MOODY'S INVESTORS SERVICE

CREDIT OPINION
2 June 2021

Update

Rate this Research

RATINGS

British Columbia, Province of

Domicile	British Columbia, Canada
Long Term Rating	Aaa
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Province of British Columbia (Canada)

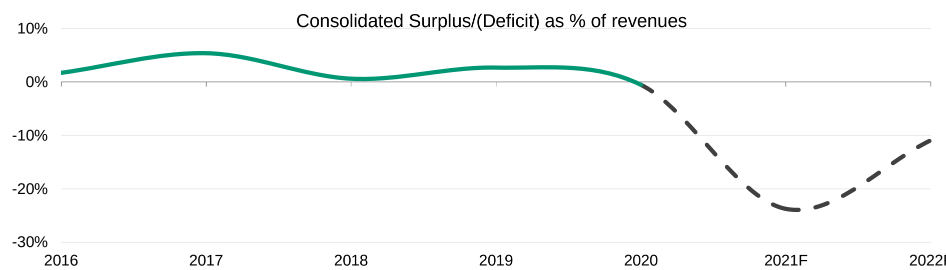
Update following rating affirmation

Summary

The credit profile of the Province of British Columbia (Aaa stable) reflects a large and diverse economy, diversified export profile and a high degree of budget flexibility. Liquidity balances from a long history of fiscal surpluses provide some cushion against economic and fiscal pressures from the coronavirus pandemic. Nevertheless, the pandemic has weakened the province's fiscal profile, including multi-year projected deficits averaging 10.6% of revenue over the next three years, and rising debt levels as debt is needed to finance both deficits and capital spending. In addition, the growing debt of BC Hydro represents material contingent liability risk for the province, although the likelihood of these liabilities crystallising on the province's balance sheet is low. At the same time, debt affordability remains very strong.

Exhibit 1

A lengthy period of historical surpluses provides some cushion against multi-year deficits (fiscal years ending March 31)



All forecasts are Moody's

Source: Moody's Investors Service, Province of British Columbia

Credit strengths

» Diversified economic base, resilient exports and competitive tax environment

» Considerable fiscal policy flexibility from institutional framework and large federal transfers

» Forecast prudence, debt management policies and access to liquidity provide safeguards

Credit challenges

» Multi-year deficits and an extended timeframe to return to balance

» Rising debt levels and rising contingent liability of BC Hydro

Rating outlook

The stable outlook incorporates our view that British Columbia is highly likely to implement measures that will slow the erosion in its fiscal strength over the next 18-24 months. The high level of contingency and conservative economic forecasts built into its budget projections provides a significant cushion against further erosion. In addition, the province has sufficient liquidity and fiscal flexibility, supported by a large, diversified economy, to address unforeseen coronavirus-related pressures.

Factors that could lead to a downgrade

The rating could be downgraded if the province were unable to meaningfully improve its deficit trajectory over the next 18-24 months, coinciding with continued deterioration in the debt burden or a weakening in the province's liquidity profile. A faster than forecasted rise in interest rates or a material weakening in BC Hydro's financial metrics beyond our current assumptions could also add pressure to the rating.

Key indicators

Province of British Columbia

(Year Ending 3/31)	2018	2019	2020	2021F	2022F	2023F	2024F
Net Direct and Indirect Debt as a % of Revenue	81.5	71.9	77.1	96.2	120.5	129.5	141.2
Net Direct and Indirect Debt as a % of GDP	15.0	13.9	14.6	19.9	22.6	24.7	26.7
Cash Financing Surplus (Requirement) as a % of Revenue	1.3	1.0	-4.4	-19.8	-20.1	-13.0	-11.1
Consolidated Surplus (Deficit) as a % of Revenue	0.6	2.7	-0.5	-13.4	-16.5	-8.7	-6.6
Adjusted Interest Expense as a % of Revenues	3.4	3.2	3.1	3.0	3.3	3.3	3.5
Intergovernmental Transfers as a % of Revenue	17.4	15.8	16.3	21.9	17.9	16.5	16.8
Real GDP Growth (%) [1]	2.7	2.7	-5.3	4.4	3.8	2.2	2.1

All forecasts are Moody's
(1) Calendar year
Source: Moody's Investors Service, Province of British Columbia

Detailed credit considerations

Baseline credit assessment

On 27 May 2021, we affirmed British Columbia's Aaa ratings with a stable outlook, and downgraded the baseline credit assessment (BCA) to aa1 from aaa. The rating action reflects the province's strengths including a diverse economic profile, strong institutional framework and high debt affordability, but rising debt levels and a structural deficit which will take several years to remedy.

