Rating Report

Province of British Columbia

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DBRS

Insight beyond the rating.

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 Long-Term and Short-Term Obligations of British Columbia Hydro and Power Authority (BC Hydro) based on its status as a Crown agent.

Rating Update

DBRS Limited (DBRS) confirmed the Issuer Rating and Long-Term Debt, Renminbi Bonds and Short-Term Debt ratings of the Province of British Columbia (B.C. or the Province) at AA (high), AA (high), AA (high) and R-1 (high), respectively. All trends are Stable. The ratings remain well supported by the Province's diverse and growing economy, disciplined fiscal policy, ample fiscal capacity and low debt burden.

Following 16 years of Liberal governments, the New Democratic Party (NDP) took power in mid-summer 2017, after a spring election. The new government presented its first budget in early September. The budget marks a fundamental shift in provincial fiscal policy. Despite the policy shift, the Province's budget continues to be based on the practices and principles underlying previous budgets. The new government has committed to maintain balanced budgets, use conservative budget practices, and maintain an ongoing focus on debt affordability. DBRS will look to the government's 2018 budget for greater clarity on how the government will balance its extensive policy commitments with prudent management of the Province's finances.

The budget update presented in September builds on the previous government's fiscal plan. The document outlined a small number of new revenue and expense measures and signalled that the February 2018 budget would be the new government's first substantive budget. The budget update maintains a similar track for surpluses over the medium term with the new budget measures funded largely by a stronger than expected economy. For 2017-18, the Province is projecting a surplus of $246 million, which equates to a DBRS-adjusted deficit of $2.5 billion, or 0.9% of gross domestic product (GDP).

B.C.'s economy is expanding faster than previously expected and growth remains relatively broad based. Following estimated growth of 3.6% in 2016, the provincial economy is expected to expand by a further 2.9% in 2017 before slowing to a more sustainable pace of around 2.0% over the medium term.

The Province's DBRS-adjusted debt burden is projected to rise to 18.1% by March 31, 2018, from an estimated 17.6% the year prior. The increase reflects the Province's decision to eliminate bridge tolls and assume responsibility for servicing the debt associated with the Port Mann Bridge with general government revenue. The fiscal plan suggests that the DBRS-adjusted debt burden will likely remain stable at or around 18% of GDP over the medium term.

No rating action is anticipated in the near term. A positive rating action would require the Province to maintain a sustainable budgetary position and a meaningful reduction in the DBRS-adjusted debt-to-GDP ratio to below 15.0%. A negative rating action could result from a sustained deterioration in operating results, leading to a significant increase in debt.

Financial Information

	For the year ended March 31				
	2018B	**2017**	**2016**	**2015**	**2014**
Debt/GDP	18.1%	17.6%	18.9%	19.3%	19.9%
Surplus (deficit)/GDP	(0.9%)	0.6%	(0.5%)	(0.2%)	(0.6%)
Federal transfers/total revenue	16.4%	16.3%	16.7%	16.4%	17.9%
Interest costs/total revenue	3.4%	3.2%	4.1%	3.7%	3.7%
Real GDP growth	2.9%	3.6%	3.3%	3.3%	2.5%

Notes: Debt is defined as net taxpayer supported + municipal debt + unfunded pension liabilities. B = budget. P = projected. GDP on a calendar year basis.

Issuer Description

B.C. is Canada's westernmost province, located along the Pacific Ocean. The Province has a population of 4.8 million and the fourth-largest provincial economy in the country (in terms of GDP). The Province has a diverse and stable economy, with annual output of about of $250.0 billion.

Rating Considerations

Strengths

1. Stable, growing economy

B.C. has a diverse and growing economy. Among provinces, economic growth in B.C. has tended to be among the strongest in recent years ranging between 2.5% and 3.3% and among the least volatile. The provincial economy benefits from its advantageous location, a skilled workforce, ongoing population growth and a diversity of industries.

2. Disciplined fiscal policy

While many governments have stated their commitment to balanced budgets, low taxes and prudent expense management, B.C. has consistently demonstrated its commitment to these principles. The Province has maintained a sustainable budget position for a number of years and the Province's balance sheet has nearly recovered to its pre-recession state. The new government has committed to maintain budget surpluses, use conservative budgetary practices and continue to focus on debt affordability.

3. Low debt burden

B.C. has one of the lowest debt burdens among provinces and only modest unfunded pension liabilities. The September budget update suggests that DBRS-adjusted debt will remain around 18.0% of GDP over the medium term. The low debt burden results in relatively low interest costs and greater flexibility to absorb the impact of rising interest rates, though DBRS notes that the Province's debt profile is tilted toward the longer end, with a weighted-average term to maturity of 13.9 years.

4. Fiscal capacity

The Province has a relatively low tax burden when compared with most other provinces, which provides it with flexibility to raise revenue to address budget pressures should they emerge.

Challenges

1. Policy uncertainty

The change in government has given rise to policy uncertainty. The Province has outlined an ambitious social agenda and has begun to implement many of its campaign promises. In the three months since taking power, the government has shifted tax policy, outlined its social agenda, eliminated bridge tolls, cancelled the procurement of a major infrastructure project and stated that it will seek to halt the Kinder Morgan Trans Mountain Pipeline expansion. With only tenuous control of the legislature, DBRS expects the new government to move quickly to shift government policy given the potential for an early election.

