February 16, 2016

B.C. ON TRACK TO HOLD ONTO SURPLUS

Highlights

- B.C. tabled its 2016 Budget today with the province on track to register a fourth consecutive surplus in Fiscal Year (FY) 2016-17. B.C. is one of just two provinces to currently be in surplus territory.
- In light of robust economic growth and fiscal prudence over the last few years, B.C. has room to increase spending and take on a bit more borrowing to help support infrastructure spending, while still on course to reduce its debt burden and keep the budget balanced.
- The 2016 Budget proposes $1.6 billion in additional program spending and $12 billion in infrastructure investment, while still maintaining a surplus at least through FY2018-19.
- Higher program spending is expected to be offset by greater revenue streams, aided by changes to the medical service plan (MSP) premiums and some temporary factors. However, more than 70% of the new infrastructure spending will be funded through new debt.
- Falling operating debt requirements, which have decreased to the lowest level since FY1984-85, should enable the B.C. government to reduce the net debt-to-GDP ratio to 16.3% by the end of the three year plan, down from 17.4% in FY2015-16.

The B.C. economy has been relatively less impacted by the economic slowdown that has weighed on most provincial budget balances recently. This has enabled B.C. to remain as one of only two provinces to still run a surplus and hold onto their AAA rating. B.C. is on track to register a higher-than-expected budget surplus of $377 million in Fiscal Year (FY) 2015-16, partly related to some temporary revenue boosts. In the 2016 Budget, tabled today, the B.C. government plans to maintain its relatively healthy fiscal position while using some additional revenues to fund the $1.6 billion in new spending and $12 billion in capital expenditures over the next three years. According to the 2016 Budget, the B.C. government also plans to run slightly smaller surpluses – reduced by $100 million per year –so as to partly fund the new spending measures. The province expects the surplus to shrink to $264 million in FY2016-17 before rising back to $373 million by FY2018-19 – the last year of the current budget plan. Some of the infrastructure spending will also be funded through debt issuance. However, given that operating debt requirements have fallen to the lowest levels since FY1984-85, the government remains on track to reduce the net debt-to-GDP ratio to just 16.3% by the end of the three year plan, down from 17.4% in FY2015-16.

Higher revenues helping to fund spending

While higher spending commitments in FY2016-17 will work to shrink B.C.'s expected budget surplus that year, the bulk of the planned spending increase is expected to be funded by higher projected revenues in both FY 2015-16 and 2016-17. Like most other provinces, British Columbia has scaled back its nominal GDP growth profiles for 2015 and 2016 by an average of 0.4 percentage points, while leaving the forecast for the future years largely untouched. Despite the downgrade to nominal GDP, revenues are on track to come in, on average, about $450 million stronger between FY 2015-16 to 2017-18 than what

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BRITISH COLUMBIA ECONOMIC PLANNING ASSUMPTIONS [Annual Per Cent Change, unless stated]	2015E	2016	2017	2018	2019	2020
Real GDP	2.4	2.4	2.3	2.3	2.3	2.3
Nominal GDP	3.3	4.0	4.3	4.3	4.3	4.3
Employment	1.2	1.2	1.2	1.2	1.2	1.2
Household Income	3.2	3.6	3.9	3.9	3.9	3.9
Retail Sales	6.5	4.3	3.7	3.6	3.6	3.6

Source: British Columbia Ministry of Finance.

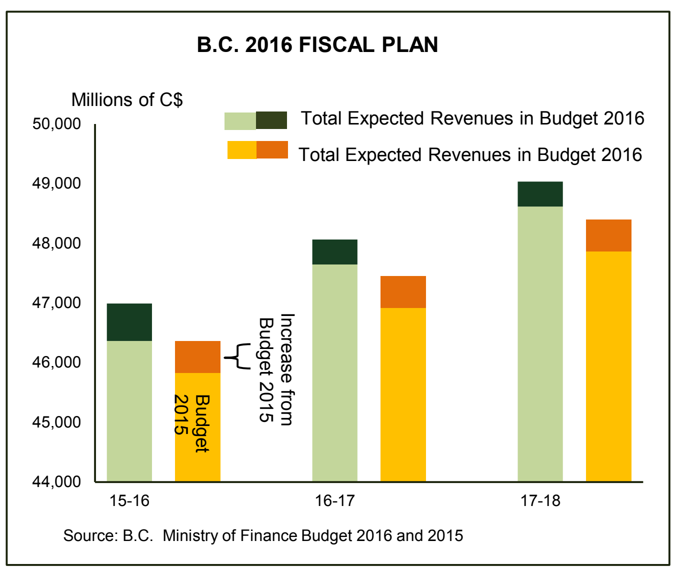
was planned in last year's budget. Some of the additional revenues over these three years are expected to be due to temporary measures.

