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Research Update:

Province of British Columbia 'AAA' Long-Term Rating Affirmed; Outlook Remains Stable

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Overview

- We expect the Province of British Columbia's (B.C.) economy will continue expanding modestly and that, in combination with sound fiscal management, will contribute to strong budgetary outcomes.
- As a result, we are affirming our ratings on B.C., including our 'AAA' long-term issuer credit rating.
- The ratings reflect the province's strong and growing economy, robust liquidity, and sound financial management practices.
- The stable outlook reflects our expectations that B.C.'s economy will continue expanding modestly through the next two years and that the government will maintain its fiscal prudence, contributing favorably to the province's budgetary performance and helping to contain its high debt burden.

Rating Action

On April 25, 2018, S&P Global Ratings affirmed its ratings, including its 'AAA' long-term issuer credit rating, on the Province of British Columbia (B.C.). At the same time, S&P Global Ratings affirmed its 'AAA' issue rating on British Columbia Hydro & Power Authority's (BC Hydro) provincially guaranteed senior unsecured debt. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, prudent financial management practices will be maintained and the government will be able to enact its policies unencumbered. We also expect B.C.'s economy to continue expanding modestly. That, in combination with new tax measures, will support provincial revenues. Together, these will, we believe, contribute to relatively stable budget performances, with modest operating surpluses, and after-capital deficits of less than 5% of total revenues through 2021.

The entrenchment of the political resolve to sustain sound fiscal outcomes, including the willingness to consistently take strong action to retain fiscal sustainability, have been key features distinguishing B.C. from its domestic and international peers. Erosion in these traits, for instance due to a perceived weakening in the government's willingness and ability to enact reforms to sustain strong fiscal outcomes in response to an external shock, could lead to a downgrade.

Rationale

We have updated our base-case scenario for B.C. and extended our forecasting horizon to fiscal 2021. Given the tabling of the new government's first full year budget, we believe that with solid real and nominal GDP growth, new revenue measures, and multiple levels of prudence, the government will continue to conservatively manage budgetary performance. Updated projections point to further modest operating surpluses through fiscal 2021. Nevertheless, unprecedented levels of capital spending will result in higher after-capital deficits and modest increases of debt in absolute terms. In our view, the ability to enact policies to preserve strong fiscal outcomes, in addition to B.C.'s other longstanding markers of credit strength such as high liquidity, strong budgetary flexibility, and a wealthy economy are critical to maintaining the 'AAA' rating.

A robust economy, superior financial management, and a supportive institutional framework bolster the province's creditworthiness.

In our opinion, B.C.'s financial management practices remain very strong. The minority New Democratic Party government tabled its first full year budget on Feb. 20, 2018. The government has maintained its stance of using prudence in its fiscal plan, maintaining a balanced budget and debt affordability within a sustainable fiscal framework. In the past, the province has demonstrated what we view as good political and managerial strength. We will continue to monitor the government's ability and willingness to make politically difficult decisions if required to sustain strong fiscal performance as expected at the 'AAA' level. In the past, this has enabled B.C. to enact structural changes, including strong expenditure management control. In addition, the civil service remains experienced and qualified to effectively enact fiscal policies. We believe that the province has well-defined financial policies and a well-documented financial plan that provides visibility. We also believe that management of debt and liquidity is prudent. We find B.C.'s financial disclosures transparent, comprehensive, and timely.

Chief among the province's credit strengths is its robust and diversified economy. Large resource endowments, high-ranking livability, and close proximity to Asian markets underpin its affluent tax base. B.C.'s nominal GDP per capita is estimated to be greater than US$42,800 (based on a three-year average). We expect the province's GDP per capita to continue modestly rising in the next two years, thanks largely to domestic activity. Some key sectors are forestry, mining, and natural gas; financial and real estate services; construction and manufacturing; and a large public sector. We believe that the province's near-term economic prospects are healthier than those of most other Canadian provinces because of B.C.'s relatively diversified economic base, which provides diversification and resiliency. Of importance, while the uncertainty regarding U.S. fiscal and trade policy remains a meaningful risk for Canadian provinces, B.C.'s more diversified mix of trade partners, particularly in Asia, mitigates the province's exposure. Exports to the U.S. account more than 80% of the total trade conducted by some Canadian provinces but for B.C., exports to the U.S. account for closer to 50% of its total international goods exports.