The credit profile of the Province of British Columbia, as expressed in its Aaa stable rating, combines a BCA for the province of aa1, and a high likelihood of extraordinary support coming from the Government of Canada (Aaa stable) in the event that the province faced acute liquidity stress.

Diversified economic base, resilient exports and competitive tax environment

British Columbia is the third largest Canadian province by population and fourth largest provincial economy, accounting for about 13% of Canada's GDP. Located on Canada's western coast, British Columbia remains an important hub for goods shipped to and from Asia, and as a result the export markets of British Columbia are more diversified than Canada and other provinces, providing a key credit strength to the province.

While Canada typically sees nearly three-quarters of exports flow to the US, the US accounts for only slightly over half of British Columbia's exports. Other key markets include China and Japan and several other countries in the Asia-Pacific region. The dominance of China in the province's Asian exports exposes the province to some concentration risk, although the wide diversification of sectors and markets reduces the vulnerability of the provincial economy from sector-specific or trading partner-specific shocks. The slowdown in the flow of goods and services due to the pandemic has added some risks, however we expect that British Columbia's principal export partners will recover relatively quickly from the crisis.

The economy provides for a large tax base which ensures that provincial revenues are not strongly impacted by a decline in one particular sector. Furthermore, British Columbia's level of taxation is at the lower end of the Canadian provinces, presenting the province the flexibility to raise taxes if revenues were to fall below expected levels while still remaining competitive with other jurisdictions.

Economic diversity is underpinned by several large industries including real estate (both rental and leasing), wholesale and retail trade, and construction. The natural resource sector is also important, primarily natural gas and forestry products. Approximately CAD40 billion in new upstream pipeline and liquefaction plant construction projects in the province by LNG Canada, a consortium of international energy companies, and TC Energy Corp. (Baa2 stable) will provide support to the natural gas industry, and will partly offset the recent exit of several key players in this sector.

Leading up to the coronavirus pandemic, British Columbia's economy outpaced the growth of most Canadian provinces. The pandemic has caused an estimated real GDP contraction of 5.3% for 2020 followed by 4.4% growth in 2021 and 3.8% growth in 2022, but more moderate stable long-term growth between 2.1% and 2.5% over the following three years.

Considerable fiscal policy flexibility from institutional framework and large federal transfers

British Columbia, like most Canadian provinces, enjoys significant flexibility in its financial management. The institutional framework governing relations, powers and responsibilities between the Canadian provinces and the federal government is well developed and stable. This framework provides British Columbia with unfettered access to a broad range of tax bases and broad discretion over expenditure decisions, and substantial flexibility to address fiscal challenges including the ability to alter spending plans.

Compared to their counterparts in other countries, including the German Länder and the Australian states, Canadian provinces enjoy far greater fiscal and budgetary autonomy. As a result, British Columbia benefits from a high degree of fiscal policy flexibility that is more similar to sovereign governments than many international sub-sovereign peers. These positive institutional factors increase the province's ability to manage through economic downturns and handle higher debt burdens.

The institutional framework also includes important federal fiscal transfers to the province, including health and social transfers. These transfers are highly predictable and secure, although have risen during the pandemic as the federal government has initiated a number of support programs for both individuals and businesses, as well as directly to provinces and municipalities. British Columbia has benefitted from significant federal support, including under the CAD19 billion (combined for all provinces) Safe Restart Program for transit, municipal support, health, testing, equipment and other coronavirus-related support, of which approximately CAD2 billion has been allocated to British Columbia.

As a result we estimate federal transfers, which have historically accounted for around 16% of British Columbia's revenues, at between 18% and 22% of total revenue for 2020-21 and 2021-22 given additional federal support for COVID relief and given weaker other provincial revenues. In subsequent years we expect this ratio to revert to historical levels.

Forecast prudence, debt management policies and access to liquidity provide safeguards

The province's forward-looking fiscal analysis incorporates several measures of prudence to minimize the impacts of potential downward pressures including from the coronavirus pandemic. These safeguards include using economic forecasts that are below private sector consensus forecasts, a practice that provides flexibility to accommodate adverse economic shocks. In addition, the high level of contingencies and forecast allowances built into the province's budget projections, which account for between 50% and 80% of projected deficits, could suggest some upside to forecasts.

