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Research Update:

Municipal Finance Authority of British Columbia Affirmed At 'AAA' After Criteria Revision; Off UCO; Outlook Stable

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Research Update:

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Overview

- We have completed our review of the ratings on the Municipal Finance Authority of British Columbia (MFABC), a Canadian-based public sector funding agency that lends to the British Columbia (B.C.) municipal sector, following the release of our "Public-Sector Funding Agencies: Methodology And Assumptions" criteria.
- We had placed the ratings on the authority Under Criteria Observation (UCO) on May 22, 2018 in conjunction with the criteria's release.
- After our review, we are affirming our 'AAA' long-term issuer credit rating on MFABC and removing the ratings from UCO.
- The stable outlook reflects our expectation that, in the next two years, MFABC will retain its status as the exclusive lender of long-term debt to B.C. municipalities, with legislatively enshrined taxing powers to backstop its capital against unforeseen losses, strong liquidity, and prudent management practices.

Rating Action

On May 31, 2018, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on Municipal Finance Authority of British Columbia (MFABC). At the same time, S&P Global Ratings affirmed its 'A-1+' and 'A-1 (High)' short-term issuer credit ratings. S&P Global Ratings also removed the ratings from UCO, where they were placed May 22, 2018. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, MFABC will remain the exclusive lender of long-term debt to British Columbia (B.C.) municipalities. We also expect the authority to retain its legislatively enshrined ability to levy a province-wide tax to replenish any potential draw on its debt reserve fund (DRF). In addition, we expect MFABC's long track record of prudent management practices to continue, with minimal asset liability mismatches, very strong liquidity position and strong capitalization spurred by strengthening of its capital policies.

Although we do not expect it, we could lower the rating in the next two years if MFABC were to have its taxing powers constrained, or it suffered reduced capital due to a full or partial distribution of the strategic retention fund (SRF) to members, or sustained operational losses. We could also consider a negative rating action in case of a sustained decline in the credit quality of B.C.'s local and regional government sector (municipalities and the Province of British Columbia).

Rationale

MFABC, which we group with other public sector funding agencies, has a strong public policy role and business position as the exclusive lender of long-term debt to B.C. municipalities. We deem the sector low risk, owing to its predictable and well-balanced institutional framework and very high economic resilience. Liquidity levels are very strong, because of its considerable holdings of liquid investments in its sinking funds. Management policies and practices are prudent. Capital adequacy is strong, in our view, because of the authority's robust cash and liquid investments held within the SRF and DRF, as well as the virtual absence of asset-liability risks.

The authority, unlike any of its peer public sector funding agencies, has taxing powers. It has the unfettered ability to impose a province-wide levy on all taxable land and improvements if needed to replenish its DRF. MFABC has not suffered a loan book default in its 48-year history, nor has it experienced a DRF deficiency and, accordingly, has never enacted a special levy. Nevertheless, it is registered as a claimant on annual local tax bills, which we believe would expedite its ability to collect on a special levy. We consider this taxing power a key strength underpinning the 'AAA' rating.

MFABC was established in 1970 to provide low-cost financing to B.C.'s municipal sector except to the City of Vancouver and South Coast British Columbia Transportation Authority. It is a not-for-profit tax-exempt corporation without share capital controlled by its member municipalities. Despite its establishment by provincial statute, the authority has an arm's length relationship with the government, with minimal direct linkages and no provincial guarantee on its debt. As a result, we do not view it as a government-related entity.

Enterprise risk profile: Public policy mandate and very strong management complement the low-risk municipal sector

- The municipal sector is low risk because of its well-balanced and predictable institutional framework, very high economic resilience, average leverage levels, and low financial system risk.
- The authority has a strong public policy mandate as the exclusive lender to the sector.
- Management policies and practices are prudent.

MFABC has a strong public policy mandate as the exclusive lender of long-term debt to the municipal sector in B.C. The policy objective at the foundation of its mandate is the provision of low-cost borrowing to municipalities by pooling bond issues and creating liquidity in bond markets. The authority is one of the biggest municipal lenders in the country. Its status as the exclusive lender stabilizes its revenues because these are tied to the sector's capital funding needs, which have been steadily rising and predictable. Unlike some of its peers, MFABC does not have the flight risk that face its peers whose borrowing members are less "sticky." On the other hand, the authority has some revenue concentration in the greater Vancouver area because a substantial proportion of the province's population lives there.

