S&P Global Ratings

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Research Update:

Province of British Columbia Downgraded To 'AA-' From 'AA' On Continued Fiscal Weakening; Outlook Negative

April 8, 2024

Overview

- The Province of British Columbia's (B.C.) 2024 budget outlines continued extensive investment for operations and record levels of capital spending over the next three years, which will lead to outsize after-capital deficits of more than 15% of total revenues and a relatively steep increase in debt through to fiscal 2027.
- As a result, S&P Global Ratings lowered its long-term issuer credit and senior unsecured debt ratings on B.C. to 'AA-' from 'AA'. At the same time, we affirmed our 'A-1+' short-term issuer credit rating on the province.
- The negative outlook reflects that, in the next two years, there is at least a one-in-three chance that a continuation of the current fiscal trajectory, with outsize after-capital deficits, will lead to climbing debt levels and very low levels of internal liquidity that are weaker than those of similarly rated peers.

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Rating Action

On April 8, 2024, S&P Global Ratings lowered its ratings, including its long-term issuer credit rating, on the Province of British Columbia, as well as its issue-level rating on British Columbia Hydro & Power Authority's (BC Hydro) provincially guaranteed senior unsecured debt, to 'AA-' from 'AA'. The outlook is negative. S&P Global Ratings also affirmed its 'A-1+' short-term rating on B.C.

Outlook

The negative outlook reflects a one-in-three chance that we could lower the ratings in the next two years if, in our view, the province's commitment to fiscal consolidation continues to waver, as reflected by persistent large after-capital deficits.

Downside scenario

We could lower the ratings in the next two years if B.C. maintains its current fiscal trajectory, as reflected by operating and sizable after-capital deficits as well as free cash flow of less than 40% of next 12 months' debt service. Lack of a medium- and longer-term view and commitment to ensure fiscal sustainability could also affect the rating.

Upside scenario

In the next two years, we could revise our outlook to stable if there is a reversal of the current fiscal trajectory, which is bolstered by stronger economic growth and/or financial prudence, that positively affects budgetary performance.

Rationale

With the continued impact of macroeconomic headwinds on the cost of living, B.C. has maintained focus on taxpayer affordability. At the same time, with robust population growth, the province is investing in infrastructure at unprecedented levels. While other provinces are contending with similar issues in their recent budget announcements, the size and persistence of material after-capital deficits differentiate B.C. from its peers. As a result, in the next two years, we expect the province will continue to produce sizable operating deficits of greater than 5% of operating revenues and a record level of after-capital deficits, not seen since the pandemic, of about 20% of total revenues. In addition, B.C.'s internal liquidity position will remain at a very low level and tax-supported debt will keep climbing, reaching 182% of operating revenue by the end of fiscal 2027 (year ending March 31). We believe the province is at a turning point with respect to the management of its finances and we will keep monitoring the evolution of the fiscal trajectory in the medium term.

Economic growth will remain weak in 2024 but recover and, in part, be bolstered by the LNG sector thereafter.

We expect that, after subdued growth in 2023, B.C.'s economic prospects will continue to wane in 2024, largely due to the impact of inflation and high interest rates. We estimate B.C.'s real GDP will increase by 1.1% in 2024 and 2.8% in 2025. This is moderately better than our national forecast of about 0.9% and 1.5%, respectively (see "Economic Outlook Canada Q2 2024: Staying Subdued," published March 26, 2024, on RatingsDirect) and incorporates our expectation that B.C.'s economic growth will outperform the province's assumptions. In addition, we forecast that B.C.'s GDP per capita will remain in line with the national figure of about US$55,400 for 2024.

The province has considerable economic strengths, such as its position on the west coast of Canada and its proximity to Asian markets, as well as large natural resource assets. We expect the economy will remain well diversified. Key sectors include forestry, mining and natural gas, financial and real estate services, and construction and manufacturing. We believe that the province's economy will be bolstered in 2025 and beyond, when LNG Canada's facility is anticipated to come online in the coming year. In addition, B.C. has a large public sector consisting of government, universities, public schools, and hospitals.

We believe that the province's commitment to fiscal discipline and stability has wavered in recent years as B.C. has materially increased its spending for both operations and capital investment to unparalleled levels, while economic growth is slowing. The provincial election will take place later this year, on or before Oct. 19, 2024. Overall, B.C.'s financial planning practices are well aligned with those of domestic peers and are transparent. We view B.C.'s debt and risk management practices as adequate and in line with those of other provinces. The province uses swaps to mitigate currency risk on its foreign currency bond issues and targets minimal exposure to floating rate risk. Cash management is sophisticated, adhering to prudent internal policies. The civil service is experienced and qualified to effectively deliver fiscal direction.

As is the case with all other provinces, the ratings on B.C. 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 support through a number of agreements and transfer arrangements, including payments under the Canada Health Transfer and the Canada Social Transfer. The share of total provincial revenues represented by federal government transfers is an estimated 18% in fiscal 2024.

