British Columbia's 2016–17 Final Results … Strong Growth Boosts Strong Surplus

- British Columbia reports a final surplus for fiscal 2016–17 (FY17) of $2.7 billion (1.0% of GDP), $2.5 billion ahead of *Budget* and $1.9 billion wider than the FY16 black ink.[1] BC is the only Province to achieve a cumulative surplus from FY10 to FY17.
- Revenues in FY17 were a hefty $3.4 billion above *Budget,* more than covering the $1.3 billion in-year expenditure increase. As well, the $350 million forecast allowance was not needed.
- Of note is the $1.2 billion absolute decline in BC's taxpayer-supported debt during FY17, the first drop since FY09. From the March 2014 peak of 17.9% of GDP, taxpayer-supported debt by March 2017 had fallen to 15.7%. BC's debt service remains very affordable, underscoring the Province's fiscal flexibility (bottom chart).

DETAILS OF THE FY17 REVENUE GAIN

Final FY17 revenue growth of 8.1% was powered by an 8.4% surge in BC's own-source receipts (table, p.2), mirroring the province's strong economic expansion and raising the revenue base for FY18. Tax receipts jumped a hefty 11.4% as personal income tax (PIT), accounting for more than 35% of total taxes, advanced by almost 16%. Over the past three fiscal years, PIT receipts have surged 41½% as full-time employment over the three years to March 2017 climbed 9.7%. Corporate income tax revenues advanced by 5.8% during FY17, a solid advance for the fourth year in a row.

The Property Transfer Tax (PTT) **rose $0.5 billion during FY17 to a record $2.0 billion**, outperforming the *Budget* estimate of a $0.3 billion decline. The additional 15% on the PTT, as of August 2, 2017 for foreign home buyers across the Greater Vancouver Regional District, added $102 million. The number of residential transactions in FY17 rose 5.7% above FY16 and the average transfer tax generated per residential transaction jumped 18.5%. BC's housing sector also contributed to the 10% FY17 rise in the Provincial Sales Tax.

Interestingly, the FY17 carbon tax rose only 2½%, dampened by decreased consumption of most fuels except gasoline.

Natural resource receipts were 5.4% higher in FY17 versus the *Budget* estimate of a significant decline. Upside surprises included higher natural gas production volumes and prices, improved coal prices from the historically low 2015 level and somewhat stronger forest stumpage revenue.

[1] The final FY17 results are close to the update estimates released by BC's prior administration early this summer (see *Fiscal Pulse,* July 11, 2017, here).

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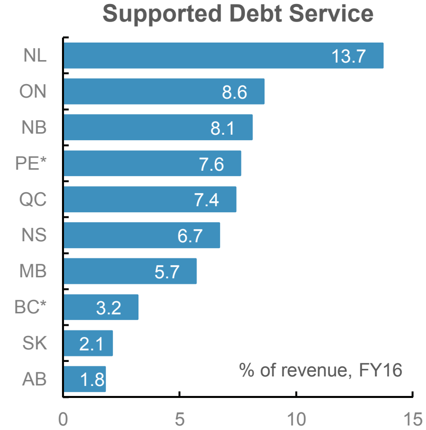
Provincial Taxpayer-Supported Debt Service



* PE:FY15; BC:FY17. Source: BC Finance, Moody's Investors Service.

A disappointment, however, was FY17 Commercial Crown corporation net income, $0.5 billion below *Budget* and 6.8% less than FY16. ICBC, after FY16 red ink of $0.3 billion, reported a further $0.6 billion loss in FY17 (text box, p.3). Historically, BC Hydro's dividend payment to the Province has been 85% of its net income ($684 million in FY17) or a lesser amount, if necessary, to hold the utility's debt-to-equity ratio at 80:20. In FY17, BC Hydro's net income was $684 million, but its debt ratio was higher than the 80:20 threshold, so only the minimum dividend of $259 million was remitted. Starting in FY18, this dividend will drop by $100 million per year to zero by FY20, consistent with the *10 Year Rates Plan* in order to achieve the forecast rate increase and repair BC Hydro's capital structure. Dividend payments to the government are currently not set to resume until BC Hydro strengthens its debt-to-equity ratio to 60:40.

