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BC stays in balance with ample padding, focuses on affordability

Highlights

- British Columbia's minority NDP government has been plenty busy since being sworn in back in mid-July. There was a budget update in September, containing a number of "first steps". But today's budget—the first full budget from the NDP—goes further, taking action on a number of fronts, mostly notably in the areas of housing affordability and child care.
- A sterling economic record means above-plan revenue. So in spite of an unprecedented wildfire season, significantly weaker Crown results and some new spending commitments, BC continues to run a budget surplus. The 2017-18 surplus is estimated at $151 million, with some residual padding still built in (a $100 million forecast allowance). Absent losses at the public auto insurer, BC would have run a nearly $1.5 billion surplus in 2017-18.
- A surplus of $219 million is projected for 2018-19, followed by slightly larger surpluses in the final two years of the fiscal plan (roughly $280 million/year). Net losses at ICBC continue to weigh, although a suite of reforms aim to lessen this fiscal risk and bolster the corporation's capital position longer term. Ample prudence has been set aside. Together, the forecast allowance and contingencies amount to $900 million in 2018-19, rising to $1.25 billion for 2019-20 and $1.35 billion in the final year of the fiscal plan.
- The one-two punch from a stronger economic base and new revenue-raising measures creates room for significant investments, with underlying room available in each of 2019-20 and 2020-21 for "priority spending initiatives" to be developed in future budgets.
- On housing, a new property tax targets foreign and domestic speculators who don't pay tax in BC. This new tax is expected to generate $200 million/year once fully implemented. Separately, the existing foreign buyers' tax was both increased (from 15% to 20%) and broadened in terms of its applicability. The property transfer tax and school tax rate on high end homes are going up. As telegraphed, the government is seeking to close loopholes and/or reduce tax fraud in the housing market (including pre-sale condo flipping). At the same time, BC will undertake a sizeable investment to develop and maintain affordable/social/student housing. There are greater safeguards/protections for renters too. Expanded/accessible child care was another noted focus of this budget.
- The budget makes a record $15.8 billion capital investment over three years for education-health facilities and transportation networks, thought to support over 50,000 jobs during construction. Infrastructure investments have major bearing on the province's borrowing program. The coming fiscal year's gross funding requirement stands at $7.9 billion, well up from the outgoing year's $2 billion but hardly insurmountable for a 'AAA'-rated credit with established investor bases at home and abroad. The province puts gross funding requirements at roughly $6-7 billion/year in 2019-20 and 2020-21.
- BC expects to have barely $1 billion in direct operating debt by the end of 2017-18. What little remains should be eliminated in the fiscal year ahead. Total taxpayer-supported debt is due to end 2017-18 at 15.6% of GDP. The debt-to-GDP ratio is expected to ease a tick to 15.5% in 2018-19, before moving slightly higher thereafter (peaking at 15.9% in 2020-21). The profile for the debt burden is lower than that foreseen in September's budget update.
- After blistering GDP and employment gains in 2017, the budget assumes 2.3% real growth this year, followed by average annual gains of 2.0% through 2022. The budget's economic planning assumptions are somewhat more cautious than the private sector average.
- As a minority government, the NDP will likely require the support or abstention of the third party Greens to ensure passage of the budget bill. Certain budget provisions appear designed to ensure the Greens' continued support, and we view it likely that the budget passes. Still, as in any minority legislature, the attitudes and reactions of opposition parties require ongoing and close monitoring.

New government = new direction

British Columbia's minority NDP government has been plenty busy since being sworn in back in mid-July. Clearly, this is a government intent on charting a new direction.

There was a budget update in September, containing a number of "first steps", including a cut in medical services premiums, an elimination of bridge tolls, changes to business and personal tax rates, a series of housing-related measures, increased social assistance/disability rates, etc. Additional pronouncements followed, giving way to last week's ambitious Throne Speech.

And that brings us to today's budget—the first full-blown fiscal blueprint from the NDP. Labelled "working for you", the budget took action on a number of fronts. Consistent with the Throne Speech, there was a clear focus on making life more affordable, including a noted and fully expected concentration on housing affordability and expanded child care supports. Still, certain core elements of BC's fiscal framework remained intact, including a continuation of modest budget surpluses, a highly manageable debt burden, and meaningful fiscal prudence (which is something of a hallmark in BC).

