FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Municipal Finance Authority of British Columbia, Canada at 'AAA'; Outlook Stable

Wed 13 Apr, 2022 - 12:13 PM ET

Fitch Ratings - New York - 13 Apr 2022: Fitch Ratings has affirmed the Municipal Finance Authority of British Columbia, Canada's (MFABC) Issuer Default Rating (IDR) at 'AAA'. The Rating Outlook is Stable. In addition, the long-term ratings on approximately CAD9.3 billion in outstanding senior unsecured debentures have been affirmed at 'AAA'. The Rating Outlook is Stable.

MFABC's rating is based on its independent and unlimited property taxing authority, which supports its mission of providing access to capital for local and regional governments within the province of British Columbia (rated AA+/Stable).

KEY RATING DRIVERS

Risk Profile: Stronger

MFABC's 'Stronger' risk profile is based on its broad revenue powers, narrow and predictable expense profile and solid liquidity and debt profile, which support its mission of issuing debt to meet the financing needs of local governments, and result in 'Strong' assessments for all six categories under Fitch's LRG criteria.

Revenue Robustness: Stronger

MFABC's most important revenue source is a property tax levied on the province's massive property tax base, which is assessed at CAD2.168 trillion as of the 2022 assessment by BC Assessment, an independent provincial authority that reassesses property tax values each year. Every property owner's annual tax bill includes a nominal MFABC levy, which ensures a consistently working mechanism that allows MFABC to increase the levy if needed to address a borrower's failure to pay. MFABC's assessment generated $440,000 in 2021.

Rapidly rising housing prices and affordability concerns in British Columbia, especially in greater Vancouver, are elevating the risk of a property market correction, particularly as interest rates rise. Although the pandemic resulted in a 2.9% dip in assessed value, in 2020, the 10-year CAGR through 2022 for the assessment roll total value has been 8.2%; this includes a 21.3% gain in the 2022 assessment.

Fitch does not view a correction in assessed values to be a material risk to MFABC's ability to levy sufficient property taxes, given the small size of the levy necessary to ensure payment of debt service compared to the total value of the provincial assessment roll. Over the long term, property market fundamentals are expected to remain strong, consistent with Fitch's view of British Columbia's economy.

Beyond the nominal levy for property tax, the largest sources of annual revenues are interest on loans to clients, which generated CAD230 million in 2021 (CAD232 million in 2020), and investment income from the portfolio of assets, mainly sinking funds, managed by MFABC, which generated CAD144 million in 2021 (CAD141 million in 2020). Total revenue stood at CAD399 million in 2021 (CAD398 million in 2020).

Revenue Adjustability: Stronger

The authority, through a vote of its governing board of trustees, can levy a province-wide property tax base following any draw on its debt reserve fund (DRF) if it determines that loan repayments will be insufficient to restore the DRF within a reasonable period. If the DRF is drawn down by more than 50% from its required level, MFABC is statutorily required to levy a province-wide tax to restore it. The size of the levy is limited to restoring the DRF to its required level of half of the average annual principal and interest payments on borrower loans for all regional districts and half of the average annual principal and interest payments on borrowings by districts' member municipalities. There is no other limitation on the rates the authority can levy, and no approvals are necessary from provincial or local authorities.

Fitch believes any potential property tax levy necessary to support MFABC's obligations to bondholders will be affordable. Using 2021 tax revenue data, British Columbia's property owners paid governments just over $9 billion. MFABC's interest on long-term debt, at $245 million in 2021, represents only 2.7% of the total, suggesting substantial tax leeway for MFABC in the event that a default triggered the levy. Interest on MFABC's long-term debt in 2021 measures only 8 hundredths of 1 percent of household income of CAD306 billion.

Property tax rates are set in March, bills are mailed in May, and payments are due in July; MFABC receives its levy by August 1. Debenture debt service falls either in June and December, or April and October, leaving a maximum gap of nearly a year between a potential missed borrower repayment and levied property tax revenues.

British Columbia's tax base appears well-positioned to absorb any additional tax levy imposed by MFABC, if it became necessary. The provincial government estimates that for most representative taxpayers, British Columbia residents' property tax and overall tax burdens are comparable or lower than most other provinces. The province provides a detailed analysis comparing provincial tax burdens every year as part of its budget and fiscal plan.

Expenditure Sustainability: Stronger

MFABC's operating profile consists primarily of servicing market-issued debt with loan repayments from borrowing governments, managing pools of invested sinking fund and providing secondary financial services to client governments, including asset management. Rising interest rates on debt over time are passed through to borrowers in the form of higher loan repayments, insulating MFABC from interest rate risk.

MFABC provides no direct program services to citizens and does not perform capital planning or construction services. Within its narrow scope of activity, MFABC regularly runs small annual surpluses and has built a sizable strategic retention fund (SRF) at CAD102 million in 2021 (CAD95 in 2020), indicating a track record of tight control over expenditure growth.

Expenditure Adjustability: Stronger

The authority's primary expenses for interest on debt are matched over time by incoming borrower loan repayments. Secondary services for client governments, such as pooled fund offerings and financial risk training (including cyber risk), are demand based and impose limited additional operating costs on MFABC. There is a small staff of 17.

Liabilities and Liquidity Robustness: Stronger

MFABC debt is issued at fixed rates and benefits from excellent access to capital markets, as demonstrated through consistently favorable spreads to provincial debt in the highly liquid Canadian domestic market. Long-term debt outstanding totals CAD9.3 billion in 2021 (CAD8.5 billion in 2020), consisting of debentures with bullet maturities typically at 5, 10 and 20 years. The weighted average maturity calculated by Fitch is between four and five years.

