

## CREDIT OPINION

25 May 2022

Update



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### RATINGS

#### Municipal Fin. Authority of British Columbia

Domicile	British Columbia, Canada
Long Term Rating	Aaa
Type	Senior Unsecured - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

### Contacts

Adam Hardi, CFA +1.416.214.3636  
 Vice President-Senior Analyst  
 adam.hardi@moody.com

Max Pinto +1 16474176303  
 Associate Analyst  
 suchith.pinto@moody.com

Michael Yake +1.416.214.3865  
 Associate Managing Director  
 michael.yake@moody.com

Alejandro Olivo +1.212.553.3837  
 Managing Director  
 alejandro.olivo@moody.com

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# Municipal Fin. Authority of British Columbia (Canada)

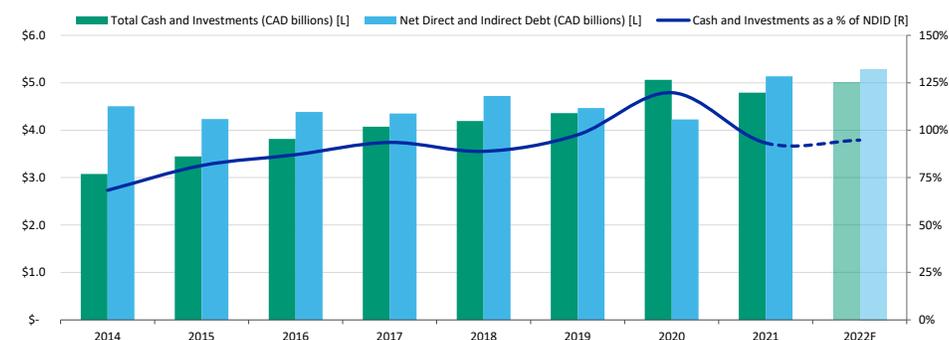
Update to credit analysis

## Summary

The credit profile of the [Municipal Finance Authority of British Columbia](#) (Aaa stable) (MFABC) reflects very strong management and institutional framework, robust credit protection mechanisms and high levels of liquidity from cash and investments that ensure high levels of cash flow coverage. MFABC's continued strong credit metrics despite the coronavirus pandemic reflect the stability of its borrowers' revenue bases. MFABC's credit profile is also supported by its taxing powers on all taxable properties in British Columbia. These strengths are balanced against geographical and single-name concentration that could represent a challenge in case of an unexpected severe event that would lead to a deterioration of credit quality and municipal fiscal performance in the region.

Exhibit 1

### MFABC maintains strong liquidity despite continued growth in borrowing (years ending Dec 31)



Source: MFABC, Moody's

## Credit strengths

- » Very strong management and institutional framework ensures high quality loan portfolio
- » Robust credit protection mechanisms provide debenture holder security
- » Borrowing structure and substantial liquidity ensure strong cash flow coverage

## Credit challenges

- » Single-name and geographic concentration of the loan portfolio

## Rating outlook

The rating outlook is stable, which reflects continued strong governance and credit protection mechanisms within a stable institutional framework which ensures ongoing strong performance of the loan portfolio.

## Factors that could lead to a downgrade

A substantial decline in MFABC's reserves and liquidity leading to weaker coverage levels, weaker loan portfolio quality or a significant weakening of the credit protection mechanisms could lead to a downgrade of the rating.

## Key indicators

Exhibit 2

### Municipal Fin. Authority of British Columbia

(Year Ending 12/31)	2016	2017	2018	2019	2020	2021
Total Direct Debt (CAD millions)	8,073.1	8,342.1	8,809.8	8,717.5	9,145.0	9,784.0
Loans Outstanding to Clients (CAD millions)	4,606.3	4,681.1	4,972.3	4,913.6	4,946.3	5,617.7
Total Cash and Investments (CAD millions)	3,816.9	4,071.0	4,192.5	4,359.3	5,060.3	4,789.6
Operating Margin as % of Revenues [1]	32.1	31.1	31.6	32.2	33.1	36.5
Debt Burden [2] (%)	0.4	0.3	0.3	0.3	0.2	0.2
Cash and Investments as % of Direct Debt	47.3	48.8	47.6	50.0	55.3	49.0
% Change in Loans Outstanding	0.1	1.6	6.2	(1.2)	0.7	13.6

