

Municipal Finance Authority of British Columbia

Primary Credit Analyst:

Shameer M Bandeally, Toronto + 1 (416) 507 3230; shameer.bandeally@spglobal.com

Secondary Contact:

Stephen Ogilvie, Toronto + 1 (416) 507 2524; stephen.ogilvie@spglobal.com

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Municipal Finance Authority of British Columbia

Major Rating Factors

Strengths:

- Exclusive lender of long-term debt to municipalities in British Columbia, with a unique legislatively enshrined taxing power
- Solid capitalization, conservative financial and governance policies, and consistent access to funding markets
- Strong creditworthiness given solid liquidity and a match-funded borrowing structure (given the pass-through nature of operations)

Issuer Credit Rating

AAA/Stable/A-1+

Weaknesses:

- High geographic and borrower concentration
- Profitability pressures amid low interest rates

Outlook

The stable outlook reflects Municipal Finance Authority of British Columbia's (MFABC's) long history of prudent management and governance practices, conservative risk appetite and risk management framework, and sophisticated asset-liability management, all of which we expect will continue. S&P Global Ratings believes that the strengthening of the authority's capital policies in the recent past, and enhancement of its lending mandate, will continue to support creditworthiness. We also expect that the authority will maintain its strength in accessing capital markets through a diversified investor base, as demonstrated by consistent planned debt issuances despite heavy market volatility last year; and that its funding and liquidity position will stay strong in the next two years. Our stable outlook also underscores the expectation that 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 provincewide tax to replenish any potential draw on its debt reserve fund (DRF).

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 if capital adequacy ratios fell significantly due to a fall in capital following sustained operational losses or a full or partial distribution of the strategic retention fund (SRF) to members. We could also consider a negative rating action if the authority was no longer the exclusive long-term lender to B.C. municipalities or in the case of a sustained decline in the credit quality of the B.C. local government sector.

Rationale

Like other public sector funding agencies, MFABC has a very strong public policy role and business position as the exclusive lender of long-term debt to B.C. municipalities. We believe the sector has low risk, owing to its predictable

and well-balanced institutional framework and very high economic resilience. Funding and liquidity are strong, given prudent risk management practices that result from retaining liquid investments in the authority's sinking funds, which as of December 2020 reached C\$4.5 billion. Supported by a low risk appetite and a strong policy framework, MFABC's strong management, combined with robust governance, mitigates the risk that can arise from being a moderate-size organization relative to peers, in our opinion. Capital adequacy has strengthened following the introduction of a capital framework policy. We believe the pass-through nature of MFABC's operations, its plain vanilla funding, and robust cash and liquid investments held in the SRF and DRF support a strong overall financial risk profile.

The authority, unlike peer public sector funding agencies, has taxing powers. It has the unfettered ability to impose a provincewide levy on all taxable land and improvements to replenish its DRF, if needed. MFABC is already a claimant on annual local tax bills, which we believe would expedite its ability to collect on a special levy, if needed. 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: Very strong public policy mandate and management will continue to complement the low-risk municipal sector

- We expect the municipal sector will remain low risk because of its well-balanced and predictable institutional framework, very high economic resilience, average leverage levels, and low financial system risk characterized by strong oversight of municipal borrowings by the province.
- The authority's very strong public policy mandate as the exclusive long-term lender to the sector will be enhanced by revenue anticipation lending.
- Management policies and governance will remain very strong, with well-established and prudent management policies and practices, especially concerning asset-liability matching.