DETAILS OF FY17 OPERATING EXPENSES

Final FY17 program spending rose 4.9% versus the 1.9% *Budget* estimate as the Province proceeded with new *Housing Priority Initiatives,* additional cost-shared infrastructure outlays and higher fire management costs. Health authority and hospital society spending were $442 million above *Budget.* Providing some offset were lower-than-projected Ministry spending and interest costs plus favourable prior-year liability adjustments.

In November 2016, the Supreme Court of Canada ruled against BC's legislation in 2002 restraining teachers from negotiating class sizes and, with respect to special needs students, class composition. The government subsequently reached an agreement with the B.C. Teachers Federation in March to hire more teachers to achieve smaller class sizes and inject new funding.

CAPITAL SPENDING AND THE BALANCE SHEET

Total capital outlays were $975 million below *Budget.* Taxpayer -supported investment, though 5.8% higher in FY17, accounted for $592 million of the in-year reduction. Delays and reprofiling projects were broad-based with shortfalls of $175 million in Education, $189 million in Health and $154 million for highways and transit. Self-supported commercial capital spending was $363 million less than *Budget,* dampened by BC Hydro's $395 million reduction, one of several measures undertaken to meet the *2013 10 Year Rates Plan.*

The FY17 taxpayer-supported capital spending of $3.6 billion was funded by $0.8 billion of operating cash flows, $0.7 billion of external contributions, a $0.2 billion increase in P3 liabilities and $1.95 billion of direct borrowing.

British Columbia's Budget Arithmetic
$ millions except where noted

	FY17		FY18
	Budget	Final	Budget
Tax Revenue	24,304	27,093	26,804
Natural Resource Revenue	2,347	2,711	2,320
Commercial Crown Corp. Net Inc.	3,002	2,525	2,915
Other Own-Source Revenue	10,405	10,963	10,482
Federal Transfers	8,008	8,167	8,317
Total Revenue	**48,066**	**51,459**	**50,838**
Health	19,638	19,689	20,629
Education	12,476	12,468	13,124
Social Services	4,268	4,243	4,619
Other Program Spending	9,387	10,679	10,135
Program Spending	**45,769**	**47,079**	**48,507**
Debt Service*	1,683	1,643	1,686
Total Expenditure	**47,452**	**48,722**	**50,193**
Forecast Allowance	350	0	350
Surplus**	**264**	**2,737**	**295**
Capital Outlays: Taxpayer-Supp.	4,251	3,659	4,804
Self-Supported	3,108	2,725	3,279
Taxpayer-Supported Debt	43,227	41,506	43,302
Absolute Annual Increase	500	-1,221	1,796
Annual Change, %			
Tax Revenue	*-0.1*	*11.4*	*-1.1*
Natural Resource Revenue	*-8.7*	*5.4*	*-14.4*
Total Own-Source Revenue	***0.3***	***8.4***	***-1.8***
Federal Transfers	*4.7*	*6.8*	*1.8*
Total Revenue	***1.0***	***8.1***	***-1.2***
Health	*2.3*	*2.5*	*4.8*
Education	*2.2*	*2.1*	*5.3*
Social Services	*3.9*	*3.3*	*8.9*
Other Program Spending	*0.1*	*13.9*	*-5.1*
Program Spending	***1.9***	***4.9***	***3.0***
Total Expenditure	***1.4***	***4.1***	***3.0***
Memo Items, %			
Own-Source Revenue / GDP	15.2	16.4	15.3
Program Spending / GDP	17.4	17.9	17.4
Total Expenditure / GDP	18.0	18.5	18.1
Budget Balance/ GDP	0.1	1.0	0.1
Taxpayer-Supported Debt / GDP	16.4	15.7	15.6
Taxpayer-Supp. Debt / Revenue*	92.4	81.8	87.6
Debt Service* / Revenue*	3.6	3.2	3.4
Resource Price Assumptions			
Natural Gas, Plant Inlet, C$/GJ	1.04	1.19	1.61
Production, % ch	0	3.4	-2.3
Western Lumber***2x4s, US$/mfbm	288	308	326