[1] Before gains/losses from change in fair value of derivative contracts

[2] Net direct debt (total debt less sinking funds and unused commercial paper) as % of assessed property value

Sources: MFABC and Moody's Investors Service

## Detailed credit considerations

The credit profile of MFABC, as expressed in its Aaa stable rating, combines a baseline credit assessment (BCA) of aaa, and a high likelihood of extraordinary support coming from the [Province of British Columbia](#) (Aaa stable) in the event MFABC faced acute liquidity stress.

### Baseline credit assessment

#### Very strong management and institutional framework ensures high quality loan portfolio

We characterize MFABC's management as very strong with prudent, forward looking credit and debt policies. Its strong management also allows MFABC to continue to record consistent positive operating results and to refinance maturing debentures at favourable terms. Management maintains strong relations with capital market participants, resulting in ongoing solid market access at favourable rates and strong secondary market trading liquidity, despite recent coronavirus-related market pressures.

MFABC issues debt in its own name, and on-lends the proceeds to the borrowing regional districts. At year-end 2021, MFABC's loan portfolio stood at nearly CAD5 billion including both long-term and short-term loans to clients. MFABC maintains stringent guidelines for monitoring its loan borrowers' credit quality, and had no loan defaults or missed payments from any of its borrowers in its history, further supporting the Authority's management strength.

In addition, MFABC operates within a strong institutional framework. Municipalities in British Columbia, with the exception of the City of Vancouver which operates under a special charter, are prohibited from issuing debt directly. Instead, they borrow long-term through their respective regional districts, which in turn borrow from MFABC.

As with other Canadian provinces, the Province of British Columbia exercises a high degree of oversight over municipal financial activities: (1) municipalities cannot run operating deficits; (2) municipalities can only borrow long-term for capital spending; (3) long-term borrowing requires a comprehensive public approval process prior to MFABC approval; and (4) municipalities have to adhere to a debt service limit according to which only 25% of recurring revenues are eligible to service debt. This framework supports the quality of MFABC's loan portfolio. Municipal debt issuance for capital spending is also limited by the reliance on other funding sources such as pay-as-you-go financing, reserves as well as provincial and federal government grants.

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Besides loans to regional districts/municipalities, MFABC provides loans to regional hospital districts (CAD766 million, or about 14% of long-term loans in 2021) with an estimated CAD614 million in additional borrowing needed between 2022 and 2027. TransLink, the transit authority in the Metro Vancouver Area, also has CAD398 million, or 7% of MFABC long-term loans outstanding at year end 2021. This share will continue to decrease over time as TransLink issues debt directly in the capital markets.

In addition to lending, MFABC also provides pooled investment services to regional entities, including pooled investment funds and high-interest savings accounts. Starting in 2022, MFABC also launched a long-term new Diversified Multi-Asset Class pooled investment fund designed to invest those regional government reserves not needed for at least 10 years. Investment balances stood at CAD5.6 billion at year-end 2021.

During the pandemic over the last two years, MFABC implemented several strategies to improve its risk management and controls to ensure early detection of any credit stress of a borrowing member. It updated its technology policies and standards, implemented a transaction control framework, and modernized its IT infrastructure, cybersecurity and enterprise architecture to better detect threats and reduce organizational risk.

#### **Robust credit protection mechanisms provide debenture holder security**

The Local Government Act of British Columbia includes a general liability provision, whereby municipalities are jointly and severally liable for all obligations of their regional district, providing considerable strength to MFABC's institutional structure and promoting fiscal discipline across borrowers. MFABC's unlimited taxing power and the joint and several liability of borrowing municipalities are key factors in MFABC's credit rating.

MFABC withholds 1% of principal borrowed of long-term loans into a debt reserve fund (DRF), which stood at CAD123 million at 31 December 2021. Funds in the DRF must be accessed first (90% of which is available on a 1-day notice) if MFABC does not have sufficient funds to meet payments due on its obligations. MFABC has never been required to tap the DRF.