In 2018, for key indicators such as housing starts, employment, retail sales and exports, we expect that the economy will grow by 2.3% and by a further 2.0% annually thereafter. In 2017, B.C.'s economy continued to outperform compared to forecasts, with real GDP growth estimated at 3.4%. Stronger-than-anticipated employment, consumer spending, and export activity were significant contributors to economic growth last year. In addition, the province logged a record level of housing starts. We believe that higher interest rates and tighter mortgage rules will weigh on housing starts and that the real estate sector (which comprises about 12.5% of GDP) will moderate toward a soft landing in the medium term.

The ratings also benefit from the very predictable and well-balanced institutional framework for Canadian provinces. The Canadian constitution is the cornerstone of federal-provincial intergovernmental arrangements, which we view as mature and stable. The federal government provides revenue support through a number of agreements and transfer arrangements including the Canada Health Transfer and Canada Social Transfer payments. For fiscal 2018 (year ended March 31), total federal government transfers constituted an estimated 16% of provincial adjusted operating revenues. The agreements covering these transfers are long-term, formula-driven, and predictable, but can be subject to change infrequently. Typically, the federal and provincial governments discuss proposed changes to transfer programs well ahead of their implementation.

Revenue measures and strong economic performance will partially mitigate higher spending commitments, leading to modestly weaker budgetary performance and a moderately increasing debt burden.

Stronger-than-expected economic growth has given the province more fiscal room. After incorporating new tax measures, primarily the employer health tax, increased spending commitments, and the elimination of Medical Services Plan premiums in fiscal 2020, we expect only a marginal impact to our 2017-2021 base-case forecast. Nevertheless, we expect that B.C.'s overall budgetary performance will remain stronger than that of most of its domestic peers. We expect modest average operating surpluses of about 5% of operating revenues and average after-capital deficits to remain below 5% of total revenues. The province is undertaking an unprecedented level of infrastructure spending over the next three years and, as a result, capital expenditures, on average, are projected to represent about 8% of total expenses. We expect tax-supported average annual capital spending of about C$4.7 billion, reflecting investments in roads, schools, hospitals, and public safety. Of note, based on the province's historical spend rates for its capital program versus budget, we have incorporated a spend rate of about 85% into our base-case forecasts.

In the next two years, record levels of capital spending will lead to modest increases in B.C.'s already high debt burden. We are forecasting its tax-supported debt burden (including debt borrowed in the province's name and on-lent to BC Hydro) will increase to about 130% of consolidated operating revenue in fiscal 2021, from 122% in fiscal 2017. In line with historical results, B.C.'s interest expense will, we expect, average about 5% of revenues in the next two fiscal years. We consider the province's pension liabilities very manageable and not a risk for B.C.'s finances.

In our view, B.C.'s robust liquidity bolsters its creditworthiness, as the province maintains sufficient cash and liquid assets to manage cash-flow timing differences and debt service. We estimate the province's fiscal 2019 free cash and liquid investments of almost C$10.4 billion (S&P Global Ratings-adjusted) will be sufficient to cover about 157% of its budgeted debt service in the next 12 months. This excludes its sinking fund balances; however, these too would be accessible if required. We do not expect any material deterioration in B.C.'s internal liquidity in the next two fiscal years. The province also benefits from exceptional access to external liquidity. In addition to issuing in the domestic market, the province maintains liquid benchmark issues in Canada, and has active borrowing programs in the U.S., Europe, and China, providing important diversification. It uses swaps to fully mitigate currency risk on its foreign currency bond issues and targets minimal exposure to floating rate risk.

The province has high budgetary flexibility compared with that of other Canadian provinces and international peers, in our view. Compared with most central and eastern Canada provinces that receive equalization, in addition to social and health transfers, B.C. has relatively more autonomy over a large share of its revenue base, with modifiable (own-source) revenues accounting for an estimated 84% of operating revenues, on average, in our base-case scenario. Further contributing to B.C.'s robust budgetary flexibility is the province's flexibility to reduce operating spending. This reflects the government's historical willingness and ability to undertake difficult decisions when needed. For example, beginning in 2009, to help meet its balanced budget targets for fiscal 2014, the government reduced expenditure growth by limiting compensation increases in negotiated wage mandates and incorporated administrative savings across all government organizations, such as reduced full-time equivalents.

