

## BRITISH COLUMBIA BUDGET 2016

February 17, 2016

### Budget 2016: Housing comes into focus

Robust home sales and rising prices prompted the BC government to introduce measures to address escalating housing market imbalances in the release of the 2016 provincial budget. As was well telegraphed ahead of yesterday’s release, the fiscal plan proposed initiatives aimed at stimulating new home construction, enhancing transparency of housing activity by expanding data collection and increasing funding for affordable housing. These measures are likely to garner significant attention; however, the underpinnings of the province’s fiscal situation were also revealed to have remained solid. The government affirmed its enviable balanced budget position—marking the fourth consecutive budgetary surplus—abetted by an improved expected outcome for the current 2015/16 fiscal year. The ongoing inclusion of fiscal prudence measures provides upside risk to the government achieving its path of surpluses that includes a budget excess of \$264 million in 2016/17.

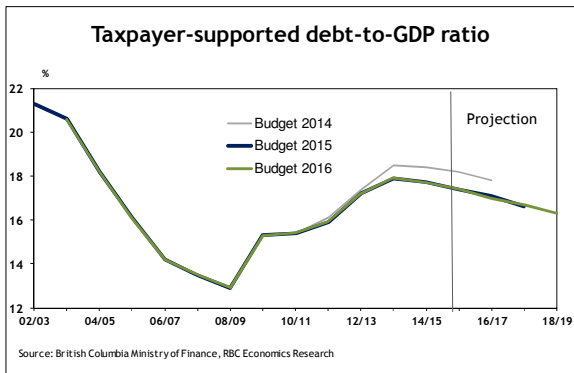
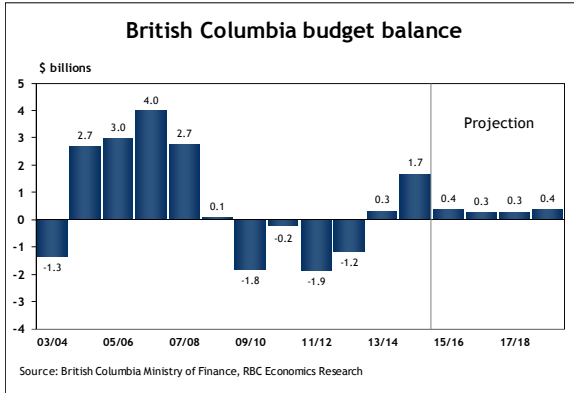
The foundation for the three-year fiscal plan was shown to be modestly improved from earlier estimates with the 2015/16 surplus now expected to come in at \$377 million (compared to \$265 million in the second quarter update released in November and \$284 million in the February 2015 Budget). A record year for home sales in the province supported property transfer tax revenues coming in well above earlier estimates while stronger-than-expected personal income taxes also contributed to the overall upward revision. The plan also projects surpluses of \$287 million and \$373 million in 2017/18 and 2018/19, respectively.

The firm fiscal footing did not dissuade the government from maintaining its cautious approach with allocations for risk continuing to be embedded within its plan. The inclusion of various layers of insurance shaved millions off of the projected path of surpluses including a forecast allowance amounting to \$250 million in 2015/16 and \$350 million in each of the 2016/17 to 2018/19 fiscal years. In addition, the ongoing setting aside of funds to “manage unexpected pressures” further tempered the projected path of surpluses (\$450 million in 2016/17 and \$400 million in each fiscal year thereafter).

#### Measures to ease housing affordability

The release of Budget 2016 coincided with housing data for January that indicated existing home sales surged to an all-time high in Vancouver with the composite MLS price index coming in a whopping 20.6% above its year-ago level. Sky-high prices and the knock-on effects to affordability for potential homebuyers prompted the inclusion in Budget 2016 of several initiatives aimed at potentially re-balancing the province’s hot housing market.

