S&P Global
Ratings

RatingsDirect®

Research Update:

Municipal Finance Authority of British Columbia 'AAA' Ratings Affirmed; Outlook Stable

Primary Credit Analyst:
Stephen Ogilvie, Toronto (1) 416-507-2524; stephen.ogilvie@spglobal.com

Secondary Contact:
Bhavini Patel, CFA, Toronto (1) 416-507-2558; bhavini.patel@spglobal.com

Table Of Contents

Research Update:

Municipal Finance Authority of British Columbia 'AAA' Ratings Affirmed; Outlook Stable

Overview

- We are affirming our ratings, including our 'AAA' long-term and 'A-1+' short-term issuer credit ratings, on the Municipal Finance Authority of British Columbia (MFABC).
- The ratings reflect our view of MFABC's robust liquidity; provincewide taxing power; and well-established and prudent risk management practices, which its low-risk loan book illustrates.
- The stable outlook reflects our expectation that the authority will maintain its robust liquidity and prudent risk management practices over the next two years.

Rating Action

On May 26, 2017, S&P Global Ratings affirmed its ratings, including its 'AAA' long-term and 'A-1+' short-term issuer credit ratings, on the Municipal Finance Authority of British Columbia (MFABC). The outlook is stable.

Rationale

The ratings reflect S&P Global Ratings' view of MFABC's robust liquidity, provincewide taxing power, and well-established and prudent risk management practices. The ratings also take into account the authority's high single-name loan concentration, thin capitalization, and reliance on wholesale funding.

MFABC was established in 1970 to provide low-cost financing to British Columbia's (B.C.) local and regional government (LRG) sector. It is a not-for-profit tax-exempt corporation without share capital controlled by its member municipalities; and is the exclusive long-term lender to the sector, except to the City of Vancouver and the South Coast British Columbia Transportation Authority. Members annually approve loan requests and authorize debt issuance. Despite its establishment by provincial statute, MFABC has an arm's-length relationship with the government, with minimal direct links. The authority's debt is not subject to a provincial guarantee.

Under provincial legislation, B.C.'s local governments (except Vancouver) must conduct all long-term borrowing through their regional districts, which borrow directly from MFABC. Local governments within each regional district are jointly and severally liable for their regional district's debt, including their district's MFABC loan obligations. However, the regional districts themselves do not jointly and severally guarantee each other's debt, unlike the systemwide joint and several guarantee support mechanism we see with some Nordic municipal funding vehicles.

Nevertheless, we believe MFABC's taxing power accomplishes a similar end to a systemwide joint and several guarantee (although not as timely), and is a key factor in the ratings. In particular, the authority has the unfettered ability to impose a provincewide levy on all taxable land and improvements if needed to replenish its debt reserve fund (DRF). This gives MFABC access to potentially significant capital to absorb loan losses, ultimately linking its loan book's credit quality to that of the LRG sector as a whole. The authority has not suffered a loan book default in its 47-year history, nor has it experienced a DRF deficiency, so it has never enacted a special levy. Nevertheless, MFABC is registered as a claimant on annual local tax bills, which we believe would expedite its ability to collect on a special levy. It also holds committed bank facilities totaling C$100 million that, along with its internal liquidity, would provide significant resources during the up-to-14 months it would need to collect additional funds from the tax base.

In our view, the authority has a very strong market position that fosters stability and predictability in its cash flows. We expect MFABC to retain its monopoly on long-term lending to LRGs, while preserving significant market share in the short-term lending market. The lending market for B.C.'s LRGs is split into short-term (five years or less) and long-term. In the short-term market, MFABC competes with Canadian banks and credit unions: it has leveraged its commercial paper (CP) borrowing terms through an established Canadian dealer network and member outreach and achieved significant market share. Due to an expected increase in spending for regional hospital projects, MFABC has temporarily increased its CP program limit to C$700 million and will maintain it at that level for the next two years. We expect its loan book to increase in tandem with the LRGs' net borrowing needs.

We consider B.C.'s LRG system to be very predictable and well-balanced, contributing to the sector's strong overall credit quality and MFABC's low-risk loan book. The province's LRGs are subject to strict and comprehensive provincial legislation governing their financial and operating activities. They must pass balanced annual operating budgets, and limit debt service to no more than 25% of sustainable revenues, excluding economically sensitive industrial property tax revenues. While the credit quality of the B.C. LRG sector has weakened somewhat, we believe that it remains 'AAA', thanks to its exceptional liquidity, a very strong provincial economy, low contingent liabilities, and very strong budgetary flexibility. The authority's provincewide property taxing powers supports the loan book's credit quality despite the LRG's sector modest weakening.

