadian Blood Services due to higher demand for plasma protein products).
- Demand for mandated **Social Assistance** programs, primarily due to caseload and cost per case growth in the Ontario Disability Support Program.
- Increased **OSAP uptake** resulting from the Student Financial Assistance program redesign, which will make average tuition free for eligible students with family incomes of $50,000 or less.
- Volatility of proceeds from the **Cap and Trade** program and timing of expenditures.

2017 Budget – Program Expense Risks, cont'd

Federal Agreements

- Ontario has been working with the federal government on a number of multilateral and bilateral agreements; the fiscal impact will depend on the design parameters of each program.
- **Health care funding:** $4.2 billion over ten years for mental health and home care programs may be subject to incrementality conditions.
- **Infrastructure:** $11.8 billion over 11 years, across four categories (public transit, green, culture/recreation, and rural/northern) will be subject to incrementality and cost-matching requirements.
- **National Housing Strategy:** replacing the Investment in Affordable Housing program will likely include a continuation of cost-matching requirements
- A number of other agreements are in the initial phases of development and could include cost-matching or incrementality conditions, or be subject to strict eligibility criteria.

Program Implementation Risks

- Additional funding to support **Child Care Expansion**, to achieve the commitment to create 100,000 new spaces.
- Increased costs resulting from changes to the **minimum wage**, in sectors such as child care and developmental services.
- Settling **land claims with Indigenous communities** in Ontario, which will depend on progress in negotiations and decisions about appropriate accounting treatment for each settlement.
- Funding to support **Corrections and Police Oversight Reform**, informed by the Sapers and Tulloch recommendations.
- Funding to support Metrolinx transit initiatives such as **Fare Integration Strategy.**

2017 Budget – Other Expense Risks and Prudence

- During the period of deficit reduction, prudence was used to help overachieve on fiscal targets and help manage against lower than forecast revenue, or expense risks that could not be mitigated.
- Prudence has been reduced in almost every area of the fiscal plan – higher savings to be achieved (‘negative prudence’) and lower Contingency Funds and Reserves.
  - The 2017-18 **Contingency Fund** ($615 million) is smaller than in 2016-17 ($1.2 billion). These reduced contingencies limit flexibility to respond to changing needs and to help mitigate expense risks that may otherwise adversely affect Ontario’s fiscal performance.
  - The 2017 Budget plan includes a **Year End Savings target** of $1.2 billion in 2017-18, which is required to achieve the program expense outlook published in the 2017 Budget. Previously, targets have been achieved through in-year expenditure management and underspending due to factors such as program management and changes in project implementation plans.
  - The 2017 Budget plan also includes a **Program Review Savings Target** of $750 million in 2018-19. The 2017 Budget highlighted that the Province would expand the review of current programs to identify opportunities for modernization.
  - The fiscal plan also includes **Savings Targets** tied to initiatives such as More Effective Business Supports and Service Fees and Non-Tax Revenue, which have risks of about $190 million in 2018-19.
  - The 2017 Budget plan set the **Reserve** at historically low amounts. It has been set at $0.6 billion in 2017-18 and 2018-19, and $0.9 billion in 2019-20. From 2009-10 to 2016-17, the reserve in the plan-year has averaged $1.0 billion.

2017 Budget – Accounting Risks

There are a number of accounting treatment issues that may have an impact on the fiscal plan moving forward.

- **Electricity Price Mitigation – Global Adjustment Refinancing** – the final accounting analysis can only be complete once the commercial agreements are finalized, which is expected in the fall of 2017. The key outstanding issues to resolve are (i) interest payments to OPG during the moratorium period on the Clean Energy Adjustment (initial 4 years), (ii) the provincial guarantee to the investors, and (iii) the impact of the underlying data on the Fair Allocation Curve, along with the impact to the LTEP and supplementary actions which could impact the use of rate regulated accounting

- **Pension Accounting –** The economic and demographic assumptions (e.g. expected long-term rate of return, salary increases) are updated annually using December 31 data. These updates impact pension expense on a go-forward basis, and may impact the valuation allowance required, if any, for pension plans – in particular HOOPP and CAATPP.

