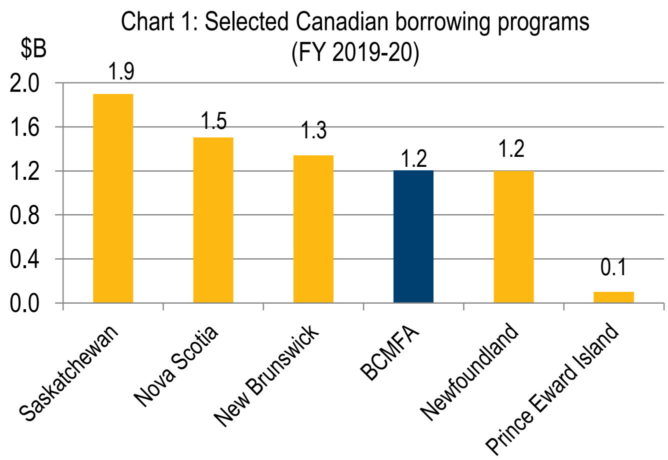
# BCMFA to benefit from strong labour market conditions and stabilizing housing dynamics

Following the publication of the 2020 British Columbia Budget, we place in perspective the economic fundamentals supporting the outlook for the Municipal Finance Authority of British Columbia (BCMFA).

**A unique position in the Canadian fixed income landscape**

BCMFA is a Canadian-based public sector borrowing agency domiciled in Victoria BC. Its primary business activity is to provide infrastructure financing to local governments such as municipalities and regional districts. Because of its ability to pool capital requirements from smaller entities into a larger program, BCMFA is able to secure lower cost financing for local entities than what they would normally have been able to do on their own. While this financing strategy is standard, BCMFA's size and position in the Canadian fixed income landscape is unique. For instance, Financement-Québec and Québec's Financing Fund, which account for over 90% of the province's total borrowing requirements, operate in the same manner. However, those programs are part of the Quebec government. In contrast, BCMFA operates at an arm's length from the BC government. BCMFA's borrowing program is similar in size to some provincial governments (chart 1). Moreover, its borrowing program, secondary trading volume and AAA credit rating make it a benchmark issuer in Canada.




Note: Provincial official program as announced in latest Budget/Fiscal Update.
Source: BCMFA, Provincial governments and Laurentian Bank Securities.

**Strong fundamentals in spite of a challenging economic environment**

In our BC Budget analysis released in February, we highlighted the challenging economic environment. The province faces significant headwinds, both domestically (dwindling timber supply, protests against natural gas pipeline) and globally (China's slowdown and the global coronavirus outbreak). As a result, most of BC's recent economic weakness came from manufacturing shipments and exports, down 2.6% and 6.4% in 2019, respectively. While BCMFA is not immune those developments, several aspects of its loan portfolio underpin the agency's credit profile.

As a long-term lender, BCMFA's financial strength is more directly tied to the economic vitality of its municipal clients than to global cyclical indicators. The good news is that the agency's portfolio is concentrated in regions where economic vitality is generally strong. For instance, more than 60% of BCMFA's long-term loans were attributed to municipalities and entities in the Mainland/Southwest development region, including the Metro Vancouver and the Fraser Valley regional districts (Table 1).[1] Employment advanced by 3.5% in that region in 2019, the second highest growth rate among development regions. This is in part due to vibrant services-oriented industries such as the technology sector. Record-high tourism activity is also a boon for the region. In the regions of Vancouver Island (13.5% of the portfolio), including Victoria, and Thompson-Okanagan (12.8% of the portfolio), including Kelowna, the unemployment rates are near a decade-low. The pioneer tech industry of Kelowna underpinned an 18K record-high job creation (6.9%) in the Thompson-Okanagan region in 2019. In the Vancouver Island region, it has been a tale of two economies. Following the job boom of the last four years (+12.0%, +20.9K), employment in Victoria took a breather in 2019 (-0.4%; -0.7K). Finally, the North Coast region is expected to reap the benefits of the LNG Canada project currently under construction.