Because of its nonprofit status, MFABC has low profitability, which has resulted in comparably weak capitalization relative to that of some Nordic municipal funding vehicles. We believe the authority's low capitalization is a source of credit weakness for the ratings but we believe that any call on capital to be minimal by virtue of MFABC's low-risk loan book, which matches assets with liabilities back-to-back. We expect the authority's profitability to grow modestly over the two-year outlook horizon, because MFABC earns positive carry on unallocated short-term debt funds (it typically issues its full CP program limit irrespective of members' loan demand) and collects service fees on its popular pooled investment loan program. In 2016, the authority's equity-to-assets ratio, improved slightly increased to 0.2% from a 0.1% a year earlier. Mark-to-market losses on derivative contracts, which arose from the substantial declines in interest rates, have weighed on profitability and retained earnings in recent years. We expect that capitalization will improve more rapidly once these contracts expire in the medium term.

MFABC's well-established practices and policies mitigate exposure to interest rate, currency, counterparty, credit and liquidity risks, in our view. The authority is also immune from bank regulatory risks. Unlike Canada's scheduled banks, it's not subject to the regulatory oversight of the Office of the Superintendent of Financial Institutions, nor must it abide by the Basel II or proposed Basel III framework.

In our view, MFABC operates under well-established and straightforward policies and practices that mitigate its risk exposures. Its loan book has 100% industry risk concentration and, being confined to a single province, has high geographic concentration. The loan book also has high single-name concentrations, with the largest obligor, Metro Vancouver, accounting for 49% of total loans as of Dec. 31, 2016, which is not surprising given that about 54% of the province's population resides in Metro Vancouver. In our view, this concentration remains appropriate for the ratings because of Metro Vancouver's strong credit quality. The top five borrowers accounted for 62% of total loans in 2016, which was down from almost 70% a year earlier. Generally, we consider these concentrations acceptable, given the LRG sector's excellent and stable credit quality, and the experience of other highly rated peers.

MFABC relies entirely on the domestic capital markets to fund loan commitments and roll over its debt obligations -- it has no foreign currency exposure. On occasion, the authority will enter short-term derivatives to secure a rate ahead of a planned debenture issue, but this is infrequent and is being phased out. It borrows strictly in Canadian dollars and matches the timing of funding on members' loans with the proceeds from the corresponding debt issuances. It also limits its exposure to interest-rate risk through broad duration matching of loans and debentures and, when duration matching is not possible, reset clauses embedded in its loan agreements. Any member with a loan term greater than that of the underlying debenture would be subject to a new lending rate commensurate with MFABC's new cost of funds at that time.

The authority maintains significant investments primarily related to its sinking funds, DRF, and retention fund. Under its investment policies, it can only invest in fixed income securities of the Canadian federal, provincial and municipal governments, as well as those of Canadian chartered banks and Canadian savings institutions.

MFABC's low-risk loan book is evidence of its prudent risk management practices. Its loan book directly covers the vast majority of B.C.'s LRGs. This largely reflects the provincial government's strict LRG regulations. Local governments must obtain the acceptance of the public and other local governments within their regional districts before taking on debt; adhere to prescribed debt service ceilings; limit the use of debt proceeds to capital infrastructure; and adopt balanced annual operating budgets. We expect B.C.'s LRGs to retain their excellent consolidated credit quality during our two-year outlook horizon.

We have used "Principles Of Credit Ratings" as our criteria foundation for our analysis of MFABC's creditworthiness. We consider the authority to be a public sector entity in light of its taxing power, lack of profit motive, and important public policy role through the delivery of low-cost loans to LRGs. It does not have a banking license.

Liquidity

We believe MFABC has robust liquidity. At year-end 2016, its DRF, retention fund, sinking funds, and credit facility totaled about C$3.7 billion, easily exceeding its prospective annual debt service obligations. We expect this to be stable in the next two years, providing a significant cushion to absorb loan losses. We also believe this mitigates risks stemming from the authority's reliance on domestic wholesale funding and lack of prefunding activities.

MFABC holds C$100 million in dedicated committed and irrevocable credit facilities to backstop its C$700 million CP program. The authority has a proven ability to retain market access during market disruptions, such as 2008. In our view, this compensates for its lack of formalized last-resort access to central bank or repo financing.

MFABC has a well-spaced debt maturity ladder and sinking funds that further mitigate debenture refinancing risk, in our view. We also believe the authority possesses strong brand name recognition in domestic capital markets. We expect it to maintain its strong market access over the coming years.

Outlook

The stable outlook reflects our expectation that MFABC will maintain its robust liquidity and prudent risk management practices and that its legislative and policy framework will not change in the next two years. We further expect B.C.'s LRGs to maintain their excellent consolidated credit quality.

We could take a negative rating action if we foresee deterioration in the credit quality of LRGs, including Metro Vancouver. A negative rating action could also occur if we expect deterioration in MFABC's legal and policy framework, or its taxing powers. In addition, the ratings could come under pressure if the authority pursues less stringent asset-liability management, erodes its liquidity profile or materially increases the size of its loan book in the absence of a commensurate increase in capital.

Related Criteria

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.