

Rating Report

Province of British Columbia

DBRS Morningstar

April 21, 2020

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Issuer Description

B.C. is Canada's westernmost province, located along the Pacific Ocean. The Province has a population of 5.0 million and is the fourth-largest provincial economy in the country by GDP. The Province has a diverse and stable economy, with nominal GDP of about \$300.0 billion.

Ratings

Debt	Rating	Rating Action	Trend
Issuer Rating	AA (high)	Confirmed	Stable
Long-Term Debt	AA (high)	Confirmed	Stable
Renminbi Bonds	AA (high)	Confirmed	Stable
Short-Term Debt	R-1 (high)	Confirmed	Stable

Includes the Short-Term and Long-Term Obligations of the British Columbia Hydro and Power Authority (BC Hydro) based on its status as an Agent of the Crown.

DBRS Limited (DBRS Morningstar) confirmed the Issuer Rating, Long-Term Debt rating, and Renminbi Bonds rating of the Province of British Columbia (B.C. or the Province) at AA (high) and the Short-Term Debt rating at R-1 (high). All trends are Stable.

The Province released its 2020 budget on February 18, 2020. Since that time, the fiscal and economic outlook have deteriorated significantly. The Province has yet to release a comprehensive economic and fiscal update, while private-sector economic forecasts have steadily fallen in recent weeks. Despite the deterioration, the Province's credit profile remains consistent with the AA (high) rating category under DBRS Morningstar's stress scenario. This reflects the underlying strength and diversity of the Province's economy and disciplined fiscal policy and management practices, which enabled the B.C. to enter this downturn with considerable fiscal flexibility and a strong balance sheet.

DBRS Morningstar assumed a meaningful contraction in economic activity for the stress scenario (5.5% real, 7.0% nominal), reflecting a shutdown of nonessential services that lasts for several more weeks, at a minimum, before an extended period of normalization characterized by a slow return to work and ongoing physical distancing requirements.

With a decline in revenue and the new measures to support households and businesses, DBRS Morningstar estimates the Province's deficit to be about \$6.5 billion under the stress scenario. This equates to a DBRS Morningstar-adjusted deficit of \$9.5 billion, or 3.3% of GDP, which is considerably larger than that recorded at the peak of the financial crisis in 2009–10 (-2.0% of GDP). However, DBRS Morningstar notes that much of the increase in spending is likely to be one-time and nonrecurring in nature.

With the deterioration in the operating outlook and the need for increased cash to fund deferral programs and higher liquidity needs, DBRS Morningstar estimates that the Province's borrowing

program could increase by \$6.0 billion to nearly \$15.0 billion in 2020–21. Similarly, DBRS Morningstar estimates that B.C.'s net debt will surpass \$55.0 billion and that the Province's DBRS Morningstar-adjusted debt will approach \$56.0 billion in 2020–21. This equates to a DBRS Morningstar-adjusted debt-to-GDP ratio of about 19.5%, a rise of nearly 4.5 percentage points from 2019–20.

Rating Drivers

A negative rating action could result from a sustained deterioration in operating results and marked increased in the debt-to-GDP ratio beyond the levels outlined under the stress scenario. A positive rating action is not contemplated in the current environment.

Next Review

DBRS Morningstar expects to conduct a subsequent review of the Province's credit profile once the outlook has stabilized and B.C. has provided a comprehensive fiscal and economic outlook. At that time, DBRS Morningstar expects to release its customary rating report.

Financial Information	Fiscal year ended March 31				
	2021 ¹	2020 ¹	2019	2018	2017
Debt/GDP	19.5%	15.1%	14.5%	15.5%	15.8%
Surplus (deficit)/GDP	-3.3%	-0.9%	-0.1%	-0.2%	0.3%
Federal transfers/total revenue	17.9%	16.1%	16.0%	17.4%	16.3%
Interest costs/total revenue	3.2%	3.1%	3.2%	3.3%	3.3%
Real GDP Growth	-5.5%	1.8%	2.6%	3.7%	2.8%

1. DBRS Morningstar has assumed modest deterioration in the Province's operating results for 2019–20. In the absence of an updated budget forecast, DBRS Morningstar has assumed a total impact of \$750 million in revenue and expense pressures. Similarly, DBRS Morningstar has applied a stress scenario to the Province's budget 2020 outlook for 2020–21. The stress scenario assumes a sharp contraction in economic activity (-5.5% real, -7.0% nominal). Details are provided are below.

Sources: Statistics Canada, Province of British Columbia, and DBRS Morningstar.

Economic Outlook

The economic outlook has deteriorated sharply, though the full extent of the downturn will depend on the severity and duration of the shutdown of nonessential services, the pace of normalization post-shutdown (both in B.C. and elsewhere), and the extent to which federal and provincial programs support economic activity. At this time, the shutdown appears likely to last for several more weeks, at a minimum, before a gradual reopening of the economy is implemented.