Despite rising debt levels, the province follows prudent debt management policies. Debt issues are hedged for interest rate and currency risk, and the debt maturity profile is well staggered with manageable annual maturities averaging around CAD3-4 billion over the next five years. The province may also pre-borrow a portion of its debt issues in a given year to take advantage of favourable interest rates. Access to both domestic and international capital markets remains strong with significant investor interest in the province's bonds, despite some stress in the early months of the coronavirus pandemic in 2020.

The province also maintains strong levels of liquidity from unrestricted cash and investments, which we project will cover 13% of net direct and indirect debt and nearly 11% of expenses at March 31, 2021. We expect that the coverage relative to debt will weaken over the next three years as debt levels continue to rise and expenses stay elevated, nevertheless the province will maintain sufficient levels of cash reserves to provide a liquidity cushion for fiscal uncertainties related to the pandemic.

Measures undertaken by the federal government over the past year provided further support for British Columbia's liquidity, with a gradual easing of these measures as the recovery is expected to take hold. These actions included the purchase of significant amounts of provincially issued money market securities in the primary markets and the purchase of bond securities in the secondary market.

Multi-year deficits and an extended timeframe to return to balance

Following a multi-year period of consistent consolidated surpluses leading up to the pandemic, British Columbia is projecting a deficit of CAD8.1 billion (13.4% of revenue) in 2020-21 and large deficits averaging 10.6% of revenue over the next three years. As a result, the province faces a multi-year structural deficit with an extended return to balance projected over a long period of 7-9 years. Therefore, the measures needed to achieve this will take a number of years to formulate and implement.

The provincial government's fiscal strategy over the next three budget years includes its projection of gradually improving revenues as an economic recovery takes hold, which is balanced against persistently elevated expenses, especially in health and social spending. Total expenses will remain elevated and near 2020-21 levels, suggesting in our view a weakening capacity and willingness to rein in spending even as the province expects to see an economic recovery take hold from the coronavirus pandemic.

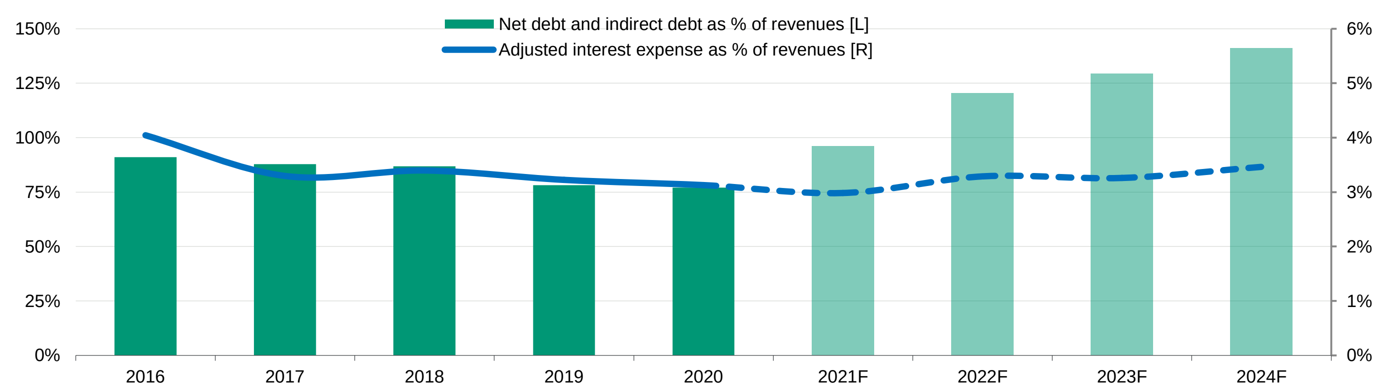
The willingness to spend is also seen in the projection of elevated capital expenditure. The province's capital program will total CAD39.5 billion over the next three years, including stimulus spending and a wide range of infrastructure projects including schools, hospitals, transit and power projects. Although high levels of spending could support higher levels of growth, they will drive the increase in the debt burden in the coming years.

While there have been signs of an economic rebound in recent months, recovery remains contingent on the speed of vaccination rollout and the easing of travel restrictions.

Rising debt levels and rising contingent liability of BC Hydro

The projected large deficits, which require debt financing, together with an elevated capital program, will result in continued increases in debt levels which we already projected to be on a rising trajectory pre-pandemic. The province anticipates an elevated borrowing program of CAD51.9 billion over the three-year budget horizon which includes borrowing for both operations and capital spending, including for provincial agencies. As a result, we forecast that net direct and indirect debt will rise substantially from 96% of revenue in 2020-21 to exceed 140% by 2023-24.