* Taxpayer-supported basis. ** Includes allocations of $100 mn in FY16 & $400 mn in FY17 to the Prosperity Fund. *** Spruce-pine-fir, calendar year. Source: BC Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

Government direct operating debt, the cumulative borrowing to finance core government operating deficits (excluding capital grants), dropped $3.4 billion in FY17, mirroring the $2.7 billion surplus and positive cash operating flows of $653 million. The Liberal administration's *Prosperity Fund,* after an initial $100 million deposit, received a further $400 million in FY17.

With respect to its pension plans, BC is responsible for half of the $372 million accrued net liability of the joint-trusteed Teachers' Pension Plan as of March 2017. However, with its Public Service Pension Plan reporting accrued net assets of $1.2 billion, across all its pension plans, the government's pension plans combined are in a $1.7 billion asset position.

THE AUDITOR GENERAL'S QUALIFICATIONS

BC's Auditor General details three issues with respect to the application of Canadian GAAP to British Columbia's 2016-17 *Public Accounts.* First, the Auditor General would report an entire transfer during the period it is received, raising the FY17 surplus by $864 million. BC believes that the Public Sector Accounting Board Standard supports deferring revenue in line with the amortization of the related expenditure when the use of the funds is externally restricted.

Second, for the Transportation Investment Corporation, the Auditor General disagrees with its classification in FY17 as a government business enterprise. Reclassifying the Corporation to a taxpayer-supported entity would shift $3.4 billion from BC's self-supported debt to its taxpayer-supported debt.

The Auditor General's third concern relates to BC Hydro's rate regulated accounting which defers certain revenues and expenses to future years. The Auditor General takes issue with this practice in the Province's summary financial statements for amounts that are deferred under the direction of the government.

OUTLOOK

British Columbia's unexpectedly robust revenues in FY17 leave FY18 revenues, as projected in the February *Budget,* 1.2% below the final FY17 level (table, p2). Given the Province's further robust output and employment gains during calendar 2017, a significant absolute drop in receipts seems unlikely, even if a stronger Canadian dollar and somewhat higher interest rates trim this advantage. Yet, maintaining balanced books remains a considerable undertaking. The provincial government's task is to manage the higher costs and consequences of its robust growth, and current issues such as housing affordability and funding stepped-up transportation/transit needs underscore the breadth and depth of this challenge.

A REVIEW OF THE INSURANCE CORPORATION OF BRITISH COLUMBIA (ICBC)

ICBC, established in 1973, is the sole provider of the province's mandatory Basic Insurance for motor vehicles. It also offers additional optional insurance in competition with private firms. Since 2003, ICBC's premium increases have been subject to review and approval by the British Columbia Utilities Commission.

In recent years, government intervention has been required to avoid 10%-15% premium hikes, and an independent report this summer documented ICBC's structural problems which, if not addressed, would lead to a 30% premium hike by 2019. ICBC's problems include a rising number of accidents; increasing claims surpassing the rise in accidents; escalating settlements for minor injuries and a 70% jump in the number of high-value vehicles over the past four years. In reviewing these difficulties, the report references that BC is the only province retaining a litigation-based claims model. Other Provinces have adopted alternate frameworks to better contain costs that limit an individual's right to sue for minor injuries or cap minor injury settlements.

The new NDP government has committed to reviewing ICBC's systemic financial issues while maintaining affordable premiums. It accepts some of the report's recommendations such as rewarding good drivers, charging more for luxury vehicles, and short-term productivity and process improvements. However, the new government wishes to retain the litigation-based claims model. An interim rate decision from the BC Utilities Commission is expected November 1.