2. High level of household indebtedness

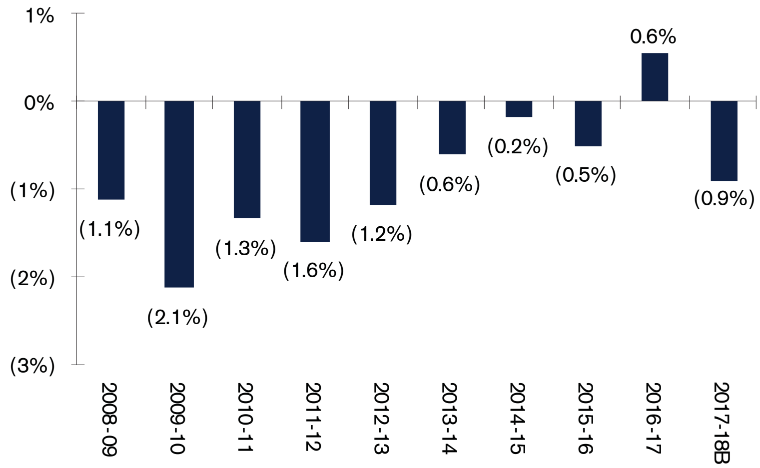
The rapid increase in home prices and historically low interest rates have resulted in elevated household indebtedness, which could amplify the severity of an external shock to the provincial economy and, by extension, the Province's fiscal plan.

3. Affordability

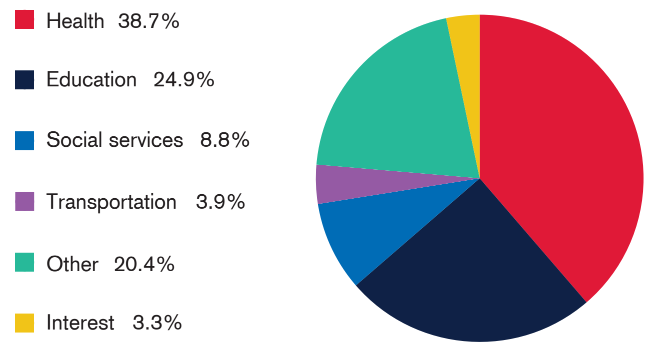
Greater Vancouver and, to a lesser extent, Greater Victoria are among the least-affordable regions in Canada mainly as a result of high average house prices. Poor housing affordability gives rise to a number of social challenges and may hinder business investment, population growth and, ultimately, longer-term economic potential. However, DBRS notes that the strong real estate market has persisted over a number of years with no apparent adverse impacts on investment or population growth.

2017–18 Budget

DBRS-Adjusted Surplus (Deficit)-to-GDP



2017–18 DBRS-Adjusted Expenditures



Sources:Province of British Columbia; DBRS calculations.

The 2017–18 budget update tabled on September 11, 2017, is the first budget of the new NDP government and marks a fundamental shift in the Province's fiscal policy. Because the NDP took office in mid-July, the first budget includes a relatively small number of new policy initiatives but does begin to articulate the overall direction of fiscal policy under the new government. The Province will prioritize new spending on a range of affordability measures and program enhancements. Specifically, the Province has defined its core policy objectives as:

- To improve affordability.
- To enhance services.
- To build a strong and sustainable economy.

Nevertheless, the Province continues to reiterate its commitment to debt affordability and the importance of maintaining a balanced operating result. The multi-year outlook for budget surpluses is similar to that presented by the previous government.

The budget update projects a surplus of $246 million for 2017-18, which includes a $300 million forecast allowance and $600 million in explicit budget contingencies. This equates to a DBRS-adjusted deficit of $2.5 billion, or 0.9% of GDP. DBRS makes the following adjustments to reported results/budget projections to improve comparability between provinces and over time:

1. The addition of capital investment and removal of capital amortization to program expense.
2. The exclusion of the net change in regulatory accounts from the net income of BC Hydro.
3. The exclusion of the forecast allowance and non-recurring items.

The Province has projected modest revenue growth for 2017–18 (+1.8% on a DBRS-adjusted basis) despite a relatively strong underlying growth. The more modest growth stems from volatility in the personal income tax revenue, which is expected to decline in 2017-18 (-6.7%). The federal government's personal income tax rate increase in 2016 likely prompted a change in taxpayer behavior, which resulted in a surge in revenue attributable to the 2015 tax year and a modest reduction for the 2016 tax year. The full extent of the change in behaviour was not clear until recently. The Province adjusted its 2016-17 revenue to $853 million higher and its 2017-18 revenue projection was lowered by $173 million. After adjusting for this impact and for incremental tax measures, personal income tax (PIT) revenue growth is 3.7% in 2017-18.

In this budget, the Province continued with the some of the prior government's tax policy commitments, but also began to implement its core tax policy positions. The government is effectively lowering taxes for small business and low and middle income households and raising taxes for higher income individuals and larger businesses. The most significant measures include:

- The reintroduction of a high income tax bracket for the 2018 tax year (16.8% for taxable incomes above $150,000).
- A 1.0-percentage-point increase to the general corporate income tax rate effective January 1, 2018 (11.0% to 12.0%).
- A 0.5-percentage-point reduction to the small business corporate income tax rate effective April 1, 2017 (2.5% to 2.0%).
- A 50% reduction in Medical Service Plan (MSP) premiums effective January 1, 2018.
- A carbon tax increase of $5.00 per tonne of carbon dioxide equivalent effective April 1, 2018.
- A phase-out of provincial sales tax on electricity purchases.

2017–18 Budget (CONTINUED)

On a full-year basis (2018-19), these measures will reduce provincial revenue by $881 million. These changes may increase the potential volatility of provincial tax revenue in the future.

Growth in federal transfers is projected to be more modest in 2017–18. Under the major health and social transfer programs, the Province's entitlement continues to rise at a steady pace, though federal infrastructure transfers are stabilizing at elevated levels after strong growth in prior years.

Total DBRS-adjusted expenditures are projected to rise by $4.7 billion (+10.0%) in 2017–18 over the prior year. The growth in spending reflects decisions by the current and previous governments. Program expense, interest costs and capital investment are all projected to be higher. However, DBRS expects actual growth in spending to be somewhat lower because of (1) a large expense contingency contained in the spending plan and (2) an expectation the government will not be able to fully deploy its expanded capital budget in the current year.