Still, many other improvements to revenues were more enduring in nature. B.C. has seen a sharp uptick in inter-provincial migration in recent years and the rising share of the overall Canadian population is entitling the province to more Federal Government Transfers, which are expected to increase by 4% year-over-year. Major overhauls of the Medical Service Plan (MSP), introduced in today's budget and set to take effect in 2017, will also be revenue positive. Premiums under the old system were a function of the number of family members. Under the current system, children will be exempt from the premium, which will instead be based on the number of adults in the family. There will be exemptions for couples who earn less than $45,000, single-parents with two children who earn up to $48,000, and couples with two children and seniors who earn up to $51,000. The government noted that premiums will be going down for over 70,000 households in the province, to be compensated by premiums rising for households (seniors included) with no children and couples with children who earn above these income thresholds. The net effect is expected to lift government revenues by $19 million in the upcoming fiscal year and $77 million in FY2017-18.

The B.C. government did partially offset higher MSP premiums with a number of tax credits that include:

- Extending the Mining Exploration Tax credit for three years and the BC Mining Flow Through Share Tax Credit for one year, for a total cost of $14 million in the upcoming fiscal year and $42 million next year.
- Extending the renovation tax credit for seniors to people with disabilities. The program will provide an annual credit worth up to $1,000 on renovations to make a home more accessible and will shave $1 million off revenues over the next two fiscal years. Effective February 17, 2016.
- Expanding the small business venture capital tax credit budget by $5 million per year.
- Introducing a tax credit for households and corporations in the farming business for food donations made to registered charities. Effective February 17, 2016.
- Increasing the income threshold for the B.C. tax reduction credit to $19,171, for a total expected cost of $2 million per year as of January 1, 2016,
- Increasing the threshold for the home owner grant phase out from $1.1 million to $1.2 million for the 2016 tax year; expected to shave $12 million per year off revenues.

As was widely expected, the B.C. government offered support for first time homebuyers, exempting new home purchases by Canadian citizens and residents worth up to $750,000 from the property transfer tax. This, however, will be fully offset by an increase in the property transfer tax rate from 2% to 3% on the portion of the home sale price above $2 million. When combined, the two measures are expected to be revenue neutral. Moreover, in order to better understand the factors driving the housing market, the B.C. government will require home purchasers to document their residency status in British Columbia, or country of nationality for non-residents. This rule, slated to take effect over the summer, will require the information from individual purchasers as well as those made by shell corporations. In effect, the measure is intended to track foreign investment and help better understand housing market dynamics in B.C., with little documented revenue or expense implications. This data was previously collected up to 1998 in British Columbia.



BRITISH COLUMBIA GOVERNMENT FISCAL POSITION (C$ millions)							
	Actual			2016 Budget			
Fiscal Year	12-13	13-14	14-15	15-16	16-17	17-18	18-19
Revenues	**42,049**	**43,728**	**46,122**	46,992	48,066	49,034	50,141
% change	0.6	4.0	5.5	1.9	2.3	2.0	2.3
Own-Source	35,013	36,226	38,796	39,333	40,058	40,839	41,731
Federal Transfers	7,044	7,502	7,326	7,659	8,008	8,195	8,410
Expenditures	**43,201**	**43,375**	**44,439**	46,365	47,452	48,397	49,418
% change	2.7	0.4	2.5	4.3	2.3	2.0	4.1
Contingencies	-	-	300	350	450	400	400
Forecast Allowance	-		100	250	350	350	350
Surplus (+) / Deficit (-)	**-1,152**	**353**	**1,583**	**377**	**264**	**287**	**373**
% of GDP	-0.5	0.1	0.6	0.2	0.1	0.1	0.1
Taxpayer-supported debt	**38,182**	**41,068**	**42,302**	42,709	43,227	44,242	45,089
% of GDP	17.2	17.3	17.7	17.4	17.0	16.6	16.3

Note: * Program spending includes all expenditures except debt servicing costs. ** Libaility for HST transition fund repayment.
Sources: British Columbia Ministry of Finance.

What's a government to spend on?

