

## 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.<sup>1</sup> 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.

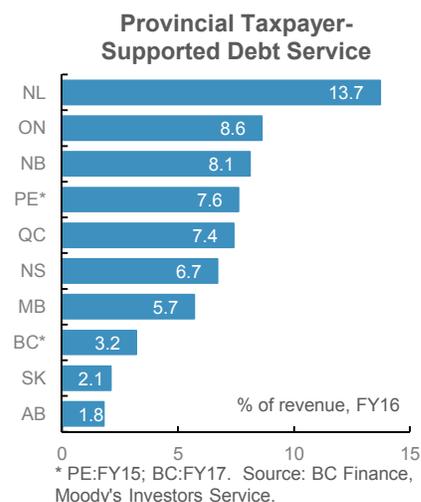
**The Property Transfer Tax (PTT) rose \$0.5 billion during FY17 to a record \$2.0 billion**, outperforming the *Budget* estimate of a \$0.3 billion decline. The additional 15% on the PTT, as of August 2, 2017 for foreign home buyers across the Greater Vancouver Regional District, added \$102 million. 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.

### CONTACTS

**Mary Webb**  
416.866.4202  
Scotiabank Economics  
[mary.webb@scotiabank.com](mailto:mary.webb@scotiabank.com)



<sup>1</sup> 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](#)).

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.

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.

### 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
<b>Total Revenue</b>	<b>48,066</b>	<b>51,459</b>	<b>50,838</b>
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
<b>Program Spending</b>	<b>45,769</b>	<b>47,079</b>	<b>48,507</b>
Debt Service*	1,683	1,643	1,686
<b>Total Expenditure</b>	<b>47,452</b>	<b>48,722</b>	<b>50,193</b>
Forecast Allowance	350	0	350
<b>Surplus**</b>	<b>264</b>	<b>2,737</b>	<b>295</b>
<b>Capital Outlays: Taxpayer-Supp.</b>	4,251	3,659	4,804
Self-Supported	3,108	2,725	3,279
<b>Taxpayer-Supported Debt</b>	43,227	41,506	43,302
Absolute Annual Increase	500	-1,221	1,796
<b>Annual Change, %</b>			
Tax Revenue	-0.1	11.4	-1.1
Natural Resource Revenue	-8.7	5.4	-14.4
<b>Total Own-Source Revenue</b>	<b>0.3</b>	<b>8.4</b>	<b>-1.8</b>
Federal Transfers	4.7	6.8	1.8
<b>Total Revenue</b>	<b>1.0</b>	<b>8.1</b>	<b>-1.2</b>
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
<b>Program Spending</b>	<b>1.9</b>	<b>4.9</b>	<b>3.0</b>
<b>Total Expenditure</b>	<b>1.4</b>	<b>4.1</b>	<b>3.0</b>
<b>Memo Items, %</b>			
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
<b>Resource Price Assumptions</b>			
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.

**With respect to its pension plans**, BC is responsible for half of the \$372 million accrued net liability of the joint-trusted 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.

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

**This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.**

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.