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CREDIT OPINION
26 May 2021

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.

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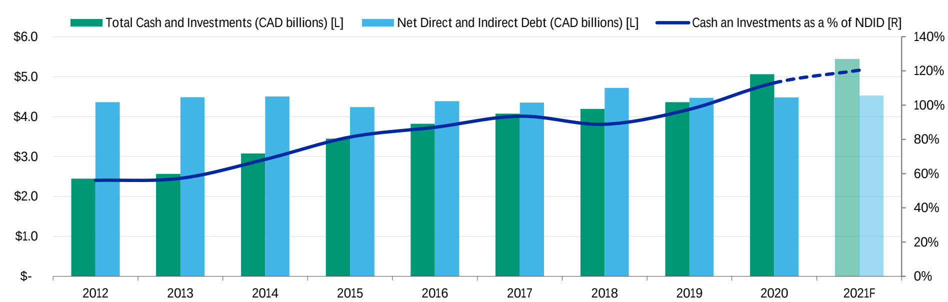
Municipal Fin. Authority of British Columbia (Canada)

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 single-name and geographic concentration in the loan portfolio and by low interest rates that pressure investment returns.

Exhibit 1
MFABC maintains strong liquidity despite continued growth in borrowing (years ending Dec 31)



Source: Moody's, MFABC

Credit strengths

» Very strong management and institutional framework ensures high quality loan portfolio despite the pandemic

» 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

» Low interest rates pressure investment returns and net interest spread

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 meaningful decline in MFABC's reserves, weaker loan portfolio quality or a significant weakening of the credit protection mechanisms could lead to downward pressure on the rating.

Key indicators

Municipal Fin. Authority of British Columbia

(Year Ending 12/31)	2015	2016	2017	2018	2019	2020
Total Direct Debt (CAD 000)	7,570,182	8,073,065	8,342,084	8,809,818	8,717,495	9,145,044
Loans Outstanding to Clients (CAD 000)	4,603,150	4,606,276	4,681,086	4,972,344	4,913,575	4,946,265
Total Cash and Investments (CAD 000)	3,445,794	3,816,891	4,070,973	4,192,538	4,359,276	5,060,344
Operating Margin as % of Revenues [1]	28.5	32.1	31.1	31.6	32.2	33.1
Debt Burden [2] (%)	0.4	0.4	0.3	0.3	0.3	0.2
Cash and Investments as % of Direct Debt	45.5	47.3	48.8	47.6	50.0	55.3
% Change in Loans Outstanding	-0.3	0.1	1.6	6.2	-1.2	0.7

[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
Source: Moody's, MFABC

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 despite the pandemic

We characterize MFABC's management as very strong with prudent, forward looking credit and debt policies. Its strong management also allowed MFABC 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 very 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 2020, 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 frameworks 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.

Besides loans to regional districts/municipalities, MFABC provides loans to regional hospital districts (CAD726 million, or 15% of long-term loans in 2020) with an estimated CAD749 million in additional borrowing needed over the next six years. MFABC has also provided loans historically to TransLink, the transit authority in the Metro Vancouver Area (CAD462 million, or 10% of long-term loans at year-end 2020, down from 30% in 2009). We expect that the share of TransLink in the portfolio will continue to decline over time as TransLink now issues debt directly in the capital markets.

During the pandemic, MFABC further strengthened its monitoring procedures to ensure early detection of any credit stress of a borrowing member. In addition, MFABC has 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 CAD120 million at 31 December 2020. 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 must 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 CAD1.8 trillion (2020) 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. At December 31, 2020 MFABC had cash and investments of CAD5.1 billion. The majority of this amount includes CAD4.5 billion in sinking fund investments set aside for future debt repayment, providing 49% coverage of total direct debt, a level we consider to be very strong. Additional notable liquidity sources included in cash and investments are CAD120 million held in the DRF, and CAD96 million in the Strategic Retention Fund, an additional liquidity reserve fund, both at December 31, 2020 levels.

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 the Authority occasionally issues debt with longer maturities, including its CAD61 million 25-year term debenture issued in 2017. In 2021, MFABC expects to refinance approximately CAD956 million of maturing long-term debentures and issue an aggregate CAD1,020 million 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 the authority recently authorized could be increased up to CAD1,250 million. The increase in the maximum authorized limit is in response to the anticipated higher need for revenue anticipation lending to municipalities. This follows a change in provincial legislation in 2020 which provides local municipalities which borrow from MFABC for short-term operating needs ("revenue anticipation") more favourable repayment terms over two years rather by year-end, to ease potential fiscal pressures. However, given that municipal borrowing from MFABC under revenue anticipation loans to date have not increased above typical levels – which evidences credit resilience within the municipal sector and therefore within MFABC's borrowing base – we expect that MFABC will gradually decrease the outstanding balance of the CP program from CAD610 million at 31 December 2020 to around CAD400 million to match the anticipated demand for short-term loans.

MFABC also has full access to two external market disruption lines in the combined amount of CAD350 million, representing half of the active CP program limit. In addition, MFABC maintains sufficient liquidity to match weekly CP maturities, and had same day access to CAD467 million cash (at year-end 2020). MFABC also has access to a bank revolving credit facility of CAD100 million.

Single-name and geographic concentration of the loan portfolio

The loan portfolio has a high concentration of borrowers in the Vancouver Region, which includes the Metro Vancouver Regional District and TransLink, accounting for more than half of outstanding long-term loans. Loans to the Metro Vancouver region alone constitute nearly 50% of total 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% of the overall loan portfolio, mitigating concentration risk.

Low interest rates pressure investment returns and net interest spread

A continued period of lower for longer interest rates, which benefits MFABC's borrowing portfolio, will pressure investment returns and net interest spreads. Low interest rates could lead to weak returns in the short-term funding portfolio as well as the DRF and SRF, and also the short-maturity investments in its sinking fund.

MFABC's net interest margin was 1.21% in 2020, and we expect it to remain near its current level in 2021, highlighting in part the continued challenge for MFABC to earn a strong net interest spread in the current low interest environment. Further, given its mandate we would expect MFABC to generate a positive but low net interest margin through the cycle and would not anticipate high net interest margins comparable to a commercial bank. Nevertheless, MFABC's business model largely shelters it from interest rate movements, given that changes in interest on loans are balanced against changes in interest expense on debt.

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. Borrowing municipalities, for example, could be at a high risk of an earthquake with exposure to earthquake-related costs, however these are managed at the municipal level through climate and earthquake preparedness strategies.

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.

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'.

Ratings

Exhibit 3

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

Source: Moody's Investors Service

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