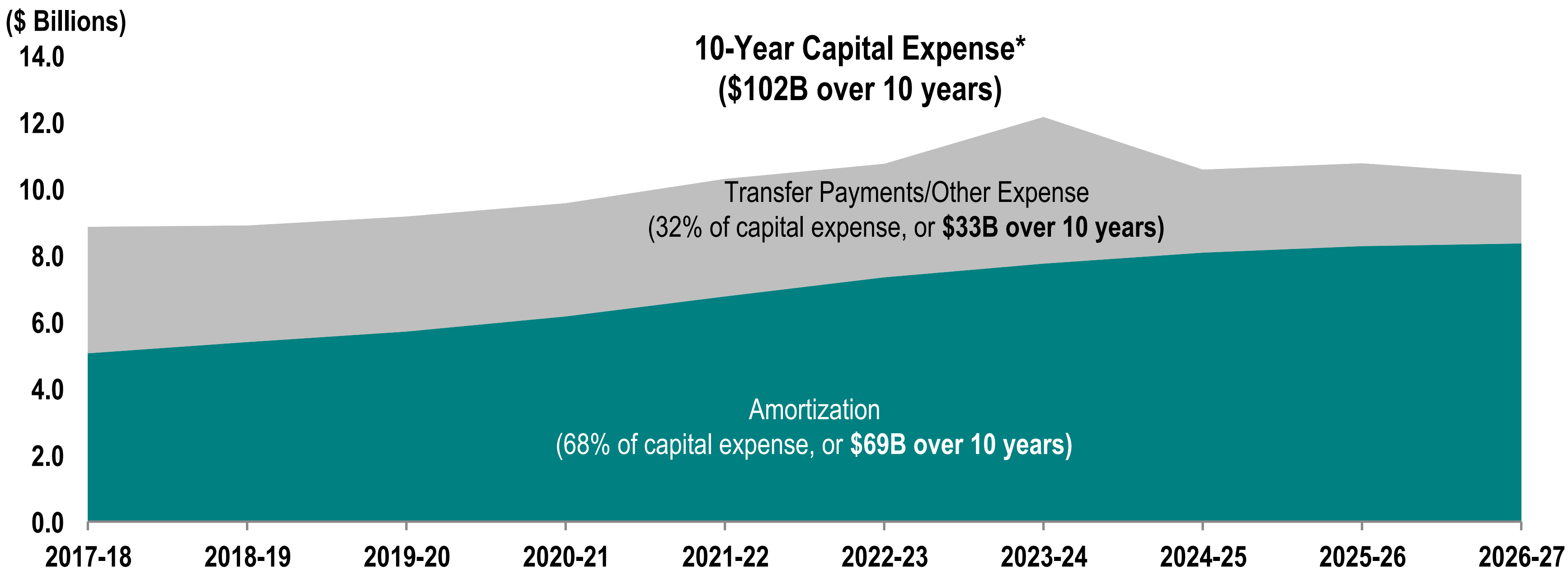
- **Contaminated Sites** -- Identification of new sites and/or increases in the estimated costs of clean-up for existing sites result in additional expense. In addition, acceptance of responsibility for clean-up of sites (e.g. Grassy Narrows) and commitments to funding, will result in increased expenses.

- **Contingent Liabilities** – Files currently on the watch list include (i) settlement with the education unions regarding Bill 115 (“Remedy”) as ETFO has determined it will return to court rather than negotiate with the Province, (ii) various land claims that are moving forward, although practice to date has been to record the settlement at ratification.

- **Asset Retirement Obligations** (related to Ontario Power Generation and classified as revenue in Income from Government Business Enterprises) – the asset retirement obligations are revalued each year based on the current discount rates, impact the actual income recognized.

