Provincial Budget Briefs

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BRITISH COLUMBIA BUDGET 2018

The NDP-led coalition's first full budget continued to work towards election pledges, while still balancing the books with ample forecast and contingencies vote allowances built in to ensure budget targets are met. New measures to cool the housing market included increasing the Foreign Buyer Tax to 20% (from 15%) and implementing a new tax targeting speculators who don't pay income tax in BC. The forecasted budget surplus of $219mn for 2018/19, up from $151mn in 2017/18, incorporates some new spending, sizeable prudency allowances, and assumes that larger losses at Insurance Corporation of British Columbia (ICBC) will persist. Total fiscal prudence (forecast allowance + contingencies vote allowance) over the three-year period totals $3.5bn. Tax increases, including a new Employer Health Tax as well as those related to housing, will help pay for increases in spending and, by 2020, the elimination of Medical Service Plan (MSP) premiums. Increased capital investment over the coming three years is expected to see provincial debt rise, although debt as a percentage of a growing GDP base will hold between 15-16%, and peak at just under 16% in fiscal 2020/21, while tracking lower than expected from the Fall 2017 Budget Update. Increased capital investment, combined with greater maturities ($1.1bn higher), also sees gross borrowing requirements jump to $7.9bn in 2018/19, from the $6.9bn forecast in the Fall 2017 Budget Update and just under $2bn in 2017/18 (updated forecast); although the latter was revised down significantly from $5.4bn in Budget 2017 and $3.5bn in the Fall Budget (first budget under the new government), due to higher other financing sources and reduced capital spending.

Table 1

$Billions	2016/17 Actual	2017/18 Fall '17 Bud	2017/18 18 Budget	2017/18 Change	2018/19 18 Budget	2019/20 18 Budget	2020/21 18 Budget
Revenue Before ICBC Impact	**52.071**	**52.632**	**53.365**	**0.733**	**54.877**	**57.580**	**58.566**
ICBC Net Loss Forecast	-0.612	-0.225	-1.296	-1.071	-1.076	-0.801	-0.920
ICBC Product Reform Impact					0.392	0.780	1.000
Revenue	**51.459**	**52.407**	**52.069**	**-0.338**	**54.193**	**57.559**	**58.646**
Own Source	43.292	44.035	43.521	-0.514	45.263	48.488	49.271
% change	*8.4*	*1.7*	*0.5*	*-1.2*	*4.0*	*7.1*	*1.6*
Federal Transfers	8.167	8.372	8.548	0.176	8.930	9.071	9.375
Expenditures	**48.722**	**51.861**	**51.818**	**-0.043**	**53.624**	**56.778**	**57.762**
Program Spending	46.135	49.186	49.240	0.054	50.885	53.962	54.851
% change	*4.8*	*6.6*	*6.7*	*0.1*	*3.3*	*6.0*	*1.6*
Public Debt Interest	2.587	2.675	2.578	-0.097	2.739	2.816	2.911
Forecast Allowance	0.000	0.300	0.100	-0.200	0.350	0.500	0.600
Surplus/(Deficit) Before ICBC Impact	**3.349**	**0.471**	**1.447**	**0.976**	**0.903**	**0.302**	**0.204**
Surplus/(Deficit)	**2.737**	**0.246**	**0.151**	**-0.095**	**0.219**	**0.281**	**0.284**

Hot Economy Expected to Cool

BC experienced continued strong growth in 2017, with latest estimates putting real and nominal GDP growth at 3.4% and 5.9%, respectively. That's even better than was expected at the time of the September Update (2.9% and 5.1%), driven in part by stronger retail sales than had been anticipated at that time.

The economy is still expected to cool in the years ahead, with real GDP growth at 2.3% in 2018 and then settling at 2.0% thereafter. That's a touch below the consensus expectations which, alongside the projection for unemployment in particular, adds some conservatism to the forecasts. After averaging 5.1% in 2017, the unemployment rate is expected to rise gradually to 5.8% through 2020-22. That's a percentage point higher than its latest reading (4.8% as of January 2018). Housing starts are expected to fall from 43.7K in 2017 to 32.0K in 2018, reflecting continued efforts on the part of the Province to cool the market.