If the DRF cannot be replenished in a reasonable time, MFABC has the option to levy a tax on all taxable properties in British Columbia in order to replenish the DRF to its required level. If the DRF falls to below 50% of its required level, MFABC is mandated to exercise this authority and levy a tax. MFABC currently sets a nominal tax rate on properties to ensure that the charge is already present on all property tax notices. This credit protection ensures that MFABC has access to CAD2.2 trillion (2021) in property values across the province. The increase of the tax rate would not require any further legislative approvals. Due to the maximum potential delay of 14 months before enacting the property tax provision, MFABC ensures it maintains sufficient liquidity to cover at least 14 months of its funding requirements. MFABC's continued strong credit metrics despite the coronavirus pandemic reflect the stability of its borrowers' revenue bases – which benefitted from provincial and federal support – and improvements in its due diligence and loan monitoring.

MFABC was created in 1970 by an act of provincial legislature, the Municipal Finance Authority Act. MFABC acts as the central borrowing agency in British Columbia for financing, through loans, the capital requirements of municipalities and regional districts, including hospital districts and other municipal-related bodies. MFABC operates at arm's length from the province, and obligations of MFABC are not the obligations of the province and are not guaranteed by the province.

#### **Borrowing structure and substantial liquidity ensure strong cash flow coverage**

MFABC maintains a robust liquidity profile and its liquidity sources continue to fully cover its commercial paper maturities and provide strong liquidity coverage ratios. The majority, or approximately 95%, of its cash and investments (which totalled CAD4.6 billion in 2021) includes sinking fund investments set aside for future debt repayment, providing 49% coverage of total direct debt, a level we consider to be very strong. The rest of cash and investments includes CAD123 million held in the DRF at December 31, 2021, and CAD103 million in the Strategic Retention Fund, an additional liquidity reserve fund. We expect that these balances will continue to grow with the growth in MFABC's loan portfolio.

MFABC maintains long-term debt with a well-structured maturity profile. The majority of debt is in the form of long-term debentures issued with a typical term of 5-10 years, although we expect that in the current rising interest rate environment the authority may look to extend the debt maturity profile by issuing longer term (e.g. 20-year) bonds to minimize refinancing risk and volatility and improve pricing. It most recently issued longer than 10-year tenor bonds in 2021 (CAD350 million 20-year debenture) and 2017 (CAD61 million 25-year debenture). In 2022, MFABC expects to refinance approximately CAD937 million of maturing long-term debentures and issue an aggregate CAD1 billion of new long-term debt in the capital markets. All debt is issued in Canadian dollars. While MFABC

almost exclusively issues debentures with bullet maturities, the amortizing structure of loan agreements with regional districts provides security for debenture holders. This structure enhances cash flow coverage, and funds paid to MFABC in excess of immediate debt service requirements are allocated to investments.

MFABC has access to short-term borrowings through its commercial paper (CP) program which is used to finance short-term loans and investments. The CP program has an active limit of CAD700 million, but which MFABC's board authorized could be increased up to CAD1,250 million. At year-end 2021, the CP program had an outstanding balance of CAD500 million, although MFABC is looking to increase the outstanding amount to CAD675 million by year-end 2022 as it projects an increase in the municipal demand for short-term loans. MFABC is largely sheltered from the risk of interest rate increases given that the anticipated increase in CP debt would be offset by higher short-term lending rates.

MFABC also has full access to committed credit lines in the combined amount of CAD350 million, representing half of the active CP program limit, as well as access to a CAD100 million uncommitted credit line.

#### **Single-name and geographic concentration of the loan portfolio**

The loan portfolio has a high concentration of borrowers in the Vancouver region, especially the Metro Vancouver Regional District which account for approximately 48% of long-term loans. The geographical and single-name concentration results in a lack of diversity of the loan portfolio and could represent a challenge in case of an unexpected severe event that would lead to a substantial deterioration of credit quality and municipal fiscal performance in the region.

