Ontario's 2016–17 Final Results … Approaching Balanced Books

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- **A final deficit of $991 million** (-0.1% of GDP) is reported for fiscal 2016–17 (FY17)—a $2½ billion improvement from FY16; $3.3 billion narrower than *Budget,* and $0.5 billion ahead of the government's April 2017 forecast (side chart).
- **Net debt,** as measured by the Province, rose by $6.3 billion (+2.1%) during FY17. This was half the projected FY17 increase, reflecting the deficit improvement and lower-than-forecast capital outlays and roughly two-thirds of the FY16 increase. At March 2017, Ontario's net debt had fallen below 38% of GDP, down from the March 2015 peak of just over 39%.

DETAILS OF THE FY17 REVENUE GAIN

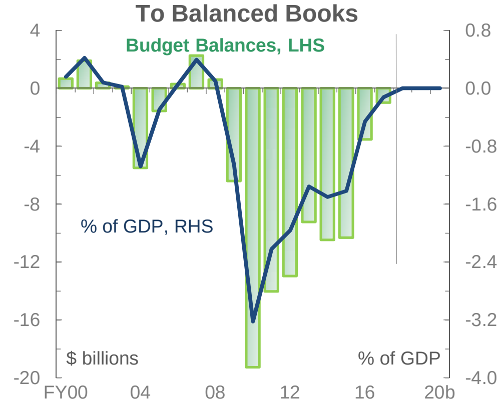
The FY17 bottom line improvement from *Budget* was driven by a $2¼ billion in-year strengthening in revenues and the year-end result that the $1.0 billion reserve was not needed (side table, p.2). Program spending was $0.6 billion ahead of plan, but the debt service was $0.7 billion lower-than-forecast. The accounting changes requiring restatement of the FY18 *Budget* estimates are discussed on pages 3–4.

Relative to FY16, revenues in FY17 advanced 3.4%, with federal transfers, though lower than *Budget,* climbing 6.1%, aided by a $0.6 billion rise in federal infrastructure funding to $0.7 billion. Mirroring some one-time events, Ontario's own-source receipts advanced just 2.8%, despite estimated nominal GDP growth of over 4.0% in calendar 2016 and a strong start to 2017. Electricity Payments-In-Lieu of Taxes (PILs) in FY17 dropped by $2.9 billion to $0.3 billion as Hydro One, after its initial public offering in November 2015, ceased to be exempt from federal and provincial corporate income taxes and thus was no longer liable for corporate tax PILs.[1]

Contributing to the 5.3% decrease in FY17 Other Non-Tax Revenues is a $0.2 billion (-27.7%) drop in the Electricity Debt Retirement Charge given its removal from residential power bills as of January 2016. For the two-thirds of the electricity load still bearing this levy, the Charge will be eliminated in April 2018.

Ontario's asset management strategy provided significant net gains in FY17. The secondary offering of 14% of Hydro One's common shares in April 2016 generated gross proceeds of $1.97 billion. This yielded a $538 million net gain for the Province in FY17, which was credited to the Trillium Trust,[2] following the $3.2 billion net impact of Hydro One's IP0 in FY16. The February 2017 sale of Hydro

Ontario in FY17 Moves Close To Balanced Books



Sources: Ontario Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

[1] Under the *Taxation Act, 2007,* however, the Minister of Finance must remit to the Ontario Electricity Financial Corporation an amount equal to Hydro One's provincial income tax payable.

[2] A $70 million gain on Ontario Power Generation's 9 million common share purchase in Hydro One's secondary offering for distribution to OPG's eligible employees under the net-zero 2015 collective agreement will be recognized over a period of up to 15 years starting in 2018. See *Public Accounts of Ontario, 2016–17*.

One Brampton Networks generated a $109 million net accounting gain, and its sale plus Ontario's reduced Hydro One ownership share were largely responsible for the $1.3 billion drop in the Province's investment in government business enterprises during FY17. As well, a $0.2 billion net gain was realized from the sale of the Liquor Control Board of Ontario's office lands. The Trillium Trust, banking the net financial benefits from the disposition of qualifying assets for the support infrastructure investments, ended FY17 with a $5.05 billion balance.