Table 2

Y/Y % Chg	2017	2018	2019	2020-22
Economic Assumptions				
Real GDP	3.4	2.3	2.0	2.0
Private Sector Average	*3.4*	*2.5*	*2.2*	*2.1*
Nominal GDP	5.9	4.4	4.0	3.9
Employment	3.7	1.4	1.1	1.0
Unemployment Rate (%)	5.1	5.4	5.6	5.8
Retail Sales	9.5	4.3	3.8	3.7
Housing Starts (K)	43.7	32.0	30.0	29.5
Personal Income	5.1	4.1	3.9	3.8
Corporate Profits	11.2	5.5	3.3	3.3
CPI	2.1	2.0	2.0	2.0
Population	1.3	1.1	1.2	1.2
Financial Assumptions				
3-month T-Bills (%)	0.7	1.3	2.1	2.8
10-year GoC Bonds (%)	1.8	2.3	2.8	3.5
Exchange Rate (US¢/C$)	77.0	78.3	79.7	80.2

Note: 2020-22 is a three-year average

Continued, but Slim Surpluses Despite Added Prudence and Spending

After their election victory last year, the NDP government continued down the road of trying to improve affordability for British Columbians, with further measures aimed at housing, health care and child care.

A new tax credit of up to $350 a month for licensed child care is designed to help working families, but stops short of the $10-a-day daycare election pledge at this stage. New investments in affordable housing were announced, costing around $400mn in both 2019/20 and 2020/21. Meanwhile taxes related to housing were expanded, with the Foreign Buyer Tax set to rise to 20% (from 15%) immediately and a new speculation tax to be introduced in the fall. That new tax of 0.5% on homes owned by people who don't pay income tax in BC will rise to 2% in 2019, by which point it is expected to bring in $200mn annually.

After the 50% reduction announced in the Fall update, it was confirmed today that Medical Service Plan (MSP) premiums would be eliminated by 2020 at a cost of nearly $1.4bn in 2020/21. Instead, businesses will start paying an Employer Health Tax in 2019, with larger companies paying a higher percentage than smaller ones. That tax is expected to bring in $1.85bn during 2019/20 and then $1.92bn in 2020/21.

The Province's projections for revenue were reported to reflect the ongoing uncertainty related to Insurance Corporation of British Columbia's (ICBC) annual losses. After being relatively stable from 2007-2015, these losses have risen in recent years with a record $1.3bn shortfall now expected for the outgoing 2017/18 fiscal year. That would be over $1bn more than previously expected and outweighed improvements in other revenue sources since budget time. The Province will introduce measures such as reforming ICBC's insurance product with the aim to close this gap and reduce its risk to the overall Fiscal Plan. Before these measures start to have a big impact, the Province assumes the larger losses seen recently will continue in 2018/19.

Through the added noise related to the ICBC loss changes, the Province is still expecting to run modest surpluses in the years ahead. The $219mn surplus in 2018/19 will be slightly above the revised $151mn estimate for the current fiscal year and would rise to just over $280mn in the next two years. Forecast allowances rise throughout the projection and, as is typical in BC, there is extra prudence added through the contingencies vote allowance to cover unexpected pressures and priorities. Total fiscal prudence (forecast allowance + contingencies vote allowance) over the three-year period totals $3.5bn.

Capital Spending Takes A Step Up; Some Debt Shifting from Self-Supported to Taxpayer-Supported

Capital spending under the new NDP-Green coalition government will take a giant step up in 2018/19, increasing from $6.8bn to $9.2bn (or +35.6% from updated 2017/18 spending estimates). They will also remain elevated thereafter. Total spending is projected to aggregate $26.2bn over the three-year capital program through to 2020/21. While there is meaningful spending planned across a broad spectrum of projects such as schools and hospitals, for example, the majority of the increase is on hydro-electric projects and transportation. Indeed, BC Transportation Finance Authority will see its capital spending increase from less than $900mn in 2017/18 to over $1.3bn in 2018/19, further increasing in subsequent years also.

BC Hydro's projected capital spending will increase from approximately $2.4bn in 2017/18 to $3.7bn in 2018/19 and also moves higher thereafter. Included in this amount is the Site-C project, a hydro-electric dam on the Peace River. It will be the Province's third power facility to meet base load demand growth. However, about 40% of BC Hydro's capital spending plans is directed to aging infrastructure to improve reliability and safety, as over 95% of the Crown utility's installed hydro-electric capacity and integration transmission and distribution was built in the 1960s and early 1980s.