MFABC will maintain its 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 will remain the provision of low-cost long-term funding to B.C.'s local and regional municipalities by pooling bond issues and creating liquidity in bond markets. While its core business will remain the provision of long-term lending, MFABC ramped up short-term commercial paper borrowing right after the onset of the COVID-19 pandemic to provide revenue anticipation lending to its clients. Under this lending, municipalities may borrow against their future anticipated revenues for the year. However, given strong revenue and good tax collection in the past year, cash reserves have remained strong, and there hasn't been any meaningful uptake in the program. We believe that MFABC's ability to provide this lending solidifies its very strong public policy role for local governments, and enhances its position as one of the largest subnational lenders in the country, particularly in the municipal realm. Its status as the exclusive long-term lender to this sector in B.C. stabilizes its revenues because these are tied to the sector's capital funding needs, which are large and predictable. Unlike some of its peers, MFABC does not face competition from other lenders, which makes its customer base very stable. It also provides a suite of investment products to local governments through its pooled investment funds and pooled

high-interest savings accounts, but faces strong competition from other financial institutions (namely banks and investment managers) in this space. MFABC's pooled investments ended the year at C\$4.6 billion in assets under management, up C\$1.4 billion from 2019, and it plans to continue to expand its lineup of investment fund offerings in 2021.

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 a reflection of the organization's low risk appetite, most recently reflected in the establishment of a capital policy outlining a clear target for on-balance-sheet risk capital, the retention of operating surplus, and the ongoing management of capital. Committees must approve both loan and investment decisions. Policies cover all key aspects of MFABC's operations, including asset-liability matching as 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 relatively small organization but the pass-through nature of its business and plain vanilla funding mitigate potential risks when compared with larger and more complex peers that compete for borrowers and whose funding practices expose them to higher market risks. In 2020, for the first time, MFABC began providing disclosures around its environmental, social, and governance (ESG) footprint, by mapping the end use of its bond proceeds to the UN Sustainable Development Goals, and intends to do so every year.

We continue to 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, moderate leverage levels, and low financial system risk. Provincial-municipal intergovernmental arrangements are stable. B.C., like all other provinces, imposes a prudent fiscal policy framework on its municipalities. Leverage in the sector is moderate: debt is forecast to remain about 1x operating revenues and interest expense about 2.4% of operating revenues. As well, and like the rest of the country, the sector has very high economic resilience thanks to the province's high GDP per capita of about C\$58,000. Canada's banking system is sound, and we view financial system risk for the B.C. municipal sector as low.

Financial risk profile: Strengthened capital levels will support MFABC's financial position

- Strengthened retained earnings and the loss-absorbing nature of the DRF complement the virtual absence of asset-liability management risks.
- The authority's new capital management policy will support strong risk-adjusted capital (RAC) levels.
- Funding and liquidity are supported by the authority's considerable holdings of liquid investments in its sinking funds of C\$4.5 billion at year-end 2020, its solid access to capital markets, strong secondary market liquidity, and favorable spreads.

We expect MFABC's new capital adequacy policy and framework, adopted in September 2019, will support strong capital. The authority has set its own capital policy far above its legislated 1% DRF and has never reported a credit loss in its 50-year history. In 2020, the growth in the authority's capital, which includes the DRF (given its loss-absorbing nature), outpaced growth in its risk-weighted assets. MFABC's capital grew stronger as a result of its retained income, investment earnings, short-term debt fund earnings, and fair value gain on investments. This resulted in a RAC ratio

before adjustments of 17.6% at December 2020, up from 16.1% a year earlier. At the same time, despite MFABC's continued concentration in its top borrowers, the after-concentration ratio was essentially flat at 8% compared with the last year.

MFABC does not take on any transformation risk because it uses fixed-rate domestic bonds to fund its lending, which supports our strong capital adequacy assessment. Risk management practices, which include very strict asset-liability matching, are sound in our view. The SRF and DRF, which make up MFABC's loss-absorbing capital, totaled C\$215.5 million in 2020, up from C\$195 million a year earlier.