In our opinion, B.C.'s contingent liabilities are low. This largely reflects limited postemployment benefits including health plan, retirement allowances, long-term disability, self-insured workers' compensation, and accumulated sick leave benefits, as well as litigation, environmental clean-up, and the portion of public-private partnership contracts still in the construction phase, which were valued, in total, at C$4.5 billion or 9% of the province's operating revenue at fiscal year-end 2017. We view the B.C. Hydro and BC Ferries Services Ltd. as self-supporting and expect that financial support would be unlikely, given the companies' strong demand profile and supportive regulation.

Key Statistics

Table 1

Province of British Columbia -- Selected Indicators							
	--Budget Year*--						
(Mil. C$)	2014	2015	2016	2017bc	2018bc	2019bc	2020bc
Operating revenues	45,300	47,667	51,620	52,627	54,036	56,668	57,665
Operating expenditures	42,602	44,906	46,084	49,624	51,631	54,889	55,890
Operating balance	2,698	2,761	5,536	3,003	2,405	1,779	1,775
Operating balance (% of operating revenues)	6.0	5.8	10.7	5.7	4.5	3.1	3.1
Capital revenues	82	83	97	105	113	128	142
Capital expenditures	3,726	3,726	3,940	4,425	4,795	4,691	4,962
Balance after capital accounts	(946)	(882)	1,693	(1,317)	(2,277)	(2,784)	(3,045)
Balance after capital accounts (% of total revenues)	(2.1)	(1.8)	3.3	(2.5)	(4.2)	(4.9)	(5.3)
Debt repaid	3,417	2,738	3,176	2,688	3,874	2,423	3,085
Gross borrowings	5,644	5,110	3,767	2,069	7,982	6,132	7,058
Balance after borrowings	1,281	1,490	2,284	(1,936)	1,831	925	928
Modifiable revenues (% of operating revenues)	84.1	84.1	84.4	84.0	83.7	84.2	84.0
Capital expenditures (% of total expenditures)	8.0	7.7	7.9	8.2	8.5	7.9	8.2
Direct debt (outstanding at year-end)	59,751	61,731	62,227	61,592	65,720	69,436	73,371
Direct debt (% of operating revenues)	131.9	129.5	120.5	117.0	121.6	122.5	127.2
Tax-supported debt (outstanding at year-end)	60,539	62,584	63,201	63,136	67,264	71,119	75,054
Tax-supported debt (% of consolidated operating revenues)	133.6	131.3	122.4	120.0	124.5	125.5	130.2
Interest (% of operating revenues)	5.4	6.0	4.9	4.8	5.1	5.0	5.2
Local GDP per capita (single units)	52,092	53,623	55,428	57,995	59,909	61,581	63,259
National GDP per capita (single units)	56,006	55,673	56,129	58,418	59,938	61,829	63,688

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case. Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

Ratings Score Snapshot

Table 2

Province of British Columbia -- Rating Score Snapshot	
Key Rating Factors	Assessment
Institutional Framework	Very predictable and well balanced
Economy	Very strong

Table 2

Province of British Columbia -- Rating Score Snapshot (cont.)

Key Rating Factors	Assessment
Financial Management	Very strong
Budgetary Flexibility	Very strong
Budgetary Performance	Strong
Liquidity	Exceptional
Debt Burden	High
Contingent Liabilities	Very low

*S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the government's foreign currency rating.

Key Sovereign Statistics

Sovereign Risk Indicators, April 10, 2018. Interactive version available at http://www/spratings.com/sri

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Governments - International Public Finance: Methodology And Assumptions: The Impact Of PPP Projects On International Local And Regional Governments: Refined Accounting Treatment, Dec. 15, 2008

Related Research

- Americas Economic Snapshots, March 2018
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local and Regional Government Default Study and Rating Transitions, May 8, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Canadian Provinces, Dec. 1, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

British Columbia (Province of)	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured	AAA
Commercial Paper	A-1(HIGH)
Commercial Paper	A-1+
British Columbia Hydro & Power Auth	
Senior Unsecured	AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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