Asset sales continue in FY18. Another offering of Hydro One common shares in May generated gross revenues of about $2.8 billion, exceeding the government's objective of raising $9 billion in gross proceeds and other revenue benefits by broadening Hydro One's ownership, leaving the Province's common equity share at 49.9%.[3] In addition, OPG in its 2017 Q2 report indicated a $283 million gain from the sale of its head office premises and an associated parking facility. Hydro One in July announced its offer to acquire a US electricity and gas utility, an expansion to benefit its shareholders, including Ontario taxpayers.

Apart from Electricity Payments-in-Lieu of Taxes, Ontario's FY17 tax receipts posted a robust gain of $5.4 billion (+6.1%), propelled by a 30% surge in corporate income tax revenues that added to a jump of almost 20% the year prior. The downside surprise was a 1.5% y/y fall in personal income tax revenues due to weaker 2016 tax assessments. As signaled last spring, stepped-up housing market activity across the Greater Golden Horseshoe raised the Land Transfer Tax by $0.6 billion to a record $2.7 billion. As of January 2017, this Tax's rates were hiked from 2.0% to 2.5% on transfer amounts over $2 million for land with one or two single-family homes and, for all other types of property, from 1.5% to 2.0% on transfer amounts over $400,000.

Income from Ontario's government business enterprises climbed 13.4% (+$658 million) in FY17 (top table, p.3). OLG this year plans to further modernize its lottery and gaming operations by broadening the private sector's role in its day-to-day site operations.

The new revenue category—fees, donations and other revenues from the broader public sector—posted a 6.2% increase (+$464 million) in FY17. Several factors such as higher international tuition fees contributed to gains across hospitals, school boards and colleges.

OPERATING EXPENDITURE DETAILS

Final FY17 operating expenditures advanced by just 1.5% (+$1.9 billion), dropping to 16.3% of GDP from 16.8% a year earlier. The FY17 increase for Health was contained to 1.9% and scheduled in-year savings of $800 million were achieved. Nevertheless, pressures persist in the major program areas, from higher school enrolment to new drug costs, and several programs such as the Ontario Rebate for Electricity Consumers are more expensive than anticipated.

For areas outside of the major spending envelopes of Health, Education, and Social Services, FY17 spending was little changed from FY16. In part this

Ontario's Budget Arithmetic
$ billions except where noted

	FY17	
	Budget	Final
Personal Income Tax	32.2	30.7
Corporations Tax	12.1	14.9
Harmonized Sales Tax	24.0	24.8
Ontario Health Premium	3.6	3.6
Other Taxes	20.0	20.5
Tax Revenue	**91.8**	**94.3**
Gov't Business Ent. Income	5.0	5.6
SUCH Sector Revenue*	7.4	8.0
Other Non-Tax Revenue	9.1	8.3
Total Own-Source Rev.	**113.3**	**116.2**
Federal Transfers	25.1	24.5
of which Equalization	2.3	2.3
Total Revenue	**138.5**	**140.7**
Health	55.8	56.0
K-12 Education	26.1	26.2
Post-Secondary Education	10.2	10.1
Social Services	15.8	16.0
Other Program Spending	21.5	21.7
Total Program Spending	**129.4**	**130.0**
Debt Service** / Revenue	12.4	11.7
Total Expenditure	**141.8**	**141.7**
Reserve	1.0	0.0
Surplus (Deficit)	**-4.3**	**-1.0**
Annual Change, %		
Personal Income Tax	*3.3*	*-1.5*
Corporations Tax	*5.4*	*30.1*
Harmonized Sales Tax	*2.2*	*5.5*
Tax Revenue	*0.0*	*2.8*
Total Own-Source Rev.	***0.3***	***2.8***
Federal Transfers	*8.6*	*6.1*
Total Revenue	***1.7***	***3.4***
Health	*1.4*	*1.9*
K-12 Education	*0.1*	*0.5*
Post-Secondary Education	*3.0*	*2.3*
Social Services	*1.8*	*3.0*
Other Program Spending	*-0.3*	*0.4*
Total Program Spending	***1.0***	***1.5***
Total Expenditure	***1.5***	***1.5***
Memo Items, %		
Own-Source Rev. / GDP	14.3	14.6
Program Spending / GDP	16.3	16.3
Budget Balance / GDP	-0.5	-0.1
Debt Service** / Revenue	9.0	8.3

