S&P Global
Ratings

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Research Update:

# Regional Municipality of Niagara Ratings Affirmed At 'AA'; Outlook Remains Stable

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## Overview

- The COVID-19 pandemic has dampened the Regional Municipality of Niagara's economy, and a larger capital plan will weaken the region's budgetary results. Nevertheless, the region benefits from manageable debt levels and very ample liquidity.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings and maintaining our stable outlook on the region.

## Rating Action

On Oct. 13, 2020, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the Regional Municipality of Niagara, in the Province of Ontario. The outlook is stable.

## Outlook

The stable outlook reflects our expectation that, in the next two years, Niagara's larger capital plan will cause its budgetary results to weaken, leading to after-capital deficits of less than 5% of total revenues, on average. The additional capital spending will require Niagara to rely more on external financing, pushing its debt burden up to about 94% of operating revenues by 2022. In addition, we believe its economic recovery will be slower than in other regions. Nevertheless, we estimate that its liquidity position will remain very ample, with debt service coverage ratios exceeding 100% in the next two years.

### Downside scenario

We could take a negative rating action if a larger capital plan resulted in sustained after-capital deficits of more than 5% of total revenues and additional borrowing resulted in tax-supported debt, excluding on-lending, increasing to more than 60% of operating revenues in the next two years.

### Upside scenario

While unlikely in the next two years, we could take a positive rating action if the region demonstrated significant and sustained economic and demographic improvement through healthier growth in population and household incomes, more in line with that of Canada, and its after-capital deficits improved to a balanced position.

## Rationale

We have updated our base-case scenario for Niagara and extended our forecast horizon through 2022. We expect the pandemic will have a small impact on the region's budgetary results, as management has implemented adequate actions to offset the increase in expenditures and the region will receive at least C$12.8 million in emergency operating funds through the federal Safe Restart Agreement. For 2020-2022, we estimate operating balances will remain relatively stable but that Niagara's larger capital plan will result in after-capital deficits of less than 5% of total revenues, on average. The additional capital expenditures are likely to increase the region's debt burden but we expect it will remain manageable, with debt service coverage ratios of more than 100% in our forecast horizon. Although we expect that the region will continue to benefit from a supportive institutional framework and from sound financial management, we believe that Niagara's less favorable socioeconomic profile partially mitigates these strengths. In addition, we believe Niagara's economic recovery will be slower than in other regions because of the region's relatively higher reliance on the tourism and hospitality sectors, which have been severely affected by the pandemic.

### Financial management is strong and institutions remain broadly supportive but a less favorable socioeconomic profile constrains the ratings.

Niagara, in southern Ontario, is home to one of the most active Canada-U.S. border crossings and enjoys a favorable climate that makes it an agricultural center and popular tourist destination under normal circumstances. On top of lockdown measures implemented as a response to COVID-19, the region's economy has been additionally hampered by travel restrictions and the closure of the Canada-U.S. border to non-commercial traffic. We believe Niagara's economy will contract in 2020 and will begin to recover over the next two years as social distancing measures ease. Nevertheless, we believe Niagara's recovery will be slower than in other regions because of its relatively higher reliance on the tourism and hospitality sectors, which have been severely affected by the pandemic. While GDP per capita is not available at the local level, we believe that it would be below the national level of about US$42,000 in 2019, based on Niagara's lower income levels. In our opinion, slow population growth and weak demographic trends result in a less favorable socioeconomic profile that could negatively affect the labor pool and hinder investment in the region. However, in the medium term, the expansion of GO commuter train service in the region could increase the influx of younger people and start reversing these trends.

We consider that the management team has adequate expertise in implementing policy changes. With Ontario's regional government review resulting in no changes to the region's structure, we expect senior positions that were acting roles will become permanent positions. We believe this will reduce turnover in senior management and will lend greater stability to management practices. Niagara maintains increased focus on long-term strategic and financial planning, which its financial policies support. The region approves operating and capital budgets annually, and presents a three-year operating budget and a nine-year capital forecast with the corresponding funding sources. Long-term plans present a good level of detail and are based on well-documented and realistic assumptions, in our opinion. Disclosure and transparency of financial reports are what we view as good. We believe that debt and liquidity management practices are prudent.

