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Alberta Non-Renewable Resource Revenue Forecast To Plunge To 40-Year Low In 2016/2017

14 APRIL 2016

The Alberta government this afternoon tabled a budget that forecasts non-renewable resource revenue of $1.36 billion for 2016/2017, a level not seen for over 40 years.

The **NDP** government said that non-renewable resource revenue in 2016/2017 accounts for 3.3 per cent of total revenue, though its share is expected to grow to 8.5 per cent by 2018/2019. It is forecast at $1.36 billion, $1.1 billion, or 45 per cent lower than in 2015/2016, and $7.6 billion or 85 per cent lower than in 2014/2015. Most of the deterioration in revenue is due to the impact of falling global oil prices on bitumen and crude oil royalties.

Resource revenue is then estimated to increase by an average of 76 per cent per year between 2016/2017 and 2018/2019, to $4.23 billion, with substantial growth in bitumen royalties, mainly due to the slow improvement in oil prices and rising production. However, the resource revenue forecast for 2018/2019 is still less than half of actual 2014/2015 resource revenue. The changes to the royalty regime recommended by the Royalty Review Advisory Panel are intended to be "revenue neutral."

"In Alberta, we're used to volatile oil markets," noted Finance Minister **Joe Ceci** during his budget speech. "But this price bust is the most dramatic in generations. It is causing tremendous economic pain and anxiety.

"In 2013/14, the province booked almost $10 billion in non-renewable resource revenue. This year, we are forecasting an almost 90 per cent drop to $1.4 billion — less revenue than we've seen in 40 years."

This has helped to produce a deficit of $10.4 billion in this year's budget, he noted.

(To see a separate story on the government's climate plan, click or tap here (http://www.dailyoilbulletin.com/article/2016/4/14/province-begins-account-climate-plan-budget/)).

Ceci said the government opted not to move forward with "extreme cuts." The government is amalgamating or dissolving 26 agencies, boards and commissions, saving roughly $33 million over three years. It is also reducing budgets for salaries and supplies in government departments by nearly two per cent this year, saving $121 million.

"Instead of taking a panicked approach, our government is deferring some of our platform commitments, slowing down their rollout and reallocating savings to where they are needed most.

"And we are streamlining programs such as Alberta Innovates and community partnership grants, and suspending payments to the Access to the Future Fund."

Management salaries have been frozen at government agencies, boards and commissions and the province has commenced a review of salary rates overall in these agencies.

Cabinet, MLAs and political staff will not see a salary increase for the entire term of this legislature, Ceci said.

During a press conference, the finance minister said he doesn't see the province returning to a surplus situation for some time.

"We know it's a bit of a fool's game to try and predict the price of oil into the future; that's why we've taken a cautious and conservative approach, and we have built in a significant risk adjustment to account for volatility in the oil price," he said. "Based on those assumptions in this budget, I'm aiming to balance the budget by 2024.

"To balance sooner would require that we undertake brutal cuts to health and education and pretty much every service provided by government," Ceci added. "If the economy improves more quickly, and we all hope it does, then the budget will come into balance sooner."

Bitumen royalties, production

Bitumen royalties are estimated at $656 million in 2016/2017, $488 million, or 43 per cent lower than in 2015/2016, and $4.4 billion or 87 per cent lower than 2014/2015.

They are forecast to increase to almost $3 billion in 2018/2019, with an average annual growth rate of 113 per cent between 2016/2017 to 2018/2019. The main drivers are increasing oil prices and higher production.

The government will supply bitumen to the **North West Upgrader**, tentatively scheduled to begin operations in 2017, which will upgrade bitumen into higher-valued products such as ultra-low sulphur diesel. The province will receive a portion of the revenue from the sale of the upgraded product, but is also responsible to pay monthly cost of service tolls for the 30-year term of the contract. The financial return from the project is heavily dependent on the costs of constructing and operating the facility, as well as the price differential between bitumen and upgraded products over the term of the contract, budget documents stated.

Raw bitumen production is forecast at 2.67 million bbls per day for the 2016/2017 fiscal year, then is expected to climb to 2.89 million and 3.15 million bbls per day the following two fiscal years.

Conventional royalties, production

Conventional oil royalties are estimated at $333 million in 2016/2017, $277 million or 45 per cent lower than in 2015/2016, and $1.9 billion or 85 per cent lower than in 2014/2015. While they are anticipated to recover, they are forecast at only $616 million by 2018/2019, with average annual growth of 36 per cent between 2016/2017 and 2018/2019.

Incentives in the royalty system have encouraged the use of new technologies to drill wells that previously would have been too costly to develop. Production has risen since 2011, but an increasing amount of production is from horizontal wells, subject to the same five per cent royalty rate as all conventional oil wells for year one of production, but then paying the five per cent rate for an additional one to three years, depending on well depth. In 2015, 83 per cent of crude oil wells placed in production were horizontal wells.

Conventional production is pegged at 524,000 bbls per day for 2016/2017, then falls to 506,000 bbls per day and further to 489,000 bbls per day the following two fiscal years.

Oil price assumptions

West Texas Intermediate (WTI) prices are forecast to average US$42 per bbl for 2016/2017, rising to $54 and $64 the following two fiscal years. Western Canadian Select (WCS) at Hardisty is forecast to average C$36.40 per bbl for 2016/2017, then rises to $48.30 and $59 per bbl the following two fiscal years.

The differential is expected to average a discount of US$15.20 per bbl for the 2016/2017 fiscal year, then rises to $17.50 and $18.50 the following two fiscal years.

Natural gas royalties, production, pricing

Natural gas and by-product royalties are estimated at $151 million in 2016/2017, $190 million or 56 per cent lower than in 2015/2016, and $838 million or 85 per cent lower than in 2014/2015. They are expected to grow at 53 per cent per year on average, out to 2018/2019, when they are forecast at $355 million.

By contrast, in 2008/2009, natural gas revenues were $5.8 billion.

Revenue includes royalties from natural gas by-products, such as propane, butane and pentane, whose prices and associated revenue more closely follow oil prices. The recently announced Petrochemicals Diversification Program, which will provide royalty credits for investment in new petrochemical facilities, is estimated to reduce revenue by $20 million in 2018/2019.

The immediate outlook for natural gas prices continues to be weak, the province noted, with abundant natural gas supplies keeping prices low. North American natural gas storage is at record levels, after weather in both the summer and winter was mild, and from continued growth in U.S. shale gas production. Gas production is anticipated to keep pace with demand growth arising from improving U.S. economic conditions, U.S. liquefied natural gas exports and retirement of coal-fired electricity plants over the medium term.

As a result, the Alberta Reference Price (ARP) for 2016/2017 is estimated at C$2.40 a gigjoule, 10 cents higher than 2015/2016, but $1.11 lower than 2014/2015.

The ARP is forecast to remain low over the next two years, reaching $3 by 2018/2019.

Output is forecast at 4.77 tcf for 2016/2017 before falling to 4.65 tcf and 4.53 tcf the following two fiscal years.

Land sales

Bonuses and sales of Crown land leases revenue has fallen substantially — at its peak, a highlight was the record $843 million taken in at a single sale on June 1, 2011, surpassing the $651.4 million paid at the Feb. 8, 2006 sale that was driven by a play for carbonates near Fort McMurray (http://www.oilsandsreview.com/index.php/component/search/?searchword=Fort%20McMurray&ordering=newest&searchphrase=all&limit=20) (DOB, June 2, 2011 (http://www.dailyoilbulletin.com/article/2011/6/2/record-land-sale-in-alberta-raises-843-million/)).

In 2015/2016, revenue from land lease sales is estimated at $210 million, while in 2016/2017 it is estimated at $95 million. With companies tightening their belts, it is anticipated that fewer hectares will be sold and at lower per hectare prices over the forecast period.

Energy ministry

Consolidated expense is budgeted at $769 million in 2016/2017 ($787.5 million the previous fiscal year). This budget provides $245 million for operations of the **Alberta Energy Regulator** (AER) and $36 million for the **Alberta Utilities Commission** (AUC). The budget for Orphan Well Abandonment, which nearly doubled in 2015/2016 to $30.5 million, will be maintained at this level in Budget 2016.

Economic Development and Trade

Consolidated expense is budgeted at $343 million in 2016/2017. This budget includes $183 million in transfers to the **Alberta Innovates Corporation**, as four corporations are amalgamated into one under this ministry in 2016/2017.

Debt to GDP ratio

The government said it is committed to maintaining one of the lowest debt to nominal GDP ratios among the provinces. The 15 per cent limit set in the *Fiscal Planning and Transparency Act* is being removed “to provide the flexibility required to deal with current economic realities.”

“We’re in a different situation than we were six months ago,” Ceci said. “We know we need to continue to invest in this province.

“We still maintain one of the best balance sheets in the country. We believe that if the economy improves more quickly, that we’ll be able to be below that 15 per cent debt to GDP, but I think it’s prudent and up-front to say in our fiscal plan that we have here, it is exceeded in year three by half a percentage point, so I will be introducing legislation today that eliminates the 15 per cent debt to GDP and it will allow us more flexibility. I’m hopeful we won’t need that additional flexibility.”

Jobs investment

In March, the government introduced the *Promoting Job Creation and Diversification Act*, which “recognizes that all Albertans will benefit from astronger and more diversified economy.”

Budget 2016 includes a two-year,$250 million package to “support job creators and encourage business capitalinvestment, attract new businesses to Alberta, support regional economicdevelopment and improve access to training opportunities.” This packagereplaces the Job Creation Incentive Program that was introduced inBudget 2015.

Over two years this new package will provide:

- $190 million to support job creators with two new tax credits (valued at $165 million) to encourage investors to support eligible small and medium-sized enterprises in Alberta, and encourage businesses to make capital investments. There is $25 million in new funding to be invested through the **Alberta Enterprise Corporation** to spur innovation and help grow companies and increase employment in areas such as clean

technology;
- $35 million to attract and support new businesses and pursue regional economic development initiatives;
- $25 million for new apprenticeship and training opportunities.

Data Central (http://www.datacentralcanada.com/)

Environmental Innovations Guidebook & Directory (http://www.environmentalservicesguidebook.com/)

Heavy Oil & Oilsands Guidebook (http://www.heavyoilguidebook.com/)

Maintenance Repair Operations (http://oilsandsreview-mro.com/)

Multistage Fracturing and Horizontal Drilling (http://newtechsupplement.com/)

New Technology Magazine (http://www.newtechmagazine.com/)

Oilfield Atlas (http://www.oilfieldatlas.com/)

Oilsands Review (http://www.oilsandsreview.com/)

Oilweek (http://www.oilweek.com/)

Oilweek East Coast Supplement (http://oilweekeastcoast.com/)

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