* Fees, donations & other revenue of hospitals, school boards & colleges. ** FY16 & FY17 debt service ex interest capitalized during construction. Source: Ontario Finance; Statistics Canada; nominal GDP forecast: Scotiabank Economics.

[3] In July 2016, Ontario agreed to sell to First Nations up to approximately 15 million Hydro One common shares. If First Nations fully participate, their 2½ ownership share would trim the government's equity to 49.4%.

reflected restructuring, such as the redesign of the Ontario Municipal Partnership Fund to better target funding to northern and rural municipalities.

CAPITAL INVESTMENT AND BALANCE SHEET DEVELOPMENTS

Infrastructure expenditures in FY17 totaled just $12.9 billion, with revised timelines for the Building Canada Fund investments and municipal transit projects contributing to the shortfall from the $16.2 billion *Budget* estimate. However, FY17 marks the third consecutive year of infrastructure outlays close to $13 billion, all surpassing the prior FY11 peak of $12½ billion that resulted immediately after the recession from federal and provincial infrastructure stimulus.

A positive balance sheet development is the $1.8 billion FY17 gain in net pension assets, continuing the upward trend since FY15 due to investment gains. With respect to Trust Funds Under Administration, as of March 2017, the Pension Benefits Guarantee Fund had a positive $0.7 billion balance and the unfunded liability attributable to Workplace Safety and Insurance Board stakeholders had declined by $2.7 billion to $3.9 billion.

The weighted average of FY17 borrowing was 13.9 years. For FY18, with $16.3 billion completed of the $26.4 billion program, the weighted average to date is 12.7 years, marking the eighth consecutive year of issuance with an average term over 12 years. The FY17 debt service absorbed just 8.3¢ of each revenue dollar, the lowest level since FY91. With interest rates now assumed to move higher, Ontario expects its longer-term debt to restrain the rise in its debt service to just 8.5¢ by FY20.

OUTLOOK

The government also reviews its progress in achieving specific service and economic outcomes. An example is the *Provincial Infrastructure Asset Inventory* compiled by the Province in 2016 to better inform infrastructure planning, including the balance between physical asset expansion versus renewal. A long-term infrastructure plan is scheduled for release in late 2017. Proposed labour standards legislation would raise the minimum wage from $11.60 per hour (after a 20¢ increase October 1) to $14.00 in January 2018 and $15.00 the year after. Other provisions include part-time/casual wages matching full-time workers' wages if the work is equal and enhanced benefits such as three weeks of paid vacation after five years.

With its modest FY17 deficit, the strong hand-off to FY18 and our forecast of Ontario real GDP rising 3.2% in calendar 2017, Ontario is well-positioned to achieve its longstanding target of balanced books in FY18. The tougher challenge is likely to be maintaining black ink, on average, in the years subsequent to FY18 when slower growth is anticipated with an older population. The government points to the lessons learned in managing compensation across the broader public sector and from its *Program Review, Renewal and Transformation* that worked to improve service outcomes with more limited resources. Ontario highlights the advantages of limiting new financing capital, not daily operating needs (bottom table). Its stated strategy to lower its net debt relative to GDP to pre-recession levels by the end of the next decade (side chart) depends upon balanced books and infrastructure investment to grow the economy.