**Table 1: BCMFA Long-term loan portfolio**

| Development Region | Loans Outstanding | Share of loans outstanding | Unemp.rate | Emp. Growth | |
|---|---|---|---|---|---|
| | ($ Thous.) | % | (% 2019 Avg) | (%, 2019) | (Thous.) |
| **British Columbia** | **3,716,170** | **100.0** | **4.7** | **2.6** | **65.4** |
| Cariboo | 109,172 | 2.9 | 6.3 | 0.0 | 0.0 |
| Kootenay | 149,975 | 4.0 | 5.3 | 0.8 | 0.6 |
| Mainland/Southwest (including Metro Vancouver) | 2,306,896 | 62.1 | 4.6 | 3.5 | 57.0 |
| North Coast & Nechako | 81,659 | 2.2 | 4.3 | -0.9 | -0.4 |
| Northeast | 88,772 | 2.4 | 6.3 | -2.5 | -1.0 |
| Thompson-Okanagan | 476,806 | 12.8 | 4.9 | 6.9 | 17.6 |
| Vancouver Island/Coast | 502,890 | 13.5 | 4.1 | -2.1 | -8.4 |

Notes: Regional districts aggregated to the development region level. Metro Vancouver does not include Translink direct borrowings. Amounts do not include E-COMM (911 Emergency Service), CREST and Regional Hospital Districts.

Source: BCMFA 2018 Annual Report, BC Stats and LBS Economic Research and Strategy calculations.

## The real estate market has stabilized

An important source of credit strength for BCMFA is its broad and independent taxation authority. Under its institutional framework, the agency withholds 1% of principal borrowed from long-term loans into a Debt Reserve Fund (DRF). As of November 2019, the DRF stood at $108M. Its purpose is to meet BCMFA's debt obligation in case the economic environment significantly alters the agency's liquidity position. So far, this never happened. If the agency faces difficulties in replenishing the fund, a levy on all taxable land and improvements in BC can be applied. The tax levy *must* be applied if the DRF falls under a certain threshold. Together, the DRF and the taxation authority provides strong credit enhancement to the agency.

Granted, the amount of taxes that can be collected depends significantly on housing market conditions. In the past few years, important policies have been introduced by the city of Vancouver (empty home tax), the province of BC (foreign buyer tax and vacancy tax) and the federal government (B-20 stress test) to cool down speculative investment, increase rental supply and improve the financial resilience of households and banks. These targeted policies delivered good results despite the setback in home sales and housing starts of 2017 and 2018. Housing conditions have improved in most areas during 2019 (chart 2). Residential sales rebounded from a 6-year low and housing starts reached an all-time high of 44.5K. Vancouver Island prices continued their uninterrupted regional rise. However, after a brief decline in 2018, prices in Victoria have increased in late 2019, a similar pattern to the Greater

[1] The composition of BCMFA's loan portfolio was retrieved from the 2018 annual report.



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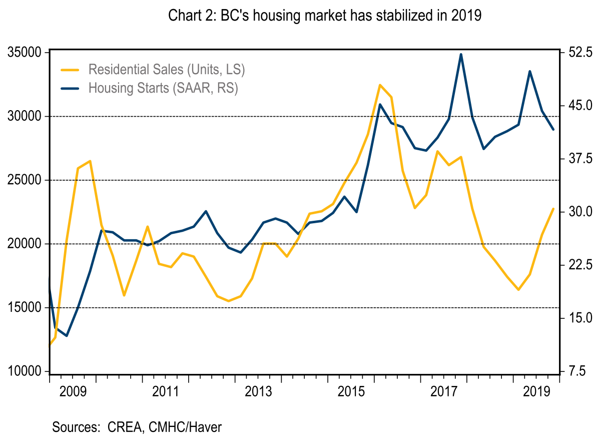
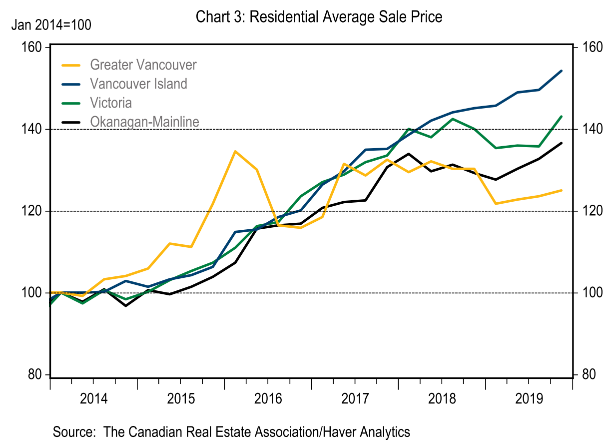
Vancouver Area (chart 3). Overall, the level of BC's housing activity is dynamic and the growth in pricing is more sustainable than before. Those reinforce the effectiveness of BCMFA's taxation authority.