The budgets include significant increases for health (+5.4%), education (+7.3%) and social services (+11.8%), as well as for most other ministries. The increases reflect base-budget funding increases, targeted funding for new policy announcements and responses to wildfire management and other emergency program areas. Between February 2017 and September 2017, budgeted program expense rose by $1.8 billion.

Increased funding for wildfire management and other emergency program expenditures accounted for nearly $700 million of the $1.8 billion in-year increase. The 2017 wildfire season has been the most severe and widespread in living memory. Despite this, the fires generally occurred in less populated areas and building losses have been limited – 71 homes and three commercial buildings as at October 2, 2017. The fires have been disruptive to local economies, particularly forestry, but the overall economic impact is likely to be limited.

Other notable policy/funding announcements contained in the budget update related to:

- Mental health and addictions programming;
- The fentanyl crisis;
- Benefit enhancements for income and disability support programs ($100 per month); and
- Affordable housing and homeless support programs.

The Province has also provided the education sector with nearly $200 million in annual incremental funding relative to the February budget to implement a recent Memorandum of Agreement (MoA) with the British Columbia Teachers' Federation, stemming from the November 2016 Supreme Court decision that found the Education Improvement Act (2012) to be in violation of the *Canadian Charter of Rights and Freedoms*. The MoA includes limitations on staff ratios and class sizes as well as a number of other standards. The implementation of the MoA will require the hiring of about 3,500 teachers (on a full-time-equivalent basis), which works out to a 10% increase in the number of teachers. Incidentally, the Province is also experiencing its first increase in K–12 enrolment after nearly 20 years of declines. This funding is in addition to increases provided in February estimates resulting in over $900 million additional spending compared to the previous year.

Outlook

Fiscal policy has shifted under the new government, but the Premier and Minister of Finance have committed to retain a number of fundamental features that set B.C. apart from most other provinces. The Province will continue to explicitly target modest surpluses, use conservative budgetary practices and seek to maintain a low debt burden.

As previously noted, B.C. makes greater and more explicit use of contingencies to limit the likelihood of concluding a year with a weaker-than-planned result. These measures include (amounts for 2017-18):

- The use of a weaker economic forecast than that forecasts by the private sector;
- An explicit forecast allowance to reduce budgeted surplus ($300 million);
- An explicit expense contingency to offset unexpected pressures and fund priority initiatives ($600 million); and
- A relatively low natural gas price for the natural resource revenue forecast.

While the budget does include significant flexibility, the recently elected government has outlined an agenda that contains a number of significant new spending commitments. While presenting this first budget, the government suggested that the policy announcements were a modest start to the broader and substantive policy announcements that would be forthcoming in the government's first full budget, which is expected in February 2018.

Additional policy commitments either raised in the recent election campaign and/or articulated in ministerial mandate letters include (among others):

- 100,000-plus new affordable housing units;
- $10-per-day universal child care;
- Full elimination of MSP premiums;
- Social assistance benefit enhancements; and
- Expansion of post-secondary training.

2017–18 Budget (CONTINUED)

While the government's messaging and public perception has, at times, suggested a rapid rise in spending, early indications from the Province suggest that spending growth is likely to be more gradual. DBRS believes that the new government will seek to demonstrate that it can govern effectively and responsibly in the coming years, particularly in the area of public finance.

Moreover, the government does not have majority control of the legislature and relies on the support of the Green Party, which committed to responsible fiscal policy during the recent election campaign. The government is seeking to fulfill its commitments to the Green Party that were laid out in the Confidence and Supply Agreement. DBRS understands that the relationship between the NDP and the Green Party remains cooperative and productive.

Some of the most significant commitments in that agreement include:

- A referendum on proportional representation;
- Election finance reform;
- Carbon tax increases;
- Introduction of a climate action strategy;
- Review of the Site C Clean Energy Project (the Site C project);
- The hindering or stopping of the Kinder Morgan Trans Mountain Pipeline expansion; and
- Improved transit and transportation infrastructure.

While there remains some uncertainty over the medium term about how the government will balance its extensive policy commitments with prudent management of the Province's finances and what this government's tolerance for deficit spending may be during a recession, the greatest near-term uncertainty appears to stem from the Province's largest government business enterprises: BC Hydro and the Insurance Corporation of British Columbia (ICBC).

ICBC has reported large losses in each of the last two years – $293 million in 2015–16 and $612 million in 2016–17. Revenue has failed to keep pace with rising claim volumes and costs. The current outlook expects ICBC to report losses in the $200 million to $400 million range over the next three years. However, results have generally been weaker than forecast in recent years. The Province has conducted reviews in past years that have found that significant increases to premiums are necessary. The NDP has now initiated another strategic review of the corporation.

BC Hydro, the Province's wholly owned and controlled electric utility, has operated under the direction provided in the Province's 2013 ten-year plan for the utility. The Province has sought to maintain low and competitive electricity rates, while continuing to invest in the electricity system. The Province has set BC Hydro's allowable net income through regulation ($698 in 2017–18 and $712 in 2018–19).

During the campaign and since assuming control of government, the NDP has made a number of commitments with respect to BC Hydro. These include a review of the Site C project (an $8.775 billion hydroelectric dam), a broader strategic review of BC Hydro and a rate freeze.

The Site C project review being conducted by the British Columbia Utilities Commission (BCUC) is set to clarify the financial implications to ratepayers of a continuation, deferral or cancellation of the project. The BCUC is not mandated to make a decision or recommendations. The provincial cabinet will make the final determination based on broader considerations, including the findings of the BCUC, economic and financial implications, agricultural and environmental considerations and the views of First Nations. The Province has indicated that it intends to make a decision in late 2017, and work on the project will continue in the interim. BC Hydro is currently spending about $60 million per month and employing more than 2,600 people on the project.