Exhibit 3
Strong debt affordability will cushion the rise in the debt burden
(Fiscal years ending March 31)



Source: British Columbia, Moody's Investors Service

The high level of contingency built into the budget projections could result in the debt burden peaking at a lower level than currently forecast. In addition, the rising debt burden is mitigated by strong debt affordability which compares favourably to domestic and global peers, with our estimate of interest expense between 3% and 4% of revenue over the next three years. Nevertheless, affordability could weaken if interest rates were to rise faster than anticipated if economic recovery over the next few years results in less accommodative monetary policy globally.

The province issues debt on behalf of British Columbia Hydro & Power Authority (Aaa stable) (BC Hydro), the wholly-owned electric utility company of British Columbia. While BC Hydro generates a steady revenue stream with sufficient cash flow to support operations, its total reported debt has risen considerably over the last decade, increasing from CAD9.2 billion in 2008-09 to an estimated CAD27.8 billion in 2021-22.

The province recently announced that it will continue the construction of BC Hydro's Site C hydroelectric dam with a one-year delay to completion and at a revised cost estimate of CAD16 billion, 50% above the province's previous estimate of CAD10.7 billion. The increase in costs and the delay in the completion date to 2025 from 2024 have been attributed mainly to pandemic-related pressures and geotechnical challenges. The rising debt of BC Hydro represents an increasing contingent liability for the province, although we believe there is a low likelihood of those liabilities crystallising on the province's balance sheet.

Extraordinary support considerations

We consider that there is a high likelihood that British Columbia would receive extraordinary support from the Government of Canada should the province experience an acute liquidity need. This reflects our assessment of the incentive to the federal government of minimizing the risk of potential disruptions to capital markets if British Columbia, or any province, were to default, as well as indications of a moderately positive federal government policy stance, as illustrated by the flexibility inherent in the system of federal-provincial transfers.

ESG considerations

How environmental, social and governance risks inform our credit analysis of British Columbia

We take into account the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of British Columbia, the materiality of ESG to the credit profile is as follows:

Exposure to environmental risks is low for British Columbia's credit profile. Although the province is susceptible to natural disasters such as floods, severe weather and wildfires that could result in mitigation expenses and economic losses, the province manages these risks prudently and the amounts do not result in significant pressure on the province's fiscal profile.

Exposure to social risks is moderate. We regard the coronavirus outbreak as a social risk, given the substantial implications for public health and safety. The uncertainty regarding the outbreak's breadth and severity adds to downward risk on fiscal outcomes. Additionally, the province faces social risks stemming from its responsibility to provide services in such sectors as healthcare, social services, transportation related infrastructure, public safety and education.

Governance considerations are material to the credit profile, but risks are low. British Columbia displays very strong governance attributes. These include the use of forward-looking plans and analysis, transparent and timely financial statements, and prudent debt and liquidity management as highlighted in our analysis above.

Further details are provided in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology 'General Principles for Assessing Environmental, Social and Governance Risks'.

Rating methodology and scorecard factors

In the case of British Columbia, the BCA matrix generates a scorecard-indicated outcome of aa1, in line with the assigned aa1 BCA. The scorecard-indicated outcome of aa1 reflects (i) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (ii) a systemic risk score of Aaa, as reflected in the sovereign bond rating for the Government of Canada (Aaa stable).

For details of our rating approach, please refer to Regional and Local Governments published January 2018.

Exhibit 4

British Columbia, Province of

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**3.80**	**20%**	**0.76**
Economic Strength [1]	5	101.94%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**1**	**20%**	**0.20**
Legislative Background	1		50%			
Financial Flexibility	1		50%			
Factor 3: Financial Position				**3.75**	**30%**	**1.13**
Operating Margin [2]	7	-3.22%	12.5%			
Interest Burden [3]	5	3.06%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	5	96.19%	25%			
Debt Structure [5]	3	13.37%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**2.39 (2)**
Systemic Risk Assessment						**Aaa**
Suggested BCA						**aa1**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance by function/operating revenues
[3] (Adjusted) interest expenses/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2020.

Ratings

Exhibit 5

Category	Moody's Rating
BRITISH COLUMBIA, PROVINCE OF	
Outlook	Stable
Issuer Rating	Aaa
Senior Unsecured	Aaa
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

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