2017 Budget – Fiscal Impact of the Capital Plan

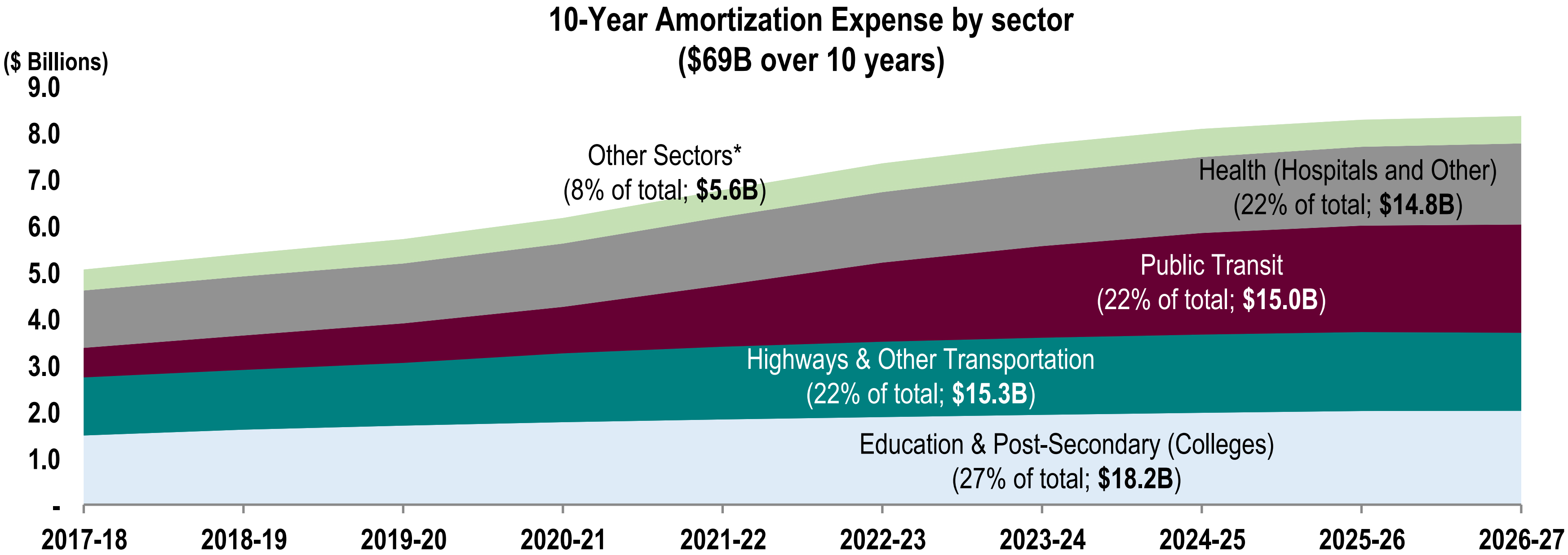
- In the 2017 Budget, the government committed to invest over **$156B** in public infrastructure over the next 10 years
- As a result of planned infrastructure expenditures, the fiscal impact (i.e., capital expense) associated with the **$156B** investment is projected to be **$102B** over 10-years, including:
  - **$69B Amortization expense**: This includes amortization of existing assets and as new projects come into service, they contribute to the growth in amortization.
  - **$33B in Transfer payments** to non consolidated entities and **Other expenses:** including to municipalities (e.g., Ontario Community Infrastructure Fund), universities (e.g., Major Capacity Expansion), etc.



*As of the 2017 Budget. Numbers may not add due to rounding

2017 Budget – Amortization Expense Impacts

- A $69B over 10-years, amortization expense associated with the 10-year infrastructure plan is projected to grow at an average annual rate of 6%. It increases from $5.1B in 2017-18 to $8.4B in 2026-27.
- Amortization expense over 10 years mainly comprises:
  - *$18.2B in the combined Education and Post-Secondary (Colleges) sectors.*
  - *$15.3B in Highways and other Transportation sector.*
  - *$15.0B in Transit sector.*
  - *$14.8B in Health sector.*



Note: As of Budget 2017. Numbers may not add due to rounding
**Includes government administration, natural resources, justice, social, culture and tourism sectors*

Ontario's Debt Ratings and Sensitivities

Credit rating agencies

- Credit rating agencies have Ontario's credit ratings on stable outlook. The rating agencies have noted that risks to the credit profile include Ontario's after-capital deficit, high debt burden, elevated household debt, the housing market and a potential rapid increase in interest rates.

Agency	Long-Term Rating	Short-Term Rating	Most Recent Review
Moody's	Aa2	P-1	Negative Outlook removed on April 26, 2016
DBRS	AA (low)	R-1 (mid)	Confirmed June 28, 2017
Fitch	AA-	F1+	Confirmed June 20, 2017
S&P	A+	A-1	Long-term rating confirmed; short-term rating lowered June 15, 2017

Sensitivities to Interest on Debt and Net Debt-to-GDP

- The Bank of Canada recently raised interest rates. IOD expense could exceed the forecast if rates are higher than the interest rate forecast used in the 2017 Budget.
- For every $1 billion increase in borrowing, IOD could increase by $30 million.
- Every 1 per cent change in GDP impacts the net debt-to-GDP ratio by ~0.5 per cent.

2017 Budget – Illustrative Risk-based Scenarios

- The 2017 Budget fiscal plan includes economic, revenue, and expense pressures in all sectors.
- In it's Spring report, the **Financial Accountability Office (FAO)** provided their assessment of the government's outlook, should some risks materialize. The FAO's projection included their own forecast for revenue and interest on debt, and adopted the program expense outlook from the *2017 Budget*, but adjusted program expense to include the impact of the Auditor General's Pension Asset accounting treatment. This FAO projection leads to a deterioration to the deficit beyond 2017-18.
  - Furthermore, the FAO recently released a statement supporting a Fraser Institute report (released in August 2017), which argued that the government's plan to lower its net debt-to-GDP ratio is overly optimistic.
- The **Auditor General** is not expected to support the government's position on the Pension Asset accounting treatment and will likely give a qualified opinion of the 2016-17 Public Accounts.

FAO Analysis