The low interest rate environment has also helped the B.C. government save a projected $500 million per year on interest charges, which will be redirected into health care funding. The B.C. government will also maintain spending measures put in place in past budgets, including continuing climate change initiatives. The government has also expanded provincial ministry budgets by $1.6 over the next three years. New spending will occur in the following areas:

- $418 million for the Economic Stability Dividend and the Economic Stability Mandate. Through these funds, the B.C. government is increasing ministry budgets for wages. Almost $207 million will be dedicated to offering higher wages to the public sector workforce.
- $143 million will be invested in the economy and communities. For example, the government will provide $1 million to the International Maritime Centre to support the shipping industry and an additional $5 million will be spent to promote B.C.'s wood brand in India. India was identified as the next big market for B.C.'s wood products.
- $673 million over three years will go to the Ministry of Children and Family Development and the Ministry of Social Development. The money will be used to create new programs, hire and train new staff and offer increased social and income assistance to persons and children in need.
- $340 million for community safety and other initiatives, including wildfire prevention and safety investments, correctional services and gun and gang control measures.

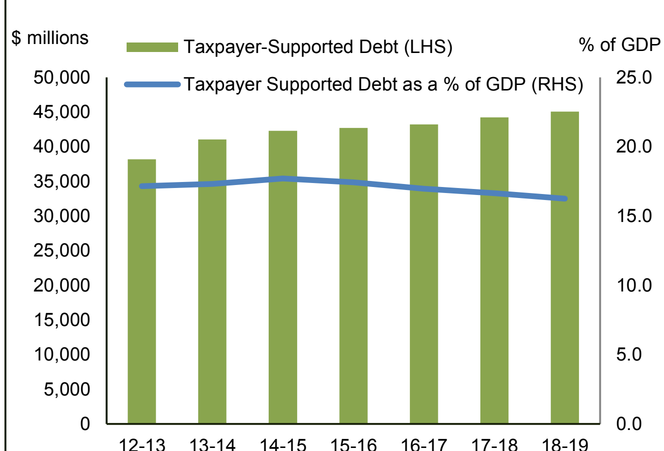
Debt will help fund increased capital spending

The Budget 2016 also planning for $20.6 billion in total infrastructure spending over the next three years, $12 billion that willl be directed to taxpayer funded spending. More than 70% of the taxpayer funded infrastructure spending will be financed by issuing debt. Direct borrowing for capital expenditures is expected to increase from $1.8 billion in FY2015-16 to $2.8 billion by FY2018-19. However, given that operating debt requirements have fallen to the lowest levels since FY1984-85, the B.C. government is still on track to reduce the net debt-to-GDP ratio.

Building a contingency

A number of unknowns remain after today's budget. B.C. has pulled together a committee to review its current

B.C. TAXPAYER SUPPORTED DEBT



Note: * Taxpayer-supported debt levels are presented.
Source: British Columbia Ministry of Finance.

retail sales tax structure. The province would like to modernize its tax system, but has committed to not going back to the HST. The province will also review the business tax credit made available to the film industry. The tax credit cost the province $1 billion in foregone revenue during FY2015-16. With the industry proving highly profitable in 2015, the province intends to find ways to limit the costs to the program.

Of course, the biggest unknown is the economic outlook in the next five years. While B.C.'s nominal GDP forecast is a touch softer than our own and consensus forecasts, the government still points to some downside risks related to external events, including a U.S. and/or Chinese economic slowdown, as well as increasing financial market volatility. As a matter of prudence, the government has baked a forecast allowance of $350 million per year into its budget forecast, as well as $450 million in FY 2016-17 and $400 million in the following two years as a spending contingency.

The B.C. Prosperity Fund was also created, which in effect will act as a savings fund. The province will invest $100 million from the surplus in 2015-16 into the fund. Half of it will go to pay down provincial debt, 25% will go to saving for future generations, and the rest will be spent on education and health care. Future contributions to the fund will depend largely on realized surpluses.

Bottom-Line

Following years of fiscal prudence and solid economic growth, B.C. now has one of the best financial standings among Canadian provinces. Over the years, the province has built up additional room to increase spending and take on a bit more borrowing to help support infrastructure investment without shelving its plan to balance the budget and reduce the debt burden. The budget tabled today is based on conservative economic assumptions relative to consensus and is largely consistent with TD Economics' own economic forecasts. Downside economic risks certainly exist. The government noted that while its forecast embeds some allowance for a miss, it only amounts to 0.1% of its budgetary revenue stream. Still, with its net debt-to-income ratio about half that of other provinces, B.C. appears better positioned than most to absorb an unexpected revenue shortfall.