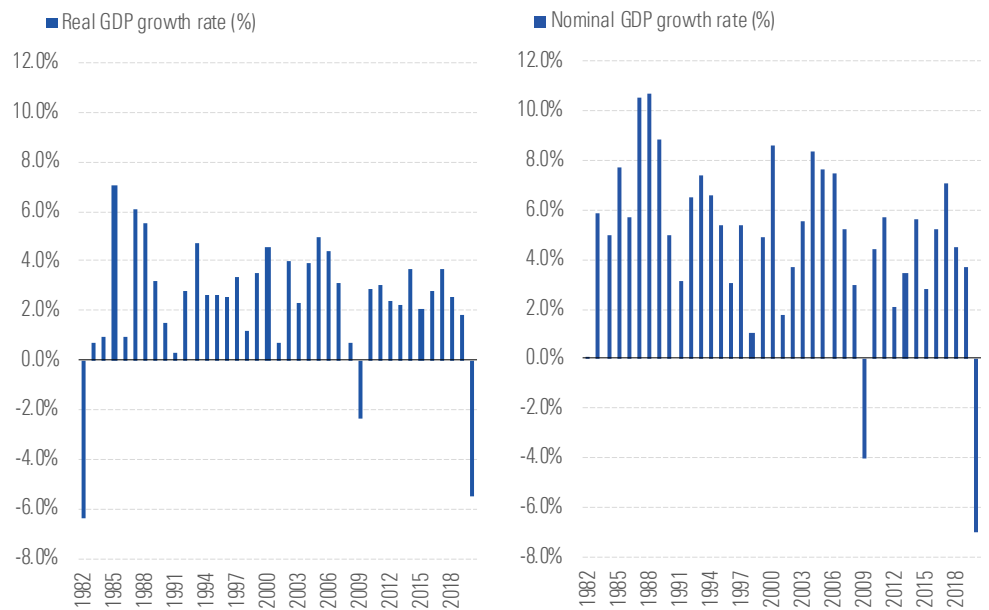
For B.C., DBRS Morningstar has assumed that real GDP will contract by 5.5% and that nominal GDP will contract by 7.0%. This scenario is comparable with recent private-sector forecasts, in which real GDP forecasts range between -3.6% and -7.9%. The assumed contraction is more severe than that experienced in 2009 when real GDP contracted by 2.4% and nominal GDP contracted by 4.0%. However, the assumed contraction is less severe than the 1982 contraction when real GDP fell by 6.4%.

A large share of the Province's economy has been directly or indirectly affected by the shutdown of nonessential services. And many of the industries that are still operating are operating on a reduced

basis because of weaker demand or physical distancing requirements. For B.C., retail and wholesale trade, transportation/warehousing, travel/tourism, accommodation and food services, entertainment and sporting events, personal services, and natural resources have all been significantly affected.

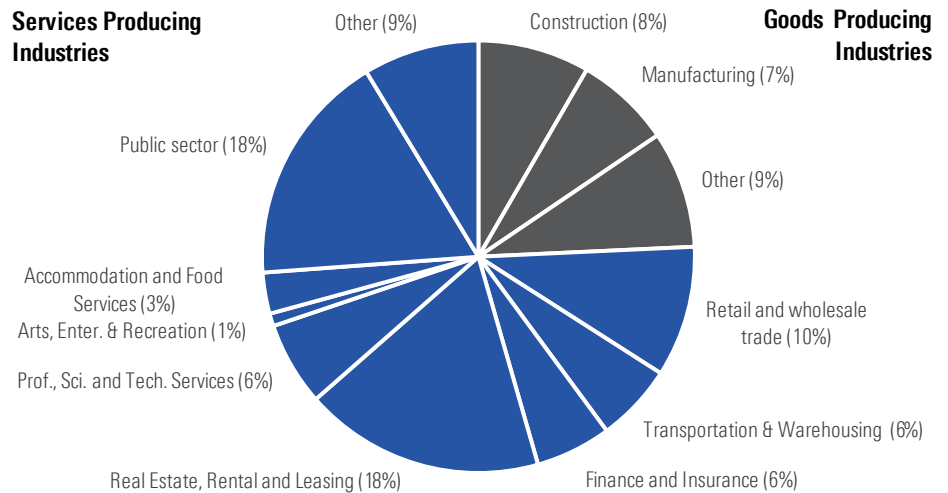
Unemployment rose sharply in March to 7.2% (an increase of 2.2 percentage points) and is expected to rise further in April. Combined with financial market losses, reduced tourism, and possibly weaker population growth, consumption will slow in the coming quarters. At the same time, the outlook for the housing market is now likely shifting for many of the same reasons. DBRS Morningstar expects a drop in transaction volumes and that some of the recent price pressures will ease. High household debt levels remain a key downside risk for the provincial outlook and could exacerbate a downturn.