Management policies and practices are prudent, and contribute to our view of the authority's management and governance as very strong. MFABC's business plan sets out the organization's annual goals, both financial and nonfinancial. The board tracks progress on outcomes in regular meetings with senior staff. Risk management policies and practices are sensible. Committees must approve both loan and investment decisions. Asset-liability matching is a key risk management practice. The management team is experienced; key members have long tenure with the authority. Management has a board-approved succession plan. In terms of personnel, MFABC is a small organization but it has recently expanded with new hires in IT and portfolio management.

We view the B.C. municipal sector as low risk. Our public-sector industry and country risk assessment is favorable because of the sector's well-balanced and predictable institutional framework, very high economic resilience, average leverage levels, and low financial system risk. Provincial-municipal intergovernmental arrangements continue to be stable. Operating revenues remain sufficient generally to cover operating expenditures and still generate an operating surplus big enough to fund most capital expenditures. B.C., like all other provinces, imposes a prudent fiscal policy framework on its municipalities. As well, and like the rest of the country, it has very high economic resilience thanks to the province's high GDP per capita levels of about US$43,000). Canada's banking system is sound and we view financial system risk for the B.C. municipal sector as low. The sector's debt levels (about 80% of operating revenues, with interest expense of about 2% of operating revenues) are average, in our view.

Financial risk profile: Very strong liquidity complements strong capital adequacy

- Our view of the authority's strong levels of retained earnings and the loss-absorbing nature of the DRF is complemented by its virtual absence of asset-liability management risks.
- Some funding concentration offsets very strong liquidity levels.

MFABC's risk-adjusted capital ratio is 14.3% before adjustment and 7.4% after adjustments for single-name concentrations. Sound risk management practices, including very prudent asset-liability matching and an absence of loss or delayed payments, support this strong assessment. We consider the SRF and DRF, which together stood at C$173 million at year-end 2017, to be MFABC's main source of capital to absorb unexpected losses.

The authority holds considerable levels of liquid investments in its sinking funds and they help to give the authority very strong liquidity levels. Investments totaled C$3.8 billion at the end of 2017. MFABC's ratio of adjusted assets to liabilities (including scheduled disbursed loans) is about 1.2x, leading us to believe that the authority could continue lending to its borrowing members in a stress scenario. The Canadian bond market, which we consider deep and diversified, provides 100% of MFABC's funding, making the authority's funding sources somewhat concentrated. Investor diversification is however stronger and improving, looking at investor type and investor domicile. Furthermore, the authority's liquidity position is boosted by lines of credit totaling C$350 million.

Key Statistics

Municipal Finance Authority of British Columbia--Selected Indicators

	--Year ended March 31--				
(Mil. C$)	**2017**	**2016**	**2015**	**2014**	**2013**
Business position					
Total assets*	8,944.7	8,507.3	8,128.5	7,765.5	7,299.3
Customer loans (gross)	4,681.1	4,606.3	4,603.2	4,615.6	4,659.1
Growth in loans (%)	1.6	0.1	(0.3)	(0.9)	N.A.
Net interest revenues	115.4	123.7	110.0	103.9	108.5
Noninterest expenses	3.2	3.5	3.4	3.0	3.0
Capital and risk position					
Total liabilities*	8,494.2	8,235.1	7,816.5	7,455.8	7,208.8
Total adjusted capital	172.9	163.1	154.0	144.1	133.4
Assets/capital	51.7	52.2	52.8	53.9	54.7
RAC ratio before diversification	14.3	N/A	N/A	N/A	N/A
RAC ratio after diversification	7.4	N/A	N/A	N/A	N/A
Gross nonperforming assets/gross loans	0	0	0	0	0
Funding and liquidity					
Liquidity ratio with loan disbursement (one year)	1.2	N/A	N/A	N/A	N/A
Liquidity ratio without loan disbursement (one year)	1.7	N/A	N/A	N/A	N/A
Funding ratio (one year)	0.5	N/A	N/A	N/A	N/A

*As per the balance sheet. RAC--Risk-adjusted capital. N.A.--Not available. N/A--Not applicable.

Ratings Score Snapshot

Issuer Credit Rating	AAA/Stable/A-1+;A-1(High)
SACP	aa+
Enterprise Risk Profile	Very strong (1)
PICRA	Strong (2)
Business Position	Very strong (1)
Management & Governance	Very strong (1)
Financial Risk Profile	Strong (2)
Capital Adequacy	Strong (2)
Funding	Neutral
Liquidity	Very strong (1)
Support	0
GRE Support	0
Group Support	0
Additional Factors	+1

Related Criteria

- Criteria - Governments - International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Municipal Finance Authority of British Columbia	
Issuer credit rating	AAA/Stable/A-1+
Senior unsecured	AAA
Commercial paper	
Global scale	A-1+
Canada scale	A-1(High)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.