We believe Canadian municipalities benefit from a very predictable and well-balanced institutional framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

## Larger capital plan will weaken budgetary performance but debt levels will remain manageable.

In our base-case scenario for 2018-2022, we expect operating balances to remain high at 12% of operating revenues on average. We expect the operating balance to remain stable in 2020 and to decline in 2021 as a result of the pandemic before starting to recover thereafter. We believe the impact will be small, as management's actions to reduce operating expenditures and the receipt of at least C$12.8 million in emergency operating funds (including for transit) through the Safe Restart Agreement will largely offset the increase in pandemic-related expenditures in 2020, most of which are associated with the region's long-term care homes. Nevertheless, maintenance capital projects and work related to the region's long-term care homes and the expansion of GO commuter train service will increase capital spending, resulting in an after-capital deficit of 1% of total revenues, on average, in 2018-2022. Of note, a special-purpose levy of 1% of the prior year's tax levy helps to offset capital infrastructure expenditures.

In 2020-2022, Niagara plans to issue C$337 million in debt on behalf of its lower-tier municipalities as well as to fund part of its capital projects. As a result, we expect tax-supported debt, which includes both the region's debt as well as the on-lent debt to Niagara's lower-tier municipalities, will increase to 94% of operating revenues at year-end 2022, up from 82% at year-end 2019. We expect that, excluding on-lending, the region's debt burden will increase to 56% of operating revenues. We believe that Niagara's lower-tier municipalities are able to support their obligations and will reimburse the region for all principal and interest payments as they come due. We recognize that there is a lower credit risk associated with this debt, which, in our opinion, mitigates the region's overall debt burden. Interest costs accounted for 3% of operating revenues in 2019 and we expect they will remain stable during our two-year outlook horizon.

In our view, Niagara's liquidity is a key credit strength. We estimate total free cash in the next 12 months will be enough to cover almost 7x the estimated debt service for the period. We expect this ratio will remain well above 100% during the outlook horizon. Similar to that of its domestic peers, the region's access to external liquidity is satisfactory.

## Key Statistics

Table 1

## Regional Municipality of Niagara -- Selected Indicators

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. C$)** | **2018** | **2019** | **2020bc** | **2021bc** | **2022bc** |
| Operating revenues | 825 | 852 | 908 | 889 | 899 |
| Operating expenditures | 713 | 752 | 799 | 801 | 797 |
| Operating balance | 111 | 100 | 109 | 88 | 102 |
| Operating balance (% of operating revenues) | 13.5 | 11.7 | 12.0 | 9.9 | 11.3 |
| Capital revenues | 39 | 44 | 50 | 60 | 60 |
| Capital expenditures | 104 | 158 | 168 | 200 | 200 |
| Balance after capital accounts | 46 | (14) | (9) | (52) | (38) |
| Balance after capital accounts (% of total revenues) | 5.4 | (1.5) | (0.9) | (5.4) | (4.0) |
| Debt repaid | 56 | 65 | 62 | 62 | 64 |
| Gross borrowings | 87 | 98 | 124 | 97 | 117 |
| Balance after borrowings | 78 | 20 | 53 | (16) | 15 |
| Tax-supported debt (outstanding at year-end) | 663 | 700 | 760 | 793 | 844 |
| Tax-supported debt (% of consolidated operating revenues) | 80.4 | 82.2 | 83.7 | 89.2 | 93.8 |
| Interest (% of operating revenues) | 2.8 | 2.8 | 2.7 | 2.5 | 2.3 |
| National GDP per capita (single units) | 60,011 | 61,291 | 57,181 | 60,677 | 63,026 |

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

# Ratings Score Snapshot

Table 2

## Regional Municipality of Niagara -- Ratings Score Snapshot

| Key rating factors | Scores |
|---|---|
| Institutional framework | 2 |
| Economy | 3 |
| Financial management | 2 |
| Budgetary performance | 2 |
| Liquidity | 1 |
| Debt burden | 2 |
| Stand-alone credit profile | aa |

Table 2

**Regional Municipality of Niagara -- Ratings Score Snapshot (cont.)**

| Key rating factors | Scores |
|---|---|
| Issuer credit rating | AA |

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

## Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 12, 2020. Interactive version can be found www.spratings.com/SRI

## Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

## Related Research

- S&P Global Ratings Definitions, Aug. 7, 2020
- Public Finance System: Canadian Municipalities, May 12, 2020
- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019

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 | |
|---|---|
| **Niagara (Regional Municipality of)** | |
| Issuer Credit Rating | AA/Stable/-- |
| Senior Unsecured | AA |