The cancellation of the project could have a significant impact on the Province's budgetary results. Absent a legislated requirement or a BCUC decision enabling BC Hydro to recover the Site C Project–related costs over time through higher rates, BC Hydro would be required to write off all the development, cancellation and remediation costs in the current year, which are currently estimated at $3.2 billion. Under CPA Canada Public Sector Accounting Standards, the Province recognizes BC Hydro's net income as revenue.

Initial indications suggest BCUC may be open to allowing BC Hydro to recover the costs through rate increases. BC Hydro estimates that rate increases would be about 9.0% higher over the ten-year smoothing period than they would be if the project continued. The Province has not provided any indication of what its preferred approach could be.

DBRS believes a cancellation is unlikely given the political risk of being seen as closed to major capital projects given the Province's efforts to halt the Kinder Morgan Trans Mountain pipeline expansion and the recent cancelation of the George Massey Tunnel Replacement (GMTR) project procurement. In addition, BC Hydro has already expended a considerable sum on the project, would incur further costs for cancelation and remediation and ultimately does have long-term electricity supply requirements.

The new government has also committed to a rate freeze and a comprehensive review of the utility. DBRS understands that the rate freeze is intended to be a temporary measure while the Province conducts its review of BC Hydro. A one-year rate freeze would have a modest impact on budgetary results – approximately $150 million – if not offset by other measures. Over the medium term, rates are

2017–18 Budget (CONTINUED)

expected to continue to rise. The intent and outcome of the review are less clear: B.C. has among the lowest rates for electricity in North America, most of the expense growth in coming years is unavoidable and opportunities for rationalization are limited.

2016–17 Results

The Province reported a surplus of $2.7 billion for the year ended March 31, 2017, which was well ahead of the budget projection ($264 million) and the interim July 2017 forecast of $1.5 billion. The strong result reflects rapid revenue growth and cautious expense management.

On a DBRS-adjusted basis, total revenue rose by $4.3 billion (+9.6%), with relatively strong growth across all major revenue categories. There were no major policy changes implemented in 2016–17. The revenue growth was principally the result of the general strength of the Province's economy, with the largest and most important sources of revenue posting strong results: personal income tax was +15.8%, provincial sales tax was +10.3%, corporate income tax was +7.4% and natural resources revenue was +5.4%. The increase in PIT revenue was, in part, the result of an $853 million prior-year adjustment likely stemming from behavioural changes associated with the federal government's tax rate increases for high-income individuals.

Despite the sharp and sustained rise in housing prices/activity and the associated increase in property transfer tax revenue (+32.2%), property transfer tax revenue remains a relatively small share of provincial revenue at $2.0 billion, or 4.0% of total revenue.

DBRS-adjusted expenditures (post-capex) were moderately higher (+3.5%), which was largely consistent with budget expectations. The Province announced net funding for health and social services – a common theme across provinces following years of constraint and relatively strong caseload pressures in income and disability support programs. These increases were to account for about half of total growth in program spending.

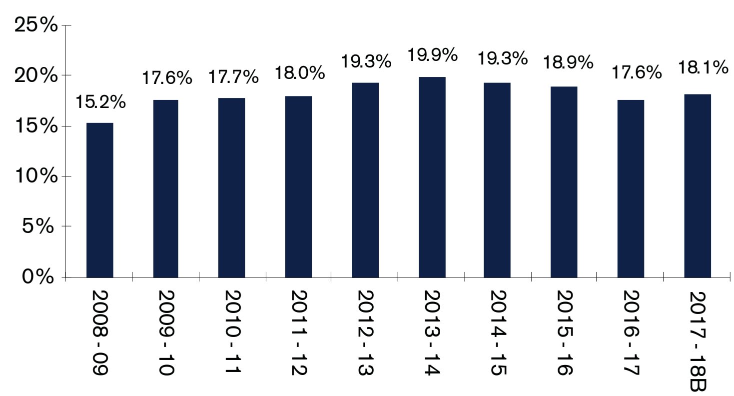
With the strong result, net debt fell by $1.8 billion to $37.8 billion and the accumulated surplus rose by $3.0 billion to $6.4 billion. This continues a multi-year improvement in the Province's balance sheet.

Debt Profile

B.C. continues to have one of the lowest debt burdens among provinces. In 2016–17, the DBRS-adjusted debt burden fell by $1.1 billion to $46.2 billion, or 17.6% of GDP. This was the first outright decline in the Province's DBRS-adjusted debt burden in a decade and was principally because of the strong budgetary result.

In 2017–18, the DBRS-adjusted debt burden is projected to rise by $3.7 billion to $49.9 billion, or 18.1% of GDP. The growth in the debt burden is the result of the Province's decision to eliminate tolls on the Port Mann and Golden Ears Bridges. The Port Mann Bridge is owned and operated by the Province, while the Golden Ears Bridge is owned and operated by the South Coast British Columbia Transportation Authority (rated AA with a Stable trend by DBRS). Previously, DBRS considered the debt associated with the Port Mann Bridge to be self-supporting since the tolling mechanism was sufficient to meet the operating and debt-servicing requirements of the bridge. After the tolls were eliminated, DBRS reclassified the associated debt ($3.5 billion) as taxpayer-supported debt. The additional debt is equivalent to 1.3% of provincial GDP.

DBRS-Adjusted Debt-to-GDP



The debt profile is largely unchanged, with a prudent maturity profile, no unhedged foreign currency exposure and a limited amount of floating-rate debt (19% of the debt stock as at March 31, 2017). The Province has an internal oversight committee, which advises the Ministry of Finance on the borrowing program and provides oversight.

Debt Profile (CONTINUED)

The Province issues debt in both the domestic market and international market, often looking for opportunities to reduce its overall borrowing costs. It has established borrowing programs in the United States, Europe and Australia. The Province does not have an explicit policy or guideline dictating domestic/foreign issuance, but the Province will generally go offshore if the all-in cost is lower than that available in the domestic market. As at September 22, 2017, about $10.2 billion (17%) of gross market debt outstanding was sourced outside of the domestic market. This foreign currency exposure is fully hedged back to Canadian dollars.