- Canadian citizens or permanent residents will be fully exempt from paying the property transfer tax on newly built homes priced up to \$750K if they occupy it for a full year and maintain it as their principal residence. The exemption will apply to all homebuyers including



Budget assumptions				
	2015	2016	2017	2018
<b>Real GDP growth (%)</b>				
Budget 2015 planning assumption	2.4	2.4	2.3	2.3
RBC	2.9	3.1	2.9	
Private sector average*	2.6	2.7	2.6	2.4
<b>Nominal GDP growth (%)</b>				
Budget 2015 planning assumption	3.3	4.0	4.3	4.3
RBC	4.5	4.8	5.2	
Private sector average*	3.8	4.3	4.8	4.5

\* BC Economic Forecast Council survey (updated January 2016)  
Source: BC Ministry of Finance, RBC Economics Research

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first-time buyers and is effective immediately. To offset the anticipated \$75 million cost of this initiative, the government is increasing the tax rate on the portion of the home value that is in excess of \$2 million to 3% (the current 1% on the first \$200K and 2% on the value between \$200K and \$2 million will be maintained).

- Budget 2016 confirmed an earlier announcement that the province is committing \$355 million over a five-year period to construct or renovate affordable housing units throughout the province.
- The government proposes new measures to improve data collection around real estate transactions, specifically to monitor foreign investment. These include: homebuyers will have to identify as Canadian citizens or permanent residents when they register their property and individuals who are neither will be required to disclose their country of citizenship; corporations will be required to disclose their directors' citizenship; homebuyers will have to disclose whether they are buying the property as a bare trustee.

Greater transparency into the currently opaque foreign investment component of housing activity is long overdue and should enlighten the discussion about foreign housing investment in the coming years. That being said, the overall effectiveness of the measures outlined above remains to be seen. On the surface the property transfer tax exemption is unlikely to improve affordability in the near-term given the \$750K threshold. At the same time, the measure is also intended to increase the supply of new homes and resultantly, over time, it may ease some of the price pressure evident within the province's housing markets. The more significant measure remains the proposed changes to the way data is collected on home purchases.

Housing-related initiatives appeared to take the place of a previously prominent issue on the government's agenda, Liquefied Natural Gas. The challenging price environment has delayed the development of what was initially touted as a potential game changer for the province (the government's natural gas forecast is CAD\$1.04/GJ in 2016/17 compared to \$2.32 in Budget 2015); however, Budget 2016 saw the government proceed with its plan to establish a BC Prosperity Fund by contributing \$100 million from the 2015/16 surplus. Initially proposed in 2013, the fund was intended to collect royalty and tax revenues from the still-nascent LNG industry. Finance Minister De Jong also proposed legislation to divert a share of future budget surpluses into the fund which is in contrast to the current framework where excess budgetary funds are used for debt repayment.

Other notable initiatives in Budget 2016 are limited, but include:

- Medical Services Plan Premiums will increase by approximately 4% as of January 1, 2017. The calculations will also exempt children and the rate paid by couples will be twice that paid by single adults (currently is less than double).

## Revenues

Total revenues in the province are projected to increase by 2.3% in 2016/17 at \$48.1 billion. The elimination of the temporary personal income tax rate of 16.8% on individual incomes over 150K (announced in Budget 2015 and effective January 1, 2016) is projected to keep taxation revenue growth subdued (at 0.3%) in 2016/17 despite strong projected increases in sales tax revenue and property tax revenues. Despite the offsetting changes to the Property Transfer Tax rates as outlined above, this component of revenues is still projected to decline by 16.8% in 2016/17 as housing market activity is forecast to slow (Housing starts forecast to fall in each year of the three-year plan). Natural resource revenues are also slated to fall 7.2% in 2016/17 reflecting, in part, the low commodity price environment; however, this component accounts for a relatively small share of total revenues at less than 5%. Providing some offset to the revenue weakness are transfers from the Federal Government (up 3.9% to \$8.0 billion) in 2016/17.

The revenue growth profile is projected to remain subdued through the rest of the fiscal plan with average annual growth of 2.1% in 2017/18 and 2018/19. A strengthening in household incomes and firm consumer spending growth are expected to support 3.5% average annual growth in taxation revenues (the largest component of revenues at greater than 50%). At the same time, lower revenues from the sale of Crown land leases are expected to more than offset a lift to natural gas royalty revenues stemming from an improving commodity price environment, resulting in natural resource revenues declining through the three-year fiscal plan.