Exhibit 1 History of Economic Growth and 2020 Working Assumption



Sources: Statistics Canada, Province of British Columbia, and DBRS Morningstar.

Exhibit 2 Real GDP Shares by Industry (2018)



Sources: Statistics Canada and DBRS Morningstar.

Budget Outlook

The Province tabled its 2020–21 budget in mid-February. At that time, the government continued to plan for modest budget surpluses and its policy priorities remained (1) making life more affordable, (2) enhancing public services, and (3) building a strong and sustainable economy. B.C.'s underlying budget practices continued to be conservative, which provided it with flexibility to address normal unforeseen spending pressures, revenue volatility, and statutory spending requirements (e.g., response to disasters, litigation, etc.).

The budget projected a \$227 million surplus and included more than \$1.0 billion in budget flexibility through the use of a weaker-than-consensus economic forecast, a \$300 million forecast allowance, \$600 million in explicit expense contingencies, and a relatively low natural gas price for resource revenue projections.

In response to the impact of the Coronavirus, the Province announced \$5.0 billion in new fiscal measures in late March, including income supports; tax relief; and direct funding for people, businesses, and services. The announcement included \$1.5 billion for an economic recovery program that is now under development. The Province also announced payment deferral programs for individuals and businesses, including programs for the Insurance Corporation of British Columbia, BC Hydro, and provincial taxes.

The Province has yet to provide guidance on revenue impacts. However, using B.C.'s budget sensitivities, DBRS Morningstar estimates that own revenue could be \$2.5 billion lower than the 2020 budget forecast, though DBRS Morningstar notes that the provincial revenue sensitivity estimates are less reliable with large changes to underlying assumptions. DBRS Morningstar expects declines in income tax revenue, sales and other consumption tax revenue, some Government Business Enterprise (GBE) net income (BC Hydro and liquor and lotteries), and various licenses and fees. DBRS Morningstar believes federal transfers may be modestly higher than what was projected in the Province's February budget.

The Province planned for a significant increase in capital investment (+35.8%). In the past, actual capital investment has tended to be about 15% lower than budget projections. Physical distancing requirements and possible supply disruptions are likely to result in a lower realization rate in 2020–21. Consequently, DBRS Morningstar projects that capital investment is likely to be 20% to 25% lower than the budget projection.

Taken together, DBRS Morningstar estimates the Province's budget deficit to be in the range of \$6.5 billion in 2020–21 under this scenario, which equates to a DBRS Morningstar-adjusted operating deficit of \$9.5 billion (-3.3% of GDP). DBRS Morningstar typically excludes one-time and nonrecurring spending from its DBRS Morningstar-adjusted measure. At this time, it is unclear what share of the revenue and expense impacts will be one-time in nature. DBRS Morningstar will revise its adjusted figure once more details are available.

Exhibit 3 Budget Forecast (Share of GDP)

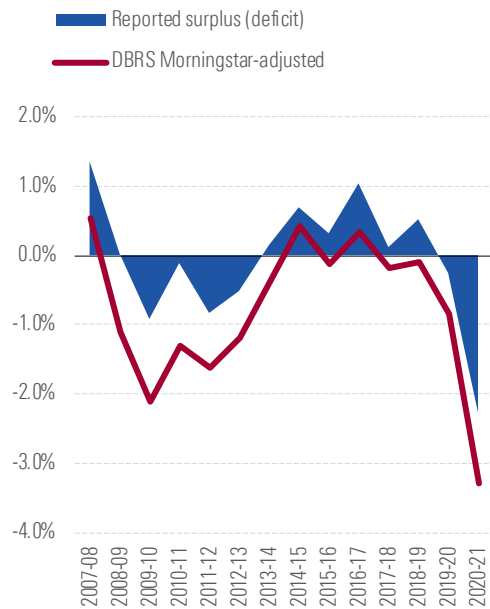
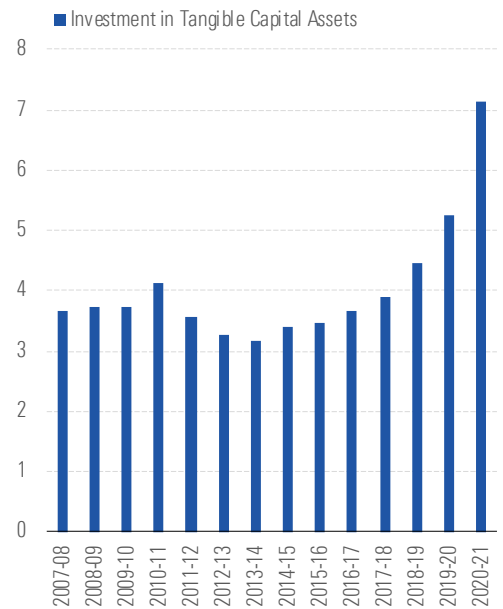


Exhibit 4 Capital Investment (CAD billions)



Sources: Province of British Columbia and DBRS Morningstar.