As at September 26, 2017, the Province was party to derivatives contracts with notional principal totalling $14.4 billion, consisting largely of foreign currency and interest rate swaps. The Province has an internal policy that limits its counterparties to high-quality financial institutions with higher standards for longer-dated swaps.

Like other provinces, B.C. has sought to extend the term of the debt profile to lock in lower interest rates. The average term to maturity is now 13.9 years. The maturity profile is relatively smooth over the next decade, with the Province generally targeting to have no more than $5.0 billion maturing in any given year. The Province has reduced the size of its short-term promissory note program and continues to focus its domestic issuance on larger benchmark issues.

The Province maintains considerable liquidity relative to the size of its short-term program (typically $3 billion to $4 billion) and its long-term borrowing requirement ($3.3 billion in 2017–18). In the narrowest sense, the Province has cash balances ($3.9 billion on average in 2017–18) and special-purpose investments ($1.1 billion) that can be readily accessed in the event of a broad market disruption. The Province could further access liquidity in the broader public-sector entities it controls or draw on a $400 million credit facility.

The Province has limited unfunded pension liabilities. As at March 31, 2017, these amounted to $187 million (0.1% of GDP). Unfunded pension liabilities are expected to remain low. The Province's major pension plans are defined-benefit/defined-contribution hybrid plans. They provide a basic guarantee, but indexation is on a defined-contribution basis. In addition, the plans have joint trusteeship, with employers and employees equally sharing risk, which results in more proactive management.

Outlook

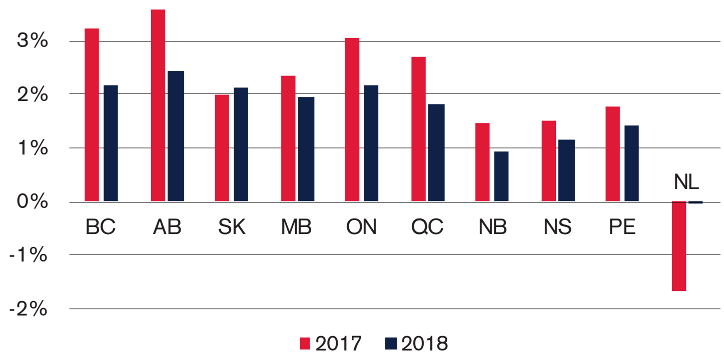
The Province continues to stress its focus on prudent and responsible fiscal policy and, ultimately, debt affordability. In considering the affordability of the Province's debt, the Province typically looks at debt as a share of revenue and the debt-to-GDP burden. Debt-to-revenue is set to rise modestly, while debt-to-GDP is expected to remain relatively stable over the medium term.

The GMTR Project does add some uncertainty to the debt outlook. The Province had previously intended to use tolls to finance the bridge but has cancelled the procurement process and restarted consultations with the Mayors' Council on Regional Transportation. A tunnel replacement project remains likely, though the scope and timelines are now uncertain. The debt associated with the project now seems likely to be taxpayer supported. The estimate for the previous project was $3.5 billion (about 1.5% of GDP).

The outlook for debt is subject to uncertainty, as the new government has yet to unveil a fully fledged budget. However, the policy direction being taken by the Province suggests that the DBRS-adjusted debt-to-GDP ratio is likely to remain stable at around 18.0%.

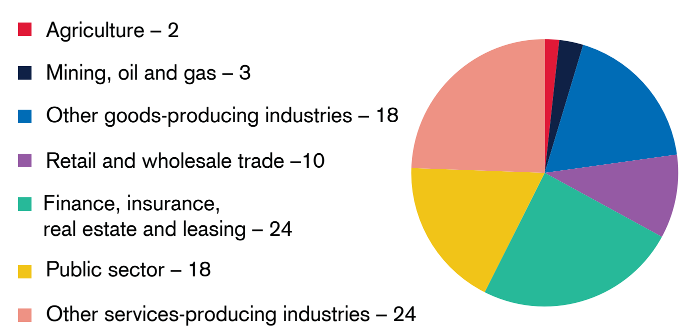
Economy

Real GDP Growth Outlook



Source: DBRS Survey of Private Sector Forecasts.

2016 Real GDP Breakdown



Source: Statistics Canada. CANSIM 379-0028.

B.C. is one of Canada's larger provinces with a population of 4.8 million and economic output of about $250.0 billion annually. The Province has experienced consistently stable population and strong economic growth in recent years, which reflects, in part, the diversity of the provincial economy. The primary sector (farming and resource extraction) contribute a relatively small share to provincial output (7.0%) and the goods sector, more broadly, only accounts for about 25.0% of output. Compared with other provinces, B.C.'s economic growth tends to be among the least volatile. The Province has only experienced one contraction (2009) over the last 30 years and in recent years economic growth has typically ranged between 2.5% and 3.3% annually.

Similarly, the Province continues to experience stable population growth, typically in the range of 1.0% to 1.3% annually. In general, natural increase, international migration and interprovincial migration have all been positive in recent years. B.C. remains a desirable location for many Canadians, though the recent increase in interprovincial migration has largely been the result of the downturn in Alberta.

The provincial economy has performed well over the last two years, with growth expected to be 3.6% in 2016 and 2.9% in 2017. The economic expansion has been broad based. Most industries are benefiting from a relatively weak Canadian dollar, low interest rates and general improvement in business confidence across North America. While housing-related industries have fared well in recent years (e.g., construction, finance, real estate, insurance, etc.), many other industries have also experienced relatively strong growth, including the film, technology, manufacturing, tourism and trade industries.

The broad-based expansion has translated into significant increases in employment, with gains concentrated in full-time private-sector employment. The unemployment rate recently fell to 4.9% – its lowest level since 2008 – and wage growth has strengthened but remains muted, with wages up by only 2.2% year to date. Nevertheless, retail sales and motor vehicle sales continue to rise strongly, likely a wealth effect as labour market improvements have coincided with continued increases in housing prices and equity markets.

