

March 20, 2008

Municipal Finance Authority of British Columbia

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Major Rating Factors

Strengths:

- B.C. municipal sector's strong credit quality
- Solid access to liquidity from bank lines and sinking funds
- Strong legal framework within which loan obligor borrowings take place
- Moderate-but-increasing debt burden
- Supportive relationship between the province and its municipal sector

Issuer Credit Rating

AAA/Stable/A-1+

Weaknesses:

- High and increasing degree of loan portfolio concentration
- Significant increase in total debt in 2008

Rationale

The ratings on the Municipal Finance Authority of British Columbia (MFABC or the authority) reflect the following:

- The financial health of the B.C. municipal sector is the foundation for the authority's credit strength. The high credit quality of municipal obligors results from B.C. municipalities' strong aggregate operating and after-capital performances, superior aggregate liquidity levels, and the robust B.C. economy. Specifically, their aggregate operating revenue growth has averaged more than 7% a year for the 2002-2006 period, cushioning increases in the authority's total debt.
- MFABC has solid access to liquidity, thanks to its bank credit facilities and sinking fund holdings. The authority maintains an on-demand nonrevocable bank facility of C\$300 million and two C\$200 million bank lines backstopping its commercial paper (CP) program. MFABC had cash and investment holdings of C\$1.3 billion at the end of fiscal 2007.
- There is a strong legal framework in which the authority borrows on behalf of members. The framework provides for mandatory debt service reserve contributions by obligors at the time of borrowing, the ability to establish sinking funds, and access to the local property tax base. MFABC's statutory ability to access the property tax base for debt reserve fund replenishment creates a de facto joint and several liability among all municipal members.
- MFABC's long-term debt burden has been moderate. At the end of 2007, the authority's debt represented about 53% of total municipal operating revenues, which is consistent with MFABC's high investment-grade ratings. The municipal sector's operating revenue growth has been robust for much of this decade, and has largely offset debt issuance that has exceeded retirements.
- The Province of British Columbia (AAA/Stable/A-1+) has a history of supporting its municipal sector. It continues to provide a high level of financial support, particularly for smaller and more rural municipalities that have a lower level of own-source revenues compared with those of urban municipalities. Furthermore, although instances of municipal financial distress are rare, the province has a record of timely assistance for those

municipalities.

Offsetting these credit strengths somewhat are the following:

- The concentration of MFABC's two biggest obligors is a potential source of credit weakness. The two obligors, the Greater Vancouver Regional District (GVRD) and its related transit company (TransLink), represented close to 60% of total lending at the end of 2007. The total debt of GVRD municipalities, including Vancouver, and TransLink stood about 66% of their total operating revenues at the end of the 2007 and could exceed 100% of projected operating revenues by the end of the decade.
- MFABC's debt will increase again substantially in 2008, and total debt net of sinking funds could reach as high as C\$4.9 billion by the end of this year. As the authority returns to a more historical level of annual issuance, total debt net of sinking funds should be close to C\$6 billion by the end of 2012.

Outlook

The stable outlook reflects Standard & Poor's Ratings Services' expectation that the aggregate operating revenues of the B.C. municipal sector will continue to grow in line with the average of the past five years and that the sector's aggregate debt burden will remain comparable with those of 'AAA' rated non-U.S. municipalities. New issuance likely won't materially exceed forecasts, and we don't expect significant changes to the authority's powers and business risk profile. Larger-than-expected borrowing or a material change in the authority's powers or business risk profile would place downward pressure on ratings.

Ownership And Legal Status

The MFABC was established in 1970 and is incorporated under the Municipal Finance Authority of British Columbia Act. It is a nonshare, not-for-profit corporation that is controlled by a board of directors composed of representatives from the 27 regional districts in B.C. The authority is not governed by the Business Corporations Act and is not an agent corporation of the provincial government; accordingly, MFABC obligations do not benefit from any guarantee from the B.C. government.

Operational Profile

The MFABC Act empowers the authority to provide long-term funding to regional districts and their constituent municipalities, regional hospitals and other special purpose municipal entities through the issue of securities by MFABC and on-lending of the proceeds to the regional districts. The act also empowers MFABC to provide short-term and lease financing to and manage investment pools on behalf of its members.

The province is divided into 27 regional districts. Provincial law requires all regional districts (and their member municipalities), and regional hospital districts (outside of the greater Vancouver area), to obtain their long-term debt funding from MFABC. The only exception to this requirement is the City of Vancouver (AA+/Stable/--), which may borrow in its own name. Provincial statute permits long-term debt financing for capital purposes only.