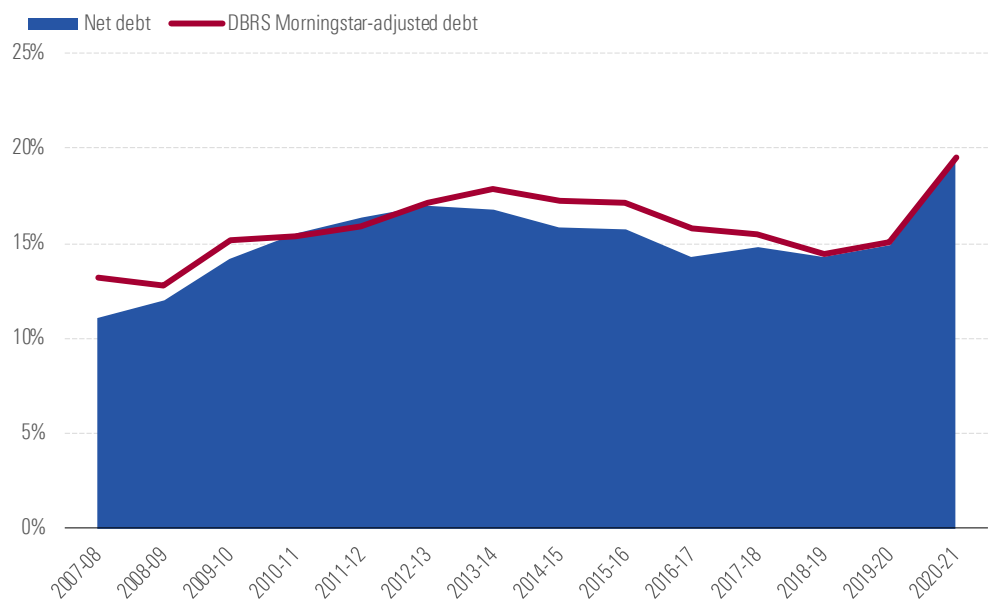
Debt and Liquidity

Under DBRS Morningstar's stress scenario, DBRS Morningstar projects the Province's borrowing requirement to rise by \$6.0 billion to \$14.6 billion in 2020–21. The \$6.0 billion increase incorporates the deterioration in the budget outlook, additional cash requirements to fund various deferral programs to enhance liquidity.

DBRS Morningstar estimates that the Province's net debt will surpass \$55.0 billion and that the Province's DBRS Morningstar-adjusted debt will approach \$56.0 billion in 2020–21. This equates to a DBRS Morningstar-adjusted debt-to-GDP ratio of about 19.5%. While this is a significant increase above recent levels and higher than those reached following the financial crisis, it remains the lowest debt-to-GDP ratio among the Canadian provinces.

DBRS Morningstar notes that B.C. has been proactive in recent weeks to enhance its liquidity position amid market uncertainty. The Province has raised \$6.6 billion since mid-March in term debt and has increased its short-term debt outstanding by about \$1.8 billion. While market conditions have been challenging, the Province continues to have broad market access and solid investor receptivity. DBRS Morningstar expects provincial funding conditions to continue to improve, particularly with the introduction of the Bank of Canada's Provincial Money Market Purchase Program and the Provincial Bond Purchase Program.

Exhibit 5 Debt-to-GDP Ratios (%)



Sources: Statistics Canada, Province of British Columbia, and DBRS Morningstar.

At the time of writing, the Province has significant liquidity. The Province has more than \$9.6 billion in cash and temporary investments, \$0.7 billion in sinking funds, an estimated \$3.0 billion in special-purpose funds, and it maintains \$400 million in undrawn credit facilities.

Notes:

All figures are in Canadian dollars unless otherwise noted.

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Generally, Issuer Ratings apply to all senior unsecured obligations of an applicable issuer, except when an issuer has a significant or unique level of secured debt.

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Together as DBRS Morningstar, we are the world's fourth-largest credit ratings agency and a market leader in Canada, the U.S., and Europe in multiple asset classes. We rate more than 2,600 issuers and 54,000 securities worldwide and are driven to bring more clarity, diversity, and responsiveness to the ratings process. Our approach and size provide the agility to respond to customers' needs, while being large enough to provide the necessary expertise and resources.



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