Nevertheless, the loan portfolio concentration closely reflects the geographical concentration of borrowers in the Metro Vancouver region, and the risks stemming from a concentrated loan portfolio are mitigated by MFABC's strong liquidity profile and institutional strength and robustness of the economy in British Columbia. In addition, the majority of individual borrowers' share is less than 1% each of the overall loan portfolio, mitigating concentration risk.

#### **Extraordinary support considerations**

While MFABC's BCA of aaa already places it in the Aaa rating bracket, the Joint-Default Analysis methodology also considers the likelihood of extraordinary support coming from the Province of British Columbia. Moody's assigns a high likelihood of support, reflecting the strategic importance of the MFABC in providing financing for municipalities in the province. A default by the MFABC could raise the cost of borrowing for all municipalities in the province, thereby offering an incentive for the province to provide the necessary liquidity to avoid a default.

Moody's also assigns a very high default dependence level between MFABC and the Province of British Columbia, reflecting the two entities' shared exposure to common economic and financial risks.

### **ESG considerations**

#### **How environmental, social and governance risks inform our credit analysis of MFABC**

Moody's takes into account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of MFABC, the materiality of ESG to the credit profile is as follows:

The exposure to environmental risks is low, consistent with our assessment of financing entities. MFABC does not own land that is subject to environmental risks, and environmental exposure is only indirect through borrowing members' operations. In addition, borrowing municipalities are not exposed to significant climate risks and neither spending nor revenue are materially impacted by environmental changes.

The exposure to social risks is low. Social issues facing regional municipalities, including the coronavirus pandemic, do not directly impact the credit quality of MFABC's loan portfolio. We regard the coronavirus outbreak as a social risk given the implications for public health, however the credit impact from the pandemic is low as the majority of health expenses are the responsibility of provincial government and not the regional governments.

Governance considerations are material to MFABC's credit profile and overall risk is low. The province exercises a high degree of oversight over municipalities' financial activities, including prohibiting operating deficits and a requirement that long-term borrowing must have a comprehensive public approval process prior to regional district and MFABC approval. Municipalities face a restriction on

debt accumulation, including restrictions on annual debt service (principal and interest) which cannot exceed 25% of the municipality's prior year's controllable and sustainable revenues.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology '[General Principles for Assessing Environmental, Social and Governance Risks](#)'.

## Rating methodology and scorecard factors

The assigned BCA of aaa is in line with the scorecard-indicated BCA of aaa. For details about our rating approach, please refer to the [Public Sector Pool Programs and Financings Methodology](#) (April 2020) and [Government-Related Issuers Methodology](#) (February 2020).

Exhibit 3

### MFABC - 2021 scorecard

#### Public Sector Pool Programs and Financings Methodology

Baseline Credit Assessment (BCA) – Scorecard	Base Weight	Sub Factor	Score
<b>Factor 1: Credit Strength and Default Tolerance (50%)</b>			
Credit Quality and Default Tolerance Score	50%	Aaa	Aaa
<b>Factor 2: Diversity of Portfolio (20%)</b>			
Number of Borrowers	10%	49	A
Percentage of Loan Principal to Borrowers that Represent Less than 1% of the Pool	5%	9.10%	Ba
Percentage of Loan Principal to the Top 5 Borrowers	5%	66.60%	Ba
<b>Factor 3: Debt Structure (30%)</b>			
Cash Flows	20%	Aa	Aa
Counterparties	10%	A	A
<b>Notching Factors</b>			
Unusually Strong or Weak Management		2	
Concentration of Pool Participants in a Volatile Sector		0	
<b>Total Notching Adjustments</b>		2	
<b>Scorecard-Indicated BCA Outcome</b>			aaa

Financial year-end 31 December 2021

Source: Moody's Investors Service

## Ratings

Exhibit 4

Category	Moody's Rating
<b>MUNICIPAL FIN. AUTHORITY OF BRITISH COLUMBIA</b>	
Outlook	Stable
Senior Unsecured	Aaa
Commercial Paper -Dom Curr	P-1

Source: Moody's Investors Service

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