## Expenditures

On the other side of the ledger, total expenditures are projected to rise 2.3% to \$47.5 billion in 2016/17. A 3.0% increase in health spending (which accounts for close to 40% of total expenditures) accounts for the bulk of the increase with this component expected to sustain this rate of growth through the projection period. Public debt charges are slated to rise 2.2% to \$2.6 billion in 2016/17 which would represent a slower rate of increase relative to the 3.2% estimated in 2015/16.

Beyond the upcoming 2016/17 fiscal year, total expenditures are slated to rise by 2% annually, on average. Budget 2016 incorporates public sector compensation increases in the 2018/19 fiscal year reflecting the final year of the 2014 Economic Stability Mandate. Since the mandate's inception, 80% of public sector unionized employees have reached settlements. The government outlined that there is scope for additional wage increases beyond the \$205 million allocated in 2018/19 should real economic growth outpace the

consensus forecast of private sector economists.

Taxpayer-supported capital spending is projected to jump by 17.1% to \$4.3 billion in 2016/17. Broad-based increases across sectors are projected including in Health (up 18.9% to \$1.2 billion) and Education (up 16.8% to \$1.4 billion). Capital spending is expected to unwind some of this surge in 2017/18 with spending slated to decline 9.6% to \$3.8 billion and led by a 32% drop in health spending. The addition of 2018/19 to the fiscal plan indicates spending will edge up modestly to reach \$3.9 billion.

The taxpayer-supported debt profile was lowered modestly, in part reflecting a better outcome in 2015/16 (namely a larger surplus). Taxpayer-supported debt is now projected to rise from \$42.7 billion in 2015/16 to \$45.1 billion by 2018/19. Taxpayer-supported debt as a share of GDP is expected to gradually decline from 17.4% in 2015/16 to 16.3% in 2018/19.

### Borrowing Requirements

Total borrowing requirements are expected to reach \$16.1 billion over the fiscal plan with \$13.5 billion allocated for capital spending and \$2.6 billion to be directed to refinance existing debt maturities the next three years. In 2016/17, provincial borrowing is projected to be \$4.6 billion (\$4.4 billion in new borrowing and \$0.2 billion in direct borrowing by Crown corporations and agencies). This compares to the \$5.3 billion required in 2015/16 as new borrowing is expected to decline by 11.0%.

### Conservative assumptions

The foundation of Budget 2016 is based on lower economic growth assumptions than that provided by the consensus of private sector forecasters. Real GDP growth in the province is expected to come in at 2.4% in 2016 and 2.3% in 2017; this compares to the private sector forecast for growth to average 2.7% over the period. These compare with our own, more optimistic forecasts of 3.1% in 2016 and 2.9% in 2017. British Columbia is expected to lead the country in growth in 2016 as it continues to benefit from strong consumer spending and robust housing market activity. A strengthening in demand for the province's merchandise exports set against a backdrop of a weak Canadian currency should further position the province as a growth leader over the forecast horizon. Housing market imbalances remain top of mind; however, today's initiatives and the relatively strong fiscal position of the province should provide some degree of protection should downside risks materialize.

### British Columbia's fiscal plan

\$ billions	Actual	Forecast	Estimate	Plan	Plan
	14/15	15/16	16/17	17/18	18/19
Total revenues	46.1	47.0	48.1	49.0	50.1
Total expenses	44.4	46.4	47.5	48.4	49.4
Program spending	41.9	43.8	44.8	45.6	46.5
Interest on public debt	2.5	2.6	2.6	2.8	2.9
Surplus (before fcst allowance and BC Prosperity Fund)	1.683	0.527	0.614	0.637	0.723
BC Prosperity Fund		0.1			
Forecast allowance		-0.250	-0.350	-0.350	-0.350
Surplus	1.683	0.377	0.264	0.287	0.373

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