Table 3

$Billions	2017/18E	2018/19F	2019/20F	2020/21F
Borrowing Requirements				
Operating Deficit/(Surplus)[1]	-0.151	-0.219	-0.281	-0.284
Capital Investment/Requirements	6.811	9.235	8.239	8.727
Other Fin'l Requirements/(Source)[2]	-7.406	-4.337	-3.888	-3.927
Net Financial Requirements	-0.746	4.679	4.070	4.516
Maturities and Calls[3]	2.712	3.239	1.990	2.409
Total Gross	1.966	7.918	6.060	6.925
Sources of Funding				
Internal Sources/ST Borrowing	0.039	0.000	0.000	0.000
Bonds and MTNs	1.850	7.862	5.780	6.665
CPP	0.077	0.056	0.280	0.260
Total	1.966	7.918	6.060	6.925
Net New Issues				
Bonds & MTNs	-0.785	4.679	4.070	4.516

1. Surplus after forecast allowance of $350mln in F2016/17 and F2017/18 and $250mln in F2018/19 and F2019/20
2. Includes other financing sources for the province, the SUCH sector, Crown corps, and adjustments for non-cash items
3. Includes maturing CPP, retail product, ST paper & changes in sinking funds

Of note is that debt funded capital projects for Transportation Investment Corporation (TIC) cease to be classified as self-supporting. Due to the cancellation of tolls on the Port Mann Bridge, TIC has been reclassified from a commercial Crown corporation to a taxpayer-supported agency effective September 1, 2017. With this change, fiscal 2017/18's debt stack also incorporates a one-time reclassification of $3.5bn from self-supported to taxpayer-supported debt.

The outgoing 2017/18 year is expected to end with $43.7bn in taxpayer-supported debt and $21.5bn in self-supported debt. The aggregate is $65.3bn incorporating a $100mn forecast allowance. This is expected to grow to over $77bn by the end of 2020/21. The majority of the Province's Self-Supported Debt (over $20bn) is that of BC Hydro.

The Province projects its Net Debt (as reported in its Statement of Financial Position) to be $42.3bn at the end of 2017/18, then rising to $50.1bn at the end of 2020/21. However, as a percentage of a growing GDP base, the debt ratio is expected to hold between 15-16%, and peak at just under 16% in fiscal 2020/21. On a positive note, BC will be eliminating its operating debt this coming fiscal year.

Borrowings Increase in Fiscal 2018/19

Gross borrowing requirements are expected to take a move higher in 2018/19, increasing from $2.0bn in 2017/18 (updated forecast) to approximately $7.9bn in 2018/19 (which is $1.0bn above the estimate in the Fall 2017 Budget Update). Increased capital requirements and debt maturities ($1.1bn higher) are driving the increase, although the updated $2bn gross borrowing requirement in 2017/18 was revised down significantly from $5.4bn in Budget 2017 and $3.5bn in the Fall Budget (first budget under the new government), due to higher other financing sources and reduced capital spending. New borrowing requirements (i.e. net of maturities) will be increasing from -$0.785bn in 2017/18 to $4.7bn in 2018/19. New borrowing requirements increase by over $4bn in subsequent years over the three-year forecast horizon.

With operations staying in balance and debt affordability metrics following a lower and improved track over the Plan compared to the Fall 2017 Budget Update, we believe today's budget is relatively neutral from a credit perspective even though we note that debt-to-revenue and debt-to- GDP metrics will rise modestly over the Plan. However, today's budget does demonstrate a visible pivot in priorities under the new government reflecting the NDP party's more left of center leanings. The government is, however, demonstrating a responsible and conservative fiscal approach by implementing some revenue measures to fund increased program spending as well as incorporating very strong prudency allowances. Affordable child care and housing initiatives along with reduced revenues from the elimination of medical services plan premiums, frozen fares on BC Ferry routes, and the elimination of bridge tolls, just to name a few, characterize a budget that is all about "Making Life More Affordable".

Today's budget was in line with our expectations. Early in the year, we had changed the Province's credit trend to "Balanced" from "Upside", as we no longer expected fiscal policies to lead to a meaningful improvement in the debt burden which could support a rating upgrade by DBRS to AAA. DBRS projects its own adjusted Tax-Supported Debt/GDP to be closer to 18% at the end of 2017/18, inclusive of unfunded pension liabilities. This is significantly above the 10-15% range required for a triple-A rating under its criteria, with an upgrade predicated on being sustainably at the lower end of the range.

At the same time, although we believe that today's budget is supportive of BC's other ratings, which are all AAA, its metrics are nonetheless stretched for the AAA category. We highlight that the U.S. rating agencies focus more on debt/revenue than debt/GDP and the former metric is expected to creep up modestly, albeit remaining materially lower than estimated in the Fall 2017 Budget Update, the first budget tabled under the new NDP government. A major deterioration in the Province's credit metrics could put its AAA ratings at risk.

Credit Implications: Neutral

Credit Ratings: DBRS AA (high), Moody's Aaa, S&P AAA, Fitch AAA All Outlooks Stable