Commercial paper (CP) notes (not rated by Fitch) with maturities from 35 or 91 days are limited by policy to a maximum of CAD700 million as of 2021; the balance stood at CAD500 million as of December 31, 2021 (CAD610 million in 2020), the fiscal year-end; CP notes are backstopped by two Canadian chartered banks. CP notes provide liquidity to MFABC and interim financing for local governments, including for the initial phases of capital projects until taken out by long-term MFABC debentures. MFABC retains strong market access for the CP note program, implying limited rollover risk.

The authority's loan assets are matched with its debenture liabilities such that interest payments from client governments meet the annual interest obligations on debentures. Loans are fully amortized with principal payments deposited in dedicated sinking funds invested by MFABC, and used to retire debentures upon maturity. Loan maturities may extend beyond the corresponding maturities of debt issued by MFABC, although the loan rates reset to reflect the rate on refunding debt.

Borrowers are compensated for sinking funds accumulated and invested before the associated debenture matures, with the application of an actuarial reduction applied to each principal payment. The discount is covered through the earnings on sinking fund investments. The authority sets actuarial rates (between 1.75% and 5%) at the commencement of each loan and reviews it against actual investment performance.

The MFABC retains the right to adjust the actuarial assumption and has done so regularly. Earnings in excess of the actuarial rate are recorded as a surplus and are available to MFABC as liquidity until distributed to participating borrowers over the timeframe of the loan.

Liabilities and Liquidity Flexibility: Stronger

MFABC has considerable flexibility in managing its liquidity, with recourse to a range of internal and external sources of liquidity if needed. In the unexpected event that a borrowing government fails to make its loan payments, MFABC would cover interest first by drawing on the DRF, which held CAD123 million in 2021 (CAD120 in 2020). If the DRF is drawn on, the MFABC can unilaterally impose a property tax as described above to restore the draw; a tax must be levied if the DRF balance is drawn to less than 50% of the required level.

Beyond the DRF balance, additional sources of liquidity include the SRF, noted earlier, which held CAD102 million in 2021 (CAD95 million in 2020), and a CAD100 million revolving line of credit with Canadian Imperial Bank of Commerce (CIBC, IDR 'AA-'/Stable). Finally, MFABC can also draw against the core sinking fund balance, which stood at CAD4.3 billion in 2021 (CAD4.4 billion in 2020), equal to 46% of outstanding long-term debt.

Sinking fund assets are invested under statutory requirements that limit holdings to Canadian or provincial securities, or those guaranteed by them; securities of a local, municipal or regional government in Canada; investments guaranteed by a chartered bank; or deposits in a savings institution or non-equity or membership shares of a credit union. Statutory restrictions on the DRF are similar, except they cannot be invested in securities of Canadian local, municipal or regional governments. MFABC has developed investment policies to provide further guidance in managing DRF and SRF assets.

Maximum annual interest obligations on debentures has been less than CAD300 million for many years, indicating MFABC's resources are ample relative to potential interest demands. Short-term CP notes, which are also a source of liquidity, totaled CAD500 million in 2021 (CAD610 million in 2020); CAD3.9 billion was issued during the year.

The policy cap on CP notes is CAD700 million; this level is down from CAD1.25 billion in 2020, when the cap was increased to address possible liquidity needs during the pandemic. To backstop the CP note program, MFABC has two dedicated lines of credit of CAD175 million each with CIBC and National Bank of Canada (NBC, IDR 'A+'/Stable), respectively, together providing 50% of the current CP program size.

Debt Sustainability:

aaa category

The 'aaa' category debt sustainability assessment is based on the criteria variation, under which internal liquidity combined with the unlimited taxing power of MFABC provides substantial protection in a scenario in which borrowers fail to pay interest. Fitch views

MFABC as a 'Type B' LRG under its criteria, reflecting its taxation powers but limited operating mission as authorized by the province.

Under the rating case projection through 2026 that assumes the pledge of province-wide property taxes is triggered, the payback ratio (net adjusted debt/operating balance) gradually falls to near 1x. The synthetic debt service coverage ratio (operating balance-to-a mortgage like payoff of debt service) rises to 8.2x. Both ratios suggest a 'aaa' assessment. The fiscal debt burden (net adjusted debt/operating revenue) remains weak through the period, although is not as relevant to the overall assessment given the matched nature of MFABC's liabilities and assets over time.

DERIVATION SUMMARY

MFABC's ample sources of liquidity available to support its obligations until taxes are levied and collected support a Risk Profile that Fitch assesses as 'Stronger', and robust debt sustainability metrics in Fitch's through-the-cycle scenario analysis. Within the broad constitutional and statutory framework of Canadian LRGs, the authority functions autonomously; its liquidity and debt needs are not supported by the province.

The analysis supporting MFABC's 'AAA' rating includes a variation from the International Local and Regional Governments (LRG) Rating Criteria dated Sept. 3, 2021. A variation was made to the debt sustainability because the statutory requirement to levy an unlimited property tax on a broad economic base to restore draws on the authority's debt reserve fund, and the matched nature of the MFABC's long-term debentures by loans made to borrower governments.

These factors result in MFABC adjusting its financial performance in a manner that offsets potential stresses imposed by Fitch under the rating case, a scenario that is not anticipated in determining the rating case scenario that underlies the debt sustainability assessment. The variation provides a means to assess the likely