Over the long run, demographic is an important indicator to monitor. It underpins both the labour and housing markets. BC has been doing well on that front. Population growth has been stronger than the national average for the most part of the last two decades, averaging 1.5% since 2012 (chart 4). Until recently, household formation was in part driven by strong net interprovincial migration reflecting the attractiveness of BC in spite of the economic difficulties facing its Albertan neighbour following the 2015 oil shock. While still positive, the interprovincial migration flows have since abated. However, net international immigration has accelerated significantly in the past three years due to the higher federal targets (chart 5). They completely offset the softer net interprovincial migration. International migration reached close to 30K in the third quarter of 2019, a staggering 25% increase from a year before.[2] This is consistent with demographic trends observed nationally. The rapid pace of immigration provides an offset to an aging population and will continue to support BC's economy in the future.

In summary, BC is facing cyclical challenges as well as the unexpected economic impact of the coronavirus outbreak, like the rest of the world. Still, BCMFA's credit position remains strong, supported by outperforming demographics relative to most provinces and solid fundamentals in the labour and housing markets. If economic conditions deteriorate, other credit enhancement such as BCMFA's sinking fund investments ($3.7B)[3] and the joint and several guarantees[4] of its loan portfolio would also continue to underpin the agency's debt.

[2] Non-seasonally adjusted.
[3] Source : Moody's Investors Service.
[4] The joint and several guarantees mean that municipal borrowers guarantee each other's debt in the event of default.



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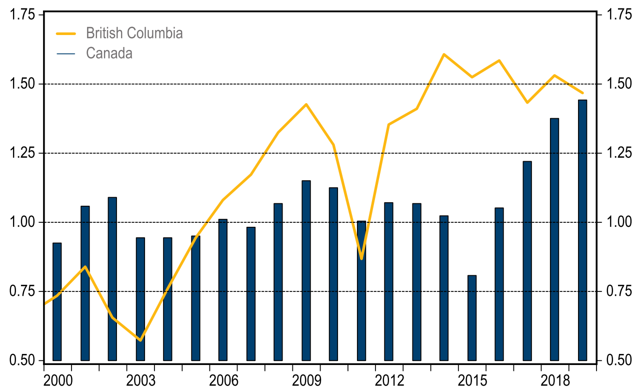
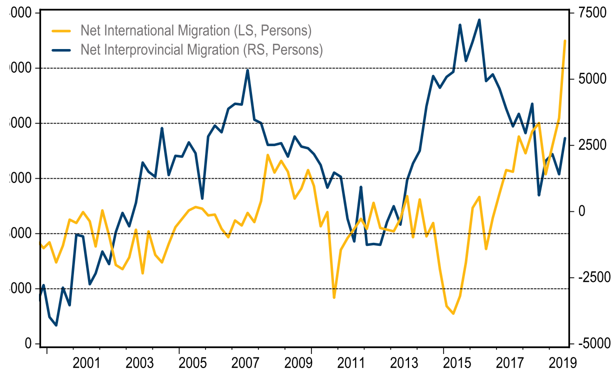
Chart 4: Population Growth




Source: Statistics Canada/Haver Analytics

Chart 5: Components of BC Population Growth
(seasonally adjusted)




Source: Statistics Canada/Haver Analytics

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