The housing market in the Greater Vancouver Area remains a risk for the Province's credit profile. Underlying demand for housing remains strong in the region because of ongoing migration and household formation and supply growth continues with housing starts well above historical norms. Supply constraints and strong demand for housing will likely lead to continued increases in housing prices over the medium term absent a downturn or significant policy action.

In recent months, growth in single-family home prices has slowed, but price growth in the condominium market has accelerated, which likely reflects a worsening of affordability in the region and could hamper growth/investment in the region. The Province has committed to introduce measures to support lower- and middle-income households, but there is no indication these measures are likely to significantly affect the pace of house-price growth or overall levels of household indebtedness. DBRS believes that high house prices and household indebtedness could exacerbate the effects of an external shock to the provincial economy.

The outlook for trade also poses some risk to the provincial economy. Like most provinces, B.C.'s economy has significant exposure to international trade, with exports accounting for 22.1% of nominal GDP and imports accounting for 28.1% of nominal GDP in 2015. The greatest risk stems from the North American Free Trade Agreement as negotiations are underway and the United States accounts for more than 50% of the Province's merchandise trade exports (goods). In 2016, domestic merchandise trade exports to the United States amounted to $21.2 billion. The largest product categories were:

- Wood and articles of wood (29.5%);
- Mineral products (17.0%);

Economy (CONTINUED)

- Base metals and articles of base metal (10.7%); and
- Machinery and mechanical appliances, electrical equipment, etc. (9.2%).

At the state level, the largest export markets are Washington (27.7%), California (11.8%), Illinois (6.4%) and Oregon (6.3%).

Softwood lumber remains a major export for the Province, though its relative importance to the provincial economy and government revenue has diminished over the last two decades. The forestry industry currently accounts for about 3.0% of provincial output; the direct employment of 60,000 people; and 1.7% of provincial revenue. The recent measures introduced by the government of the United States are putting pressure on the industry and regional economies but are unlikely to result in a significant contraction in the industry or mass layoffs. Healthy U.S. lumber demand remains supportive of pricing and is limiting the overall impact on Canadian exporters. For more information, DBRS has published two commentaries on the topic:

- *United States–Canada Softwood Lumber Negotiations: Reaching a deal earlier than expected would be credit positive* (August 11, 2017).
- *U.S.-Canada Softwood Lumber Negotiations: Slow burn now, but soon to heat up* (October 25, 2016).

The outlook for resource development in the Province has weakened in recent years. The sharp declines in North American and Asian natural gas prices have led many of the proponents of major liquefied natural gas (LNG) projects to defer, delay or cancel projects. DBRS does not expect significant development of LNG facilities to occur over the next five years. Nevertheless, the Province remains supportive of LNG development in the Province, despite its stated opposition to the Kinder Morgan Trans Mountain Pipeline expansion (which would carry bitumen).

Outlook

The Province, along with most private-sector forecasters, expect growth to slow to a more sustainable pace in the coming years (about 2.0%), which reflects the anticipated moderation in housing market activity, along with the impact of rising interest rates and appreciation of the Canadian dollar.

Economy (CONTINUED)

Economic Statistics

	For the calendar year					
	2018P	**2017P**	**2016P**	**2015**	**2014**	**2013**
Nominal GDP ($ millions)	287,594	276,168	262,851	249,981	240,900	228,973
Nominal GDP growth	4.1%	5.1%	5.1%	3.8%	5.2%	3.4%
Real GDP growth	2.1%	2.9%	3.6%	3.3%	3.3%	2.5%
Population (thousands)	4,874	4,817	4,758	4,695	4,646	4,590
Population growth	1.2%	1.3%	1.3%	1.1%	1.2%	1.0%
Employment (thousands)	2,483	2,454	2,380	2,306	2,278	2,266
Unemployment rate	5.8%	5.6%	6.0%	6.2%	6.1%	6.6%
Housing starts	30,328	38,300	41,843	31,446	28,356	27,054
Retail sales ($ millions)	84,752	81,454	76,885	71,614	67,001	63,053
Inflation rate (CPI)	2.1%	2.1%	1.8%	1.1%	1.0%	(0.1%)
Household income per capita ($)	51,049	49,645	48,265	47,104	45,217	44,249

Source: Statistics Canada (actuals), For retail sales, 2016P and 2017P are based on the budget forecast growth rate applied to 2015 Statistics Canada actuals. Province of B.C. all other estimates.

Budget Summary ($ millions)

	Budget 2017-18	**2016-17**	**2015-16**	**2014-15**	**2013-14**	**2012-13**
Revenue	51,135	50,239	45,845	44,379	42,077	40,829
Program expenditure	(51,858)	(47,156)	(45,261)	(43,191)	(41,935)	(41,884)
Program surplus (deficit)	(723)	3,083	584	1,188	142	(1,055)
Interest costs	(1,764)	(1,605)	(1,865)	(1,638)	(1,553)	(1,567)
DBRS-Adjusted Surplus (Deficit)	**(2,487)**	**1,478**	**(1,281)**	**(450)**	**(1,411)**	**(2,622)**
DBRS adjustments:						
Non-recurring revenue (expenditures)	298	549	361	130	446	6
Capital assets bought less amortized	2,672	1,021	1,256	1,250	1,016	1,070
Adjustment for BC Hydro deferrals	63	(311)	475	734	265	399
Forecast allowance	(300)	-	-	-	-	-
Surplus (Deficit), As Reported	**246**	**2,737**	**811**	**1,664**	**316**	**(1,147)**
Capital investment	4,956	3,659	3,459	3,407	3,151	3,279
Gross borrowing requirement	3,295	3,767	5,110	5,644	7,438	6,438
Total Tax-Supported Debt	49,880	46,193	47,261	46,440	45,658	42,688

Note: DBRS reports B.C. Hydro net income before regulatory account transfers for comparability with other provincially-owned utilities. Debt is defined as net taxpayer supported + municipal debt + unfunded pension liabilities.