Fiscal results will deteriorate further with lower tax receipts and a large spending envelope in the next two years.

Considering B.C.'s focus on taxpayer affordability and on capital investment when economic growth is weakening, we expect that the province's fiscal performance will materially deteriorate in the next two years. With operating deficits of more than 5% of operating revenues and after-capital deficits of about 20% of total revenues, B.C.'s budgetary performance will be the weakest of its peers, both domestically and internationally. In the next three years, we expect that the province will spend about C$32.5 billion in capital investment, allocated primarily to new health care and transportation infrastructure. We also believe that the province's operating expenditures will structurally increase once B.C.'s significant capital program is complete beyond fiscal 2027. B.C.'s pension scheme is fully funded, comparing positively with that of international peers.

Higher operating and capital needs will lead to increased borrowing requirements in the next two years. We project that, although still low relative to that of other Canadian provinces, B.C.'s tax-supported debt burden, which includes debt issued in its own name and on-lent to BC Hydro, will considerably rise to about C$156 billion or 182% of operating revenues in fiscal 2027. We also expect the interest burden will remain moderate, at about 5%-6% of operating revenues in the next three years. Contingent liabilities remain manageable.

We expect that the province's internal liquidity will remain weak as a result of high projected after-capital deficits. We also expect the province's free cash will represent about 15.5% of the next 12 months' debt service and will remain very low in the next two years, which is a departure from historical levels. Of note, B.C. benefits from very good 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. and Europe, providing important diversification.

Key Statistics

Table 1

Province of British Columbia -- selected indicators

	-- Budget year* --					
(Mil. C$)	2021	2022	2023	2024	2025	2026
Selected Indicators						
Operating revenues	69,063	80,874	76,336	80,344	81,796	85,732
Operating expenditures	68,428	77,906	80,222	86,123	86,692	88,070
Operating balance	635	2,968	(3,886)	(5,779)	(4,896)	(2,338)
Operating balance (% of operating revenues)	0.9	3.7	(5.1)	(7.2)	(6.0)	(2.7)
Capital revenues	136	140	151	167	211	240
Capital expenditures	5,934	6,572	10,107	10,578	11,312	10,562
Balance after capital accounts	(5,163)	(3,464)	(13,842)	(16,190)	(15,997)	(12,660)
Balance after capital accounts (% of total revenues)	(7.5)	(4.3)	(18.1)	(20.1)	(19.5)	(14.7)
Debt repaid	7,847	26,166	5,836	4,922	7,819	8,915
Gross borrowings	11,445	24,844	20,187	21,362	26,485	25,573
Balance after borrowings	(1,565)	(4,786)	509	250	2,670	3,998
Direct debt (outstanding at year-end)	86,761	85,772	100,238	116,306	131,815	153,875
Direct debt (% of operating revenues)	125.6	106.1	131.3	144.8	161.2	179.5
Tax-supported debt (outstanding at year-end)	89,445	88,405	102,752	118,760	134,107	156,041
Tax-supported debt (% of consolidated operating revenues)	129.5	109.3	134.6	147.8	164.0	182.0
Interest (% of operating revenues)	4.1	3.9	4.4	5.1	5.6	5.8
Local GDP per capita (single units)	68,100	73,785	73,937	74,450	76,722	79,313
National GDP per capita (single units)	65,825	72,249	72,047	73,083	74,672	77,095

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 reflects S&P Global Ratings' expectations of the most likely scenario. *Budget year 2023 equals fiscal year 2024.

Ratings Score Snapshot

Table 2

Province of British Columbia -- ratings score snapshot

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	5
Liquidity	3

Table 2

Province of British Columbia -- ratings score snapshot (cont.)

Key rating factors	Scores
Debt burden	4
Stand-alone credit profile	aa-
Issuer credit rating	AA-

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Dec. 11, 2023. An interactive version is available at http://spratings.com/sri.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessment: Fiscal Autonomy Has Effective Limits For Canadian Provinces, April 2, 2024
- Economic Outlook Canada Q2 2024: Staying Subdued, March 26, 2024
- Sector And Industry Variables | Criteria | Governments | Sovereign Rating Methodology, March 26, 2024
- S&P Global Ratings Definitions, June 9, 2023

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

Downgraded		
	To	**From**
British Columbia (Province of)		
Senior Unsecured	AA-	AA
British Columbia Hydro & Power Auth		
Senior Unsecured	AA-	AA
Downgraded; Ratings Affirmed		
	To	**From**
British Columbia (Province of)		
Issuer Credit Rating	AA-/Negative/A-1+	AA/Negative/A-1+
Ratings Affirmed		
British Columbia (Province of)		
Commercial Paper	A-1(HIGH)	
Commercial Paper	A-1+	