The authority holds considerable liquid investments in its sinking funds of C\$4.5 billion at the end of 2020 (equal to over half of its gross long-term debt) and they underpin the authority's strong funding and liquidity. MFABC's funding ratio of assets-to-liabilities is 1x. The one-year liquidity ratio was 1.4x. The Canadian bond market, which we consider deep and diversified, provides 100% of MFABC's funding, making the authority's funding sources slightly concentrated. While investor diversification is much stronger and continues to improve, we view its investor base as slightly weaker than that of peers. Nevertheless, MFABC has unfettered access to the Canadian capital market, as was further demonstrated by oversubscribed public debt issuance at the height of market volatility in March 2020, when other domestic public issuers were only conducting private placements. The authority's liquidity position is also boosted by committed lines of credit totaling C\$350 million, and recently, by its access to the Bank of Canada's Contingent Term Repo Facility.

MFABC, unlike its peers, has powers to levy a tax on all taxable properties in B.C. to replenish the DRF to its required level. We consider this a significant credit strength. It has the unencumbered ability to impose a provincewide levy on all taxable land (assessed at approximately C\$1.8 trillion) and improvements if needed to replenish its DRF. If the DRF falls to below 50% of its required level, MFABC must exercise this authority and levy the property tax. The board can immediately invoke taxing powers at its discretion and needs no approval from municipal members or any higher level of government. The authority is already a claimant on annual local tax bills, and we believe this expedites its ability to collect on a special levy. It has not reported a loan book default in its 50-year history, nor has it reported a DRF deficiency. In addition, it has never had to enact a special levy. We consider this taxing power a key strength underpinning the 'AAA' rating.

Key Statistics

Table 1

Municipal Finance Authority of British Columbia -- Selected Indicators					
	--Year ended March 31--				
(Mil. C\$)	2020	2019	2018	2017	2016
Business position					
Total assets*	10,083.3	9,358.0	9,244.0	8,845.0	8,507.0
Customer loans (gross)	4,946.7	4,914.0	4,972.0	4,681.0	4,606.0
Growth in loans (%)	0.7	(1.2)	6.2	1.6	0.1
Net interest revenues	121.8	121	119	115	123.7

Table 1

Municipal Finance Authority of British Columbia -- Selected Indicators (cont.)					
	--Year ended March 31--				
(Mil. C\$)	2020	2019	2018	2017	2016
Noninterest expenses	3.6	3.5	3.3	3.2	3.5
Capital and risk position					
Total liabilities*	9,303.3	8,866.0	8,953.8	8,494.2	8,235
Total adjusted capital	216.1	195.0	181.0	173.0	163
Assets/capital (%)	46.7	48.0	51.2	51.7	52
RAC ratio before diversification	17.6	16.1	14.8	14.3	N/A
RAC ratio after diversification	8.0	7.9	6.8	7.4	N/A
Gross nonperforming assets/gross loans	-	-	-	-	-
Funding and liquidity (x)					
Liquidity ratio with loan disbursement (1 year)§	1.4	1.6	1.8	1.2	N/A
Liquidity ratio without loan disbursement (1 year)§	2.1	2.5	1.8	1.7	N/A
Funding ratio (1 year)§	1.2	1.0	1.2	0.5	N/A

*As per balance sheet. §Includes sinking funds. RAC--Risk-adjusted capital. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Municipal Finance Authority of British Columbia -- Ratings Score Snapshot	
Issuer Credit Rating	AAA/Stable/A-1+
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 Detail (As Of May 20, 2021)*

Municipal Finance Authority of British Columbia

Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	
<i>Local Currency</i>	A-1+
<i>Canada National Scale Commercial Paper</i>	A-1(HIGH)
Senior Unsecured	AAA

Issuer Credit Ratings History

19-Mar-2008	<i>Foreign Currency</i>	AAA/Stable/A-1+
29-Aug-2007		AA+/Positive/A-1+
21-Feb-2006		AA+/Stable/A-1+
19-Mar-2008	<i>Local Currency</i>	AAA/Stable/A-1+
29-Aug-2007		AA+/Positive/A-1+
21-Feb-2006		AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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