Economy (CONTINUED)

Selected Financial Indicators (DBRS Adjusted)

Debt as a share of GDP	18.1%	17.6%	18.9%	19.3%	19.9%	19.3%
Surplus (deficit) as share of GDP	(0.9%)	0.6%	(0.5%)	(0.2%)	(0.6%)	(1.2%)
Surplus (deficit) as share of revenue	(4.9%)	2.9%	(2.8%)	(1.0%)	(3.4%)	(6.4%)
Interest costs as share of revenue	3.4%	3.2%	4.1%	3.7%	3.7%	3.8%
Total tax revenue as share of revenue	55.1%	53.9%	53.1%	52.0%	49.7%	51.6%
Federal transfers as share of revenue	16.4%	16.3%	16.7%	16.4%	17.9%	17.3%
Natural resource revenue as share of revenue	4.7%	5.4%	5.6%	6.6%	7.0%	6.1%
Program expenditure as a share of revenue	101.4%	93.9%	98.7%	97.3%	99.7%	102.6%
Health expenditures as share of expenditures	38.7%	40.4%	40.7%	41.0%	41.1%	40.2%
Total revenue growth	1.8%	9.6%	3.3%	5.5%	3.1%	0.3%
Total expenditure growth	10.6%	3.5%	5.1%	3.1%	0.1%	(1.9%)
Program expenditure growth	10.0%	4.2%	4.8%	3.0%	0.1%	(1.9%)

Note: Tax-supported debt+municipal debt+unfunded pension liabilities.

Background Political Information

Party in Power:	New Democratic Party	**Legislature Seats:**	41 of 87
Premier:	John Horgan	**Election Required By:**	May 2021

DBRS-Adjusted Statement of Operations

Revenue	Budget 2017–18	2016–17	Budget 2016–17	2015–16	2014–15	2013–14
Personal income tax	9,053	9,704	8,216	8,380	8,076	6,862
Sales tax	7,042	6,606	6,296	5,990	5,762	5,303
Corporate taxes	4,878	3,552	3,311	3,307	3,117	2,885
Property & property transfer taxes	4,259	4,305	3,544	3,752	3,219	3,017
Fuel tax	975	969	948	973	932	917
Carbon tax	1,228	1,220	1,234	1,190	1,198	1,222
Tobacco tax	745	737	755	734	752	724
Total Tax Revenue	**28,180**	**27,093**	**24,304**	**24,326**	**23,056**	**20,930**
Forests	890	913	812	865	754	719
Natural gas, land tenures & minerals	949	1,188	922	1,130	1,594	1,573
Water and other resources	574	610	613	576	589	663
Total Natural Resource Revenue	**2,413**	**2,711**	**2,347**	**2,571**	**2,937**	**2,955**
Medical services plan premiums	2,248	2,558	2,549	2,434	2,254	2,158
Other fees and licenses	3,814	3,655	3,446	3,402	3,171	3,052
Investment earnings 1	272	260	242	293	315	276
Other revenue	2,945	2,966	2,910	2,943	2,735	2,769
BC Liquor Distribution Branch	1,095	1,083	983	1,031	935	877
BC Hydro and Power Authority 2	635	995	514	180	(153)	284
BC Lottery Corporation	1,301	1,329	1,233	1,304	1,245	1,165
Earnings from other Government Business Enterprises	(140)	(578)	88	(286)	605	97
Total Own-Source Revenue	**42,763**	**42,072**	**38,616**	**38,198**	**37,100**	**34,563**
Canada Health & Social Transfer	6,672	6,495	6,471	6,149	5,827	5,869
Other federal transfers	1,700	1,672	1,537	1,498	1,452	1,645
Total Federal Transfer Payments	**8,372**	**8,167**	**8,008**	**7,647**	**7,279**	**7,514**
DBRS-Adjusted Revenues	**51,135**	**50,239**	**46,624**	**45,845**	**44,379**	**42,077**

1 Excludes sinking fund earnings, which are netted against interest charges.
2 Excludes the change in regulatory defferal account balances.

DBRS-Adjusted Statement of Operations

Expenditures	**Budget 2016–17**	**2015–16**	**Budget 2015–16**	**2014–15**	**2013–14**	**2012–13**
Health	20,747	19,689	19,638	19,203	18,370	17,862
Education	13,376	12,468	12,476	12,212	11,827	11,827
Social services	4,745	4,243	4,268	4,106	3,847	3,805
Protection of persons and property	1,830	1,655	1,468	1,572	1,451	1,520
Natural resources & economic development	2,720	2,504	2,018	2,477	2,191	1,755
Transportation	2,068	1,784	1,846	1,670	1,608	1,580
Other 3	1,635	2,260	1,793	1,264	1,288	1,184
General government	2,065	1,532	1,310	1,501	1,359	1,386
Capital assets bought less amortized 4	2,672	1,021	1,995	1,256	1,250	1,016
DBRS-Adjusted Program Expenditures	**51,858**	**47,156**	**46,812**	**45,261**	**43,191**	**41,935**
Total taxpayer-supported interest costs 5	1,776	1,657	1,689	1,899	1,663	1,696
Less sinking fund earnings	(12)	(52)	(12)	(34)	(25)	(143)
Net Interest Costs	1,764	1,605	1,677	1,865	1,638	1,553
DBRS-Adjusted Expenditures	**53,622**	**48,761**	**48,489**	**47,126**	**44,829**	**43,488**
DBRS-Adjusted Surplus (Deficit)	**(2,487)**	**1,478**	**(1,865)**	**(1,281)**	**(450)**	**(1,411)**
DBRS adjustments:						
Non-recurring revenue (expenditures) 6	298	549	306	361	130	446
BC Hydro adjustment 2	63	(311)	178	475	734	265
Capital assets bought less amortized 4	2,672	1,021	1,995	1,256	1,250	1,016
Forecast allowance	(300)	-	(350)	-	-	-
Surplus (Deficit), As Reported	**246**	**2,737**	**264**	**811**	**1,664**	**316**

1 Excludes sinking fund earnings, which are netted against interest charges.
2 Excludes the change in regulatory defferal account balances.
3 Includes contingencies vote.
4 Acquired capital assets are amortized over their useful lives; this adjustment converts amortization to pay-as-you-go tax-supported capital spending.
5 Includes the interest portion of debt service grants for schools, hospitals, universities, and transit/SkyTrain that are included in CRF program spending.
6 Includes release of surplus assets in 2013-14 through 2016-17 and the contribution of BC Rail to GBE net income.