Government Business Enterprise Income

$ millions except where noted

	FY16	FY17	Change $	Change %
Ontario Lottery & Gaming Corp.	2,233	2,358	125	*5.6*
Liquor Control Board of Ontario	1,957	2,349	392	*20.0*
Hydro One	236	500	264	*111.7*
Ontario Power Generation	463	342	-121	*-26.1*
Brampton Distribution Holdco.	20	18	-2	*-10.0*
Total	**4,909**	**5,567**	**658**	***13.4***

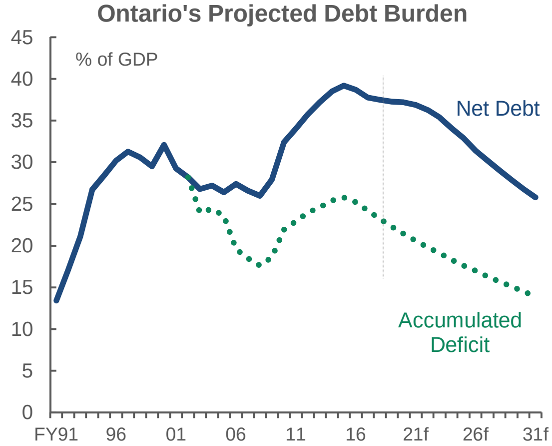
Source: Ontario Finance.

Ontario's Use of New Financing

$ billions

Operating Deficit & Other Transactions	-1.3
Investment in Capital Assets*	9.9
Decrease in Cash/Investments	-3.4
	5.2
Decrease in Other LongTerm Financing	0.5
Net New Financing	**5.7**
Total FY17 Borrowing Program**	27.0

* For government & consolidated entities including the SUCH sector. ** Three-quarters ($19.9 bn) was Canadian dollar. Source: Ontario Finance.



Source: Ontario Finance.

THE ACCOUNTING CHANGES IN ONTARIO'S 2016–17 *PUBLIC ACCOUNTS*

Net pension assets of Ontario's jointly sponsored pension plans, such as the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan, are reinstated in Ontario's financial statements. The decision aligns with Ontario's accounting policy since 2001 and the recent report of the Pension Asset Expert Advisory Panel, The latter concluded that the pension plans' accounting surpluses resulting from past actions and events have a future economic benefit, with access controlled by the government and their full value should be reported in the Province's financial statements.

For the energy-sector, rate-regulated government business enterprises, Hydro One and OPG, International Financial Accounting Standards (IFRS) replaced US GAAP as of April 2016. The impact on the FY17 deficit was not material, but it may be more significant in future years because of the different standards on asset retirement obligations which could affect OPG's obligations with respect to asset removal and nuclear waste management.

The Independent Electricity System Operator adopted rate-regulated accounting in 2016 and the change, applied retroactively to FY16 resulted in a $82 million decrease in the FY17 opening accumulated deficit and a $24 million widening of the FY17 annual deficit. Recognition of the market accounts of participants (electricity power generators and power distributors) raised both assets and other liabilities for the Province by $1.65 billion as of March 2017.

Revenues and expenses for hospitals, school boards and colleges as of April 2016 are consolidated on a line-by-line basis in the Province's *Consolidated Statement of Operations*. This boost both revenues and expenditures, but leaves the budget bottom line unchanged.

THE QUALIFIED OPINION OF THE AUDITOR GENERAL

Two issues are the basis for the Auditor General's qualified opinion. As referenced during FY17, Ontario's Auditor General maintains that Canadian public sector accounting standards require Ontario to record a valuation allowance against the net pension asset relating to the Ontario Teachers' and the Ontario Public Service Employees' Union Pension Plans. The Auditor General maintains that the government has no unilateral legal right to this asset to either reduce future minimum contributions or withdraw any of the plan surplus without the agreement of the pension plans' joint sponsors.

For FY17, the valuation expense would:

- Raise the Education expense and the General Government and Other Expense by $1.4 billion, widening the final deficit from $0.9 billion to $2.4 billion.
- Reverse the current $11.0 billion net pension asset to a net pension liability of $1.4 billion, increasing both the net debt and the accumulated deficit by $12.4 billion.

With respect to the Independent Electricity System Operator Market Accounts, the Auditor General states that the government has neither access to nor liability for these Accounts and thus they should not be included on Ontario's books.