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Research Update:

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

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(**Editor's Note**: This research update, originally published Nov. 15, 2017, misstated the debt burden score in Table 2. A corrected version follows.)

Overview

- We are affirming our ratings on the Province of British Columbia (B.C.), including our 'AAA' long-term issuer credit rating.
- The ratings reflect the province's strong and increasing 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 newly elected 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 Nov. 15, 2017, 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, early signs of broad continuity in financial management practices under the newly elected government will become more entrenched. We also expect B.C.'s economy to continue expanding modestly, supporting provincial revenues. Together, we believe these will contribute to relatively stable budget performances, with modest operating surpluses, and after-capital deficits close to 5% of total revenues through 2020.

Maintaining strong financial management practices and sound fiscal outcomes 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 in response to an external shock, or after-capital deficits rising past 10% of total revenues, or some combination of both, could lead to a downgrade.

Rationale

We have updated our base-case scenario for B.C. incorporating the impacts of a change in government, including the release of a mid-year budget update. We expect the new government's policy intentions to become increasingly clear with the passage of a full-year budget next spring. However, its midyear update provided some encouraging early signs that it will continue the tradition set by its predecessor of managing the province's finances prudently, with updated projections pointing to further modest operating surpluses through fiscal 2020. In our view, preserving strong fiscal outcomes, in addition to B.C.'s other longstanding markers of credit strength such as high liquidity, strong budget flexibility, and a wealthy economy are critical to maintaining the 'AAA' rating, particularly in light of the province's relatively high debt burden.

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, despite the recent change in government. In June 2017, following a close election and a loss of confidence vote for the prevailing party, the New Democratic Party formed a minority government with support from the third-place Green Party, thus ending 16 years of Liberal Party rule. The NDP government released a midyear budget update in the fall and has publicly stated that it will continue to use 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. 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 also 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. The 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 revenue 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. On average, exports to the U.S. account for 75% of the total trade conducted by Canadian provinces but for B.C., exports to the U.S. account for about 54% its total international goods exports.

In 2017, based on year-to-date results for key indicators such as housing starts, employment, retail sales and exports, we expect that the economy will grow by 2.9% and by a further 2.1% annually thereafter. In 2016, B.C.'s economy outperformed forecasts, recording real GDP growth of 3.5%. Consumer spending and residential investment were the main contributors to economic growth last year. In addition, the province logged a near record level of housing starts. We believe that higher interest rates and tighter mortgage rules will weigh on housing starts and that the sector (which comprises about 12% 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 2017 (year ended March 31), these 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 moderately increasing debt burden.

Stronger-than-expected economic growth has given the province more fiscal room. After incorporating increased spending commitments and a 50% cut in medical services plan premiums, increased taxes for the higher income individuals, and increases to the corporate income tax and carbon tax rates announced in the midyear budget, we expect only a marginal impact to our 2016-2020 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 3% of operating revenues and average after-capital deficits to remain below 5% of total revenues. In addition, capital expenditures, on average, are projected to represent 8% of total expenses. We expect tax-supported average annual capital spending of about C$4.5 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 86% into our base-case forecasts.

We expect B.C.'s already high debt burden to rise modestly in the next two years.. Capital spending will continue to be the main impetus for growth in the province's debt. We are forecasting its tax-supported debt burden (including debt borrowed in the province's name and on-lent to BC Hydro) increase to about 135% of consolidated operating revenue in fiscal 2020, from 123% in fiscal 2017. In line with historical results, B.C.'s interest expense will, we expect, average slightly less than 6% of revenues in the next two fiscal years.

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 2018 free cash and liquid investments of C$10.5 billion (S&P Global Ratings-adjusted) will be sufficient to cover about 175% 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. We consider the province's pension liabilities very manageable and not a risk for B.C.'s finances.

The province has high budgetary flexibility compared with that of other Canadian provinces, 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. Further contributing to B.C.'s very strong 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. 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 a reduction in 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 worker's 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 as self-supporting and expect that financial support would be unlikely, given the utility's strong demand profile and supportive regulation.

Key Statistics

Table 1

Province of British Columbia -- Selected Indicators						
	--Budget year*--					
(Mil. C$)	2014	2015	2016	2017bc	2018bc	2019bc
Operating revenues	45,075	47,553	51,472	51,186	51,391	52,376
Operating expenditures	42,602	44,906	46,084	49,877	49,996	51,041
Operating balance	2,473	2,647	5,388	1,309	1,395	1,335
Operating balance (% of operating revenues)	5.2	5.7	10.5	2.6	2.7	2.5
Capital revenues	307	197	245	537	524	663
Capital expenditures	3,726	3,726	3,940	4,568	4,435	4,387
Balance after capital accounts	(946)	(882)	1,693	(2,722)	(2,516)	(2,389)
Balance after capital accounts (% of total revenues)	(2.1)	(1.8)	3.3	(5.3)	(4.8)	(4.5)
Debt repaid	3,417	2,738	3,176	2,701	3,867	2,403
Gross borrowings	5,644	5,110	3,767	3,595	6,930	5,319
Balance after borrowings	1,281	1,490	2,284	(1,828)	547	527
Modifiable revenues (% of operating revenues)	84.5	84.3	84.6	84.7	84.4	84.6
Capital expenditures (% of total expenditures)	8.0	7.7	7.9	8.4	8.1	7.9
Direct debt (outstanding at year-end)	59,751	61,731	62,227	63,093	66,170	69,085
Direct debt (% of operating revenues)	134.3	131.6	120.9	123.3	128.8	131.9
Tax-supported debt (outstanding at year-end)	60,539	62,584	63,201	64,637	67,714	70,768
Tax-supported debt (% of consolidated operating revenues)	134.7	131.4	122.8	126.3	131.8	135.1
Interest (% of operating revenues)	5.5	6.1	4.9	5.1	5.5	5.6
Local GDP per capita (C$)	52,092	53,623	55,428	57,516	59,202	60,859
National GDP per capita (C$)	55,807	55,430	55,910	58,448	60,211	61,903

Note: 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. 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. *Budget year 2017 equals fiscal year 2018. bc--Base case.

Ratings Score Snapshot

Table 2

Province of British Columbia -- Ratings Score Snapshot	
Key rating factors	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Very strong
Budgetary Flexibility	Very strong
Budgetary Performance	Average

Table 2

Province of British Columbia -- Ratings Score Snapshot (cont.)	
Key rating factors	**Assessment**
Liquidity	Exceptional
Debt Burden	High
Contingent Liabilities	Low

Note: S&P Global Ratings' credit ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of our "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 foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, Oct. 13, 2017. Interactive version available at http://www/spratings.com/sri

Related Criteria

- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- 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, October 2017
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local and Regional Government Default Study and Rating Transitions, May 8, 2017
- Public Finance System Overview: Canadian Municipalities, 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	
Global scale	A-1+
Canada scale	A-1(High)
British Columbia Hydro & Power Authority	
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.