Statement of Financial Position (DBRS Adjusted)

Public-Sector Debt 1	As at March 31							
($ millions)	2018B	2017	2016	2015	2014	2013	2012	2011
Provincial direct debt	23,917	25,653	27,796	27,920	27,892	26,244	23,698	21,967
Economic development debt	16,794	12,249	11,465	10,725	10,229	9,421	8,644	8,095
Other guaranteed debt 2	4,142	3,604	3,466	3,235	2,947	2,517	2,317	1,759
Net Tax-Supported Debt (Per Province)	**44,853**	**41,506**	**42,727**	**41,880**	**41,068**	**38,182**	**34,659**	**31,821**
Net municipal debt (non-guaranteed) 3	4,840	4,500	4,288	4,299	4,376	4,341	4,207	4,419
Net Tax-Supported Debt (DBRS-Adjusted)	**49,693**	**46,006**	**47,015**	**46,179**	**45,444**	**42,523**	**38,866**	**36,240**
Self-supporting Crown corporations:								
B.C. Hydro & Power Authority	20,365	19,692	17,928	16,544	15,559	14,167	12,978	11,710
B.C. Lotteries, Columbia Power & others	1,259	1,255	1,248	1,161	857	857	777	475
Transportation Investment Corporation		3,430	3,389	3,335	3,209	2,610	1,779	1,148
Total public sector net debt	**71,317**	**70,383**	**69,580**	**67,219**	**65,069**	**60,157**	**54,400**	**49,573**
Unfunded pension liabilities**	**187**	**187**	**246**	**261**	**214**	**165**	**110**	**87**
Per Capita								
Net tax-supported debt	10,316	9,669	10,014	9,940	9,901	9,353	8,639	8,115
Net tax-supported debt + unfund. pension liab.	10,355	9,708	10,066	9,996	9,947	9,390	8,663	8,134
As % of GDP								
Net tax-supported debt	18.0%	17.5%	18.8%	19.2%	19.8%	19.2%	17.9%	17.7%
Net tax-supported debt + unfund. pension liab.	18.1%	17.6%	18.9%	19.3%	19.9%	19.3%	18.0%	17.7%
Gross Debt Breakdown by Currency 4								
Cdn$ pay	100%	100%	100%	100%	100%	100%	99%	99%
Non-Cdn$ pay	0%	0%	0%	0%	0%	0%	1%	1%
Fixed/Floating-Rate Breakdown 4, 5								
Fixed rate	81%	83%	79%	78%	73%	80%	81%	78%
Floating rate	19%	17%	21%	22%	27%	20%	19%	22%

Debt Maturity Profile 4, 6	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23 to 2026-27	2027-28+
Tax-supported debt ($ millions)	2,100	2,802	2,658	1,913	3,366	11,663	20,291
Tax-supported debt (%)	4.7%	6.3%	5.9%	4.3%	7.5%	26.0%	45.3%

Unfunded Pension Liabilities	($ millions)
Colleges Pension Plan (surplus)	0
Municipal Pension Plan (surplus)	0
Public Service Pension Plan (surplus)	0
Teachers Pension Plan	186
MLA Superannuation Plan	1
Total unfunded pension liabilities	**187**

1 Debt numbers are reported net of sinking fund assets and pre-financing (warehouse borrowing), and exclude the forecast allowance. 2 Includes tax-supported Crown corporations and agencies, other fiscal agency loans, and various loan guarantees. 3 December year-end. Net of sinking fund assets and other liquid marketable securities. 4 All amounts are net of hedges (if any). Excludes municipal debt. 5 Includes all debt that matures or is repriced within 12 months. 6 Debt maturity profile is as of the budget date of February 16, 2016.
* Balance sheet excludes tangible capital assets and prepaid capital advances. ** Historicals are on a funding basis.

Rating History

	Current	2016	2015	2014	2013	2012
Issuer Rating	AA (high)	AA (high)	AA (high)	AA (high)	AA (high)	AA (high)
Long-Term Debt	AA (high)	AA (high)	AA (high)	AA (high)	AA (high)	AA (high)
Renminbi Bonds	AA (high)	AA (high)	NR	NR	NR	NR
Short-Term Debt	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)

Previous Action

- Confirmed, March 31, 2017.

Related Research

- *British Columbia's 2017 Budget Update: Spending the Spoils of a Strong Economy,* September 12, 2017.
- *United States–Canada Softwood Lumber Negotiations: Reaching a deal earlier than expected would be credit positive,* August 11, 2017
- "DBRS Confirms British Columbia at AA (high) with a Stable Trend; Ample Flexibility as Election Nears," March 31, 2017.
- *U.S.-Canada Softwood Lumber Negotiations: Slow burn now, but soon to heat up,* October 25, 2016.
- *Rating Canadian Provincial Governments,* May 2017.
- *Rating Canadian Provincial Agents of the Crown,* May 2017.

Previous Report

- British Columbia, Province of: Rating Report, April 28, 2016.

Notes:
All figures are in Canadian dollars unless otherwise noted.

For the definition of Issuer Rating, please refer to Rating Definitions under Rating Policy on www.dbrs.com.

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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