Robust economy offsets ICBC losses

The local economy—the foundation of any budget—has been an unambiguous source of strength in British Columbia. Real GDP bounded 3.4% higher in 2017, with nominal growth just shy of 6%. The economy churned out 3.7% employment growth last year, driving the jobless rate to roughly 5%. (The more choppy monthly data showed BC ending 2017 with a 4.6% unemployment rate.)

BC's sterling economic record has meant above-plan revenue. So in spite of an unprecedented wildfire season, significantly weaker Crown results (more on that in a moment) and some new spending commitments, BC will continue to run a budget surplus in 2017-18. Officially, the 2017-18 surplus is estimated at $151 million, down from the $295 million surplus originally projected this time last year or more recent estimates: $246 million surplus in September's budget update and $190 million surplus as per the second quarterly report.

There's some residual padding built in, including a $100 million forecast allowance. Moreover, given the size of the BC economy (nominal GDP = $279 billion in 2017), the difference between the original plan (presented by the prior government) and the latest estimate for the 2017-18 surplus amounts to ~0.05% of GDP. So the ultimate fiscal revision relative to plan doesn't really qualify as "material" in our view.

Of note, mounting financial losses at the public auto insurer, the Insurance Corporation of British Columbia (ICBC), have left an indelible mark on BC's finances. Witness a new line item in the summary fiscal table: "ICBC net loss forecast before product reform". For the outgoing 2017-18 fiscal year, that net loss amounts to a substantial $1.3 billion—in line with guidance from the Crown offered up in its latest quarterly update. While one always has to be careful about excluding select items, it's clear enough that absent ICBC's financial woes, BC would have run a *much* larger budget surplus in 2017-18… approaching $1.5 billion in fact.

In the black with ample prudence

Starting from such an elevated economic perch, it stands to reason that future year growth rates are due to moderate. The budget assumes 2.3% real growth this year, followed by average annual gains of 2.0% through 2022. There are risks to be sure (not least of which is NAFTA uncertainty), but the budget's economic planning assumptions are somewhat more cautious than the private sector average. (For each year of the five-year forecast horizon, the government has trimmed 0.1-0.2%-pts off the consensus view.)

At this point, the economic outlook looks sufficiently healthy to keep the province in balance over the life of the three-year fiscal plan. In other words, BC's most recent budget surplus era—which commenced in 2013-14—shows no official signs of fading. The budget projects a surplus of $219 million (<0.1% of GDP) in 2018-19, followed by slightly larger surpluses in the final two years of the fiscal plan (roughly $280 million/year). Refer to the detailed fiscal table on page 5.

For those keen on comparing the latest budgetary framework with prior iterations, we'd note that the three-year cumulative surplus ending 2019-20 is now estimated at $651 million vs the $731 million in cumulative black ink eyed in September. Again, this hardly qualifies as a substantial fiscal adjustment when scaled to nominal GDP or provincial revenue.

The budget continues the well-established practice of setting aside ample prudence. Together, the forecast allowance and contingencies amount to $900 million in 2018-19, rising to $1.25 billion for 2019-20 and $1.35 billion in the final year of the fiscal plan. That's some significant insulation should the economy disappoint or unforeseen spending pressures emerge. As noted, GDP growth assumptions have been set below consensus; ditto for natural gas prices, which amounts to yet another layer of prudence. As the budget rightly points out, "prudence measures generally have resulted in government exceeding its budget targets."

Hearty revenue; notable tax changes

Total revenue is expected to average an even 4% per year out to 2020-21. That's consistent with the anticipated growth in nominal GDP, although growth in individual revenue streams will fluctuate owing to announced tax changes. Of note, BC is moving to fully eliminate Medical Services Plan (MSP) premiums effective January 2020, opting instead for a new employer health tax starting in calendar 2019. (The new government had already cut MSP premiums by 50% starting in January of this year.) A variety of other revenue measures were announced, incremental to the personal income tax, corporate income tax and small business tax rate changes previously outlined. Some of these earlier measures have a decided impact on the revenue outlook. Case in point, personal income revenue—easily the single largest revenue line item—is set to pop 10.7% higher in 2018-19, capturing the introduction of a new income tax bracket and negative adjustments to the prior year.

In addition to a series of housing-related measures (outlined in greater detail below), the budget unveiled higher tobacco tax rates (effective April 1) which should bring in an extra $95 million/year. Meanwhile, BC's share of a federal cannabis duty is pegged at $75 million on a full-year basis.

All told, new revenue measures are expected to generate a net $880 million in 2018-19, rising to upwards of $2.2 billion by 2019-20, before settling back to $1.25 billion in 2020-21 (the first full fiscal year of the MSP premium elimination).

Slicing up the revenue pie

BC expects to generate a bit more than 55% of its total revenue from various forms of taxation. In addition to personal and corporate income taxes, the new employer health tax is seen generating nearly $2 billion a year by 2020-21. Meanwhile, property transfer taxes are projected to top $2.2 billion in 2018-19, not too far removed from the $2.4 billion BC expects to bring in via natural resource revenue sources. On that front, natural gas royalties are expected to jump in 2018-19 (in part reflecting higher production volumes), but at $229 million we're talking about less than half of one percent of provincial revenue. Nonetheless, for those focused on natural gas, we'd note that the province is assuming C$1.08/GJ (plant inlet) in 2018-19, which resides in the 20th percentile of private sector forecasters. Official sensitivities suggest a C$0.25 change in nat gas prices would result in an annual fiscal impact of $30-50 million. As for lumber prices, a price change of US$50 per thousand board feet is worth $150-200 million a year.

Federal transfers are slated to account for a bit more than 16% of provincial revenue in the fiscal year ahead; that's a below-average share relative to other provinces, reflecting BC's so-called "have" status, which disqualifies the province from equalization.

Policy action on a number of fronts

Just because budget balance figures aren't much changed (vs prior estimates) doesn't mean the new government is standing still. Rather, there's been extensive action on many fronts.

Generally speaking, the one-two punch from a stronger economic base and new revenue-raising measures creates room for significant investments. All told, the budget announced nearly $5.4 billion in new spending over three years. In addition to these new investments, there's at least $1.25 billion of extra room available in each of 2019-20 and 2020-21 for "priority spending initiatives", be it reconciliation with Indigenous peoples, public sector compensation costs or additional government service caseload growth.

So whether on the spending or revenue side, it was a busy budget. We've summarized certain actions below. And again, it should be noted that budget initiatives in some cases build on the "first steps" delivered back in September.

- **Housing affordability** — This was a key focus, motivated by rabid (and in some cases questionable) housing market activity. The budget announced a new speculation tax. Effective for 2018, this new property tax (initially set at 0.5% of assessed value, but rising to 2% in 2019) targets foreign and domestic speculators who don't pay income tax in BC, including those leaving their units vacant. So-called "satellite families" will also be captured by the new tax. Up-front exemptions and/or non-refundable income tax credits will offset the new property tax for qualifying properties and the government is quick to point out that "the majority of homeowners in BC will be exempt". This new speculation tax is expected to generate $200 million/year once fully implemented. Separately, the existing foreign buyers' tax was both increased (from 15% to 20%) and broadened in terms of its applicability (to include regional districts in Victoria, Central Okanagan, Fraser Valley and Nanaimo). The property transfer tax and school tax rate on high end homes (those valued above $3 million) are going up. As telegraphed, the government is seeking to close loopholes and/or reduce tax fraud in the housing market (including pre-sale condo flipping). At the same time, BC will undertake a sizeable investment ($1.6 billion in operating and capital funding over three years) to develop and maintain affordable/social/student housing. There are greater safeguards/protections for renters too.
- **Affordable/accessible child care** — $1 billion over three years to reduce child care costs, expand the number of licensed child care spaces, etc. A new income-tested child care benefit and fee reductions could provide up to $1250 per month, per child for eligible families by 2020.
- **Additional affordability measures** — On top of the elimination of MSP premiums and the earlier removal of bridge tolls, fares for BC Ferries routes will be frozen or rolled back. Those receiving disability assistance will benefit from a bus pass supplement. Among other things, low-income families will receive expanded pharmacare supports. The feasibility of a basic income is also being tested. Consistent with the more

progressive income and property tax systems, there will be a PST luxury surtax on new or used purchases of vehicles valued at more than $125,000.

- **Enhanced services** — There were a variety of measures here, including expanded medical services, investments in seniors case, funding for more teachers, legal aid, counselling, crisis support and enhanced funding for Indigenous culture.
- **Support for the economy** — The government had previously taken action on the small business tax rate and reduced the PST on electricity for businesses. Extra funding for the agrifood sector featured in the budget, with skills development and a series of education initiatives designed, in part, to maintain/bolster BC's vibrant tech industry. Following last year's savage wildfire season, new investments in wildfire resiliency/recovery were announced. Meanwhile, the budget detailed new taxpayer-supported infrastructure investments, worth $15.8 billion over three years for education-health facilities and transportation networks, thought to support over 50,000 jobs during construction. These infrastructure investments have major bearing on the province's borrowing program, as discussed in the final section of our analysis.
- **Minimum wage increase** — Prior to the budget, the government announced its commitment to follow through on a plan to increase BC's minimum wage to $15/hour by mid-2021. There's a planned increase of $1.30/hour to $12.65 starting in June 2018, building on last September's $0.50/hour increase.
- **ICBC reforms** — The annual net income or loss at BC's public auto insurer (ICBC) is reported in BC's fiscal plan. As such, ICBC's mounting losses, estimated at $1.3 billion for 2017-18, have exerted a growing drag on the province's financial results, while the MCT ratio was placed on unsustainable downward trajectory. A variety of factors have contributed to hefty net losses at ICBC, including increased and/or more costly-than-expected claims per crash, a rising crash rate, etc. With ICBC's financial situation regarded as a key risk to BC's fiscal plan, the government has moved to implement a series of reforms, designed to bolster medium-term financial performance and long-term sustainability. This includes a cap on claims for minor crashes and a diversion of claim reviews away from the courts. And bad drivers can expect to pay higher premiums. Collectively, the suite of new reforms are expected to have positive benefits starting in 2018-19 (i.e., a smaller net fiscal hit relative to inaction), with savings projected to reach $1 billion by 2020-21—which could put ICBC back into a surplus position, placing capital levels on a firmer footing.

Debt & borrowing outlook

When it comes to provincial indebtedness, BC remains in a relatively favourable position. The province estimates it will have barely $1 billion in direct operating debt by the end of 2017-18. What little remains should be eliminated in the fiscal year ahead. A broader and generally preferred measure of debt—total taxpayer-supported debt—is due to end 2017-18 at $43.7 billion or 15.6% of GDP. In both level terms and as a share of the economy, that's a lighter debt load than had been telegraphed back in September. The corresponding interest bite, that is interest charges as a share of revenue, currently amounts to a scant 3.3%.

As noted, the budget outlines sizeable (in fact record) infrastructure investments, which will see the level of taxpayer-supported debt move up in each of the coming three fiscal years, topping $45 billion in 2018-19 and moving a bit beyond $50 billion by 2020-21. Given growth in the economy, the debt-to-GDP ratio is expected to ease a tick to 15.5% in 2018-19, before moving slightly higher thereafter (peaking at 15.9% in 2020-21). The future-year profile for the debt burden is, in all cases, lower than that foreseen in September's budget update.

Self-supporting capital spending amounts to $10.4 billion over the three-year fiscal plan, primarily reflecting investments in power generation, transmission and distribution at BC Hydro. That figure includes initial Site C construction costs, where the anticipated total cost (for the entire, multi-year build) sits at $10.7 billion.

With the budget in balance, capital spending and refinancings end up driving planned borrowing. All told, the budget puts the coming fiscal year's gross funding requirement at $7.9 billion —a figure, it should be noted, that incorporates significant prudence. Control for maturities and net issuance looks to be less than $5 billion. True, the coming fiscal year's supply is a step up relative to 2017-18, when just $2 billion of gross borrowing was completed via domestic benchmark bond issues. Still, BC's gross and net funding needs hardly look insurmountable for a 'AAA'-rated credit with established investor bases at home and abroad. [BC boasts three 'triple-A' ratings and stable outlooks from S&P, Moody's and Fitch. DBRS currently rates BC at 'AA(high)', with a stable outlook.] By tapping international markets, the province could potentially divert a non-trivial portion of its funding away from the home market. Further out, the province puts gross funding requirements at roughly $6-7 billion/year in 2019-20 and 2020-21 (averaging a bit above $4 billion/year net of maturities).

The party in power may have changed, and with it the province's key priorities, but BC continues to boast a relatively enviable economic and fiscal outlook, which leaves the gross funding requirements outlined in today's budget looking quite manageable to us. Many of the key tenets that support the province's credit rating remain intact, lending fundamental support to BC credit spreads.

[Note: As a minority government, the NDP will likely require the support or abstention of the third party Greens to ensure passage of the budget bill. Certain budget provisions appear designed to ensure the Greens' continued support, and we view it likely that the budget passes. Still, as in any minority legislature, the attitudes and posture of opposition parties require ongoing and close monitoring.]

Warren Lovely

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$000,000	Update 2017/18	Budget 2018/19	Plan 2019/20	2020/21	Percentage change 2018/19	2019/20	2020/21
Taxation revenue	28,224	30,592	33,502	35,136	8.4%	9.5%	4.9%
Resource revenue	2,586	2,413	2,214	2,184	-6.7%	-8.2%	-1.4%
Other revenue	10,745	9,694	9,512	8,551	-9.8%	-1.9%	-10.1%
Other federal transfers	8,548	8,930	9,071	9,375	4.5%	1.6%	3.4%
Commercial Crown corporation net income	1,966	2,564	3,260	3,400	30.4%	27.1%	4.3%
as of Insurance Corporation of British Columbia (ICBC)	*(1,296)*	*(684)*	*(21)*	*80*			
Total revenue	**52,069**	**54,193**	**57,559**	**58,646**	**4.1%**	**6.2%**	**1.9%**
Program spending	48,640	50,335	53,212	54,101	3.5%	5.7%	1.7%
Contingencies	600	550	750	750			
Debt servicing costs	2,578	2,739	2,816	2,911	6.2%	2.8%	3.4%
Total spending	**51,818**	**53,624**	**56,778**	**57,762**	**3.5%**	**5.9%**	**1.7%**
Forecast allowance	(100)	(350)	(500)	(600)			
Surplus	**151**	**219**	**281**	**284**			
Provincial Debt Changes							
Deficit (surplus) before forecast allowance	(251)	(569)	(781)	(884)			
Taxpayer-supported capital spending	4,197	5,174	5,160	5,442			
Self-supported capital investments	2,614	4,061	3,079	3,285			
Commercial Crown corp. retained earnings	(236)	195	658	772			
Amortization and other capital asset changes	765	(2,343)	(2,389)	(2,472)			
Other items	(7,708)	(2,410)	(2,203)	(2,170)			
Increase in total provincial debt	**(619)**	**4,108**	**3,709**	**3,973**			
Total provincial debt	**65,264**	**69,372**	**73,081**	**77,054**	**6.3%**	**5.3%**	**5.4%**
Provincial government direct operating	**1,024**	**-**	**-**	**-**			
Other taxpayer-supported (mainly capital)	**42,656**	**45,198**	**47,554**	**50,257**	**6.0%**	**5.2%**	**5.7%**
Self-supported	**21,484**	**23,824**	**25,027**	**26,197**	**10.9%**	**5.0%**	**4.7%**
Forecast Allowance	**100**	**350**	**500**	**600**			
Total provincial debt / GDP	23.4%	23.8%	24.1%	24.4%			
Taxpayer-supported	15.6%	15.5%	15.7%	15.9%			
Capital Spending	**6,811**	**9,235**	**8,239**	**8,727**	**35.6%**	**-10.8%**	**5.9%**
Taxpayer-supported capital spending	4,197	5,174	5,160	5,442	23.3%	-0.3%	5.5%
Self-supported	2,614	4,061	3,079	3,285	55.4%	-24.2%	6.7%
Provincial borrowing requirements	**1,966**	**7,918**	**6,060**	**6,925**			
Operatins deficit (surplus)	(151)	(219)	(281)	(284)			
Capital spending	6,811	9,235	8,239	8,727			
Refinancing requirements	2,712	3,239	1,990	2,409			
Other financing sources	(7,406)	(4,337)	(3,888)	(3,927)			
Large program expenses							
Education	13,291	13,897	14,116	14,275	4.6%	1.6%	1.1%
Health services	20,819	21,651	22,538	23,136	4.0%	4.1%	2.7%
Subtotal	41,638	43,302	45,076	46,272	4.0%	4.1%	2.7%
Other program expenses	7,002	7,033	8,136	7,829	0.4%	15.7%	-3.8%
Total education / total expenses	25.6%	25.9%	24.9%	24.7%			
Health services / total expenses	40.2%	40.4%	39.7%	40.1%			
Debt servicing costs / total expenses	5.0%	5.1%	5.0%	5.0%			

Source: Budget documents, British Columbia Ministry of Finance

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