Members seeking long-term capital funding inform MFABC of their requirements in advance. MFABC combines those requirements and borrows for all participating members in one aggregate issue. The issue's proceeds are then on-lent under separate loan agreements to the participating members. MFABC borrows in domestic and

international capital markets.

Regional districts have a several-only liability with respect to MFABC debt obligations incurred on their behalf; the lower-tier municipal members of a regional district, however, are joint and severally liable for their regional district's debt obligations.

The MFABC Act requires any borrowing regional municipality to make a mandatory payment to a debt reserve fund (DRF) that MFABC holds and controls. The minimum mandatory payment is equivalent to 1% of principal borrowed to a maximum of 50% of annual average principal and interest payments, payable on receipt of loan proceeds. Any insufficiency of the DRF can be recovered through the imposition of a province-wide property tax levy replenished by a weighted assessment tax levy on all provincial property, including that in the City of Vancouver. No further municipal or provincial authorization is required for the tax imposition.

The capability of imposing a provincewide property tax effectively changes the several-only liability (spelled out in the MFABC Act) of the regional districts and their debt obligations to a joint and several liability of all MFABC municipal members. An effective joint and several liability of all municipal members removes the potential constraint on MFABC's credit quality of weaker members.

The act also permits MFABC to establish sinking funds (the capital repayment equalization fund, or CREF). Sinking funds are established for each MFABC issue and only members participating in an individual issue must make sinking fund payments for that individual issue. MFABC has used its powers under the act and it requires all members to make annual sinking fund contributions as a condition of making loans to participating members. Sinking fund contributions must be invested in high quality fixed income securities issued by Canadian local, provincial, and federal governments; chartered banks; and credit unions incorporated in B.C.

Pool Quality

The loan portfolio increased significantly in 2007, rising close to 20% to reach about C\$4.1 billion. No new obligors joined the pool during the year. Aggregate exposure to individual obligors (regional districts and other related entities) ranged from a minimum of C\$30 thousand to of C\$1.4 billion with a median exposure size of C\$41 million.

Most loans are long-term, with a weighted average loan life of 16 years. Loan-life has been decreasing slowly as obligors made greater use of construction loans, which are typically termed out with a long-term loan postconstruction. The short-term portfolio behaves like a revolving loan facility, with existing loans being retired and new short-term loans being made.

The portfolio's geographical diversification is low-to-moderate, and decreasing. As a lender to the B.C. municipal sector, pool diversification is effectively capped. Nevertheless, the concentration of loans to municipalities and related entities in the greater Vancouver area is relatively high and increasing. At the end of 2007, about 57% of the portfolio was made up of loans to TransLink and its related government, the GVRD. The portfolio's biggest borrower, TransLink, represented about 35% of the portfolio at the end of 2007; the second biggest borrower, GVRD, was about 22%. Loans to both TransLink and GVRD are several times that of the next largest borrower. This concentration will increase in the next five years as the vast majority of MFABC's projected issuance will be for TransLink and the GVRD.

The GVRD and its 21 member municipalities represent the major population center of the province, with about 50% of the people and dwellings and 60% of property taxable assessment. The GVRD's rapid population growth in the past decade has exacerbated the need for infrastructure investment; the majority of the GVRD's future debt issuance (through the MFABC) will occur for water, sewer, water treatment, and transit and transportation. GVRD-issued debt issuance on behalf of TransLink, the Greater Vancouver Water District, and the Greater Vancouver Sewerage and Drainage District represent the majority of prospective debt-financing requirements.

Debt Service Reserve And Sinking Funds

The authority has considerable cash and investment holdings. These holdings, which are primarily sinking funds, stood at C\$1.3 billion (book value; C\$1.5 billion by market value) at the end of fiscal 2007, up 2.5% from the previous year. MFABC invests in high-quality fixed income securities (by statutory requirement) and does not include asset-backed commercial paper. The income from those investments must be retained with the sinking fund accounts.

The authority also maintains a DRF, whose balance is included in investment holdings. The DRF stood at just more than C\$90 million at the end of 2007. It is subject to the same statutory requirements on investments and income as sinking funds. The MFA Act also stipulates that MFABC may impose a provincewide property tax if it cannot make its planned debt service payments or sinking fund contributions and is required to impose the tax if the balance in the DRF is less than half of its required level. Municipalities make payments into the sinking fund according to a prescribed formula (1% of total borrowed principal) when they receive the net proceeds from MFA's borrowing. To date, there has never been a draw on the DRF.

Liquidity And Debt

MFABC has solid access to liquidity thanks to its bank credit facilities and its own sinking fund holdings. Its general bank facility consists of C\$300 million on demand, which could cover a potential timing gap in the unlikely event that the authority must exercise its provincewide property taxing power.

MFABC's C\$400 million commercial paper program is backed by two equal lines of credit. The two C\$200 million lines are placed with separate high credit quality Canadian financial institutions and are both irrevocable.

In aggregate, B.C. municipalities enjoy considerable liquidity support from their own balance sheets. At the end of 2006, municipalities had available cash and investments (net of restricted funds) totaling C\$4 billion, which was up about 5% from the previous year.

These holdings, which are held as municipal reserves, are not readily accessible by MFABC in the unlikely event that that the authority cannot meet its debt service obligations after exhausting its own considerable liquidity sources. The MFA Act does not provide a direct mechanism whereby the authority could have timely access to those municipal reserves.

Debt outstanding increased again in 2007. At the end of fiscal 2007, total short and long-term debt outstanding net of sinking funds stood at C\$4.1 billion, which was up substantially (20%) from the previous year's C\$3.4 billion. The large increase represents a departure from the steady increases of recent years: Since the beginning of the decade, the authority's debt outstanding has grown an average just more than 8% annually. We expect a similar

jump for this year, with debt growth returning back to more historical paces beyond 2008.

The authority's debt platform consists almost entirely of long-term debt with a weighted average term to maturity of 10 years. By 2012, C\$2.4 billion of debt outstanding will mature, but obligors should refinance about C\$1.1 billion of upcoming maturities. Refinancing needs arise as some obligors want terms that are longer than the Authority's standard 10-year term. The authority has issued American-dollar-denominated debt, but all current debt outstanding is in Canadian dollars.

The share of total debt composed of short-term CP and demand facility debt increased moderately in 2007. CP and demand facility debt outstanding increased to about C\$500 million, or about 13% of total debt outstanding. This is up from the previous year's share of about 8%. MFABC's CP program, which is not extendible, has a C\$400 million limit.

MFABC's debt will increase again substantially this year, but after 2008, net new issuance (issuance plus refinancing net of retirements) should return closer to historical levels. Total debt net of sinking funds could reach as high as C\$4.9 billion by the end of this year. Owing to the return to more historical annual issuance, total debt net of sinking funds should be close to C\$6 billion by the end of 2012. Slightly more than half of the new issuance in the 2008-2012 period will be on behalf of TransLink, with another third on behalf of the GVRD (water and sewer operations). The balance of expected new issuance will be spread amongst all other municipalities in the province.

MFABC's debt burden, which had been relatively stable, increased moderately in 2007. Measured against the B.C. municipal sector's operating revenue, the authority's debt net of sinking funds about 53% of total municipal operating revenues (including those of related municipal entities, such as TransLink), up from 47% the previous year. When Vancouver's debt is added to the authority's debt (Vancouver does not issue through MFABC but recovers its debt charges through the property tax base), the B.C. municipal sector's total debt represented 60% of total operating revenues. The increase in debt outstanding has historically been cushioned by the sector's robust operating revenue growth; since 2002, aggregate operating revenues have grown about 7.4 a year%.

The B.C. municipal sector's financial health is the foundation for the authority's credit strength. The robust B.C. economy and the municipalities' strong aggregate operating performances (about 20% of total operating revenues on average) and superior aggregate liquidity support the ratings on MFABC. The concentration of MFABC's two biggest obligors (GVRD and TransLink), however, is a potential weakness. The two obligors represented close to 60% of total lending at the end of 2007. The total debt of GVRD municipalities (including Vancouver) and TransLink stood about 66% of total operating revenues at the end of the 2007; it could exceed 100% of projected operating revenues by the end of the decade. Very robust operating revenue growth has offset some of the increased debt. Nevertheless, with the bulk of planned net new issuance going to GVRD municipalities or related entities, the credit profile of the greater Vancouver municipal sector will remain a key aspect of the authority's credit profile.

MFABC does not have unfunded pension liability. Pensions are the responsibility of the provincial government's municipal employee pension plan, which is estimated to be full funded at the end of 2005. The authority's financial statements do not reveal any significant unfunded liability, contingent liability, or commitment.

Ratings Detail (As Of March 20, 2008)*

Municipal Finance Authority of British Columbia

Issuer Credit Rating

AAA/Stable/A-1+

Ratings Detail (As Of March 20, 2008)***(cont.)**

Commercial Paper	
<i>Local Currency</i>	A-1+
<i>Canadian National Scale Commercial Paper Rating</i>	A-1(HIGH)
Senior Unsecured	AAA

Issuer Credit Ratings History

19-Mar-2008	AAA/Stable/A-1+
29-Aug-2007	AA+/Positive/A-1+
21-Feb-2006	AA+/Stable/A-1+
08-Apr-2004	AAA/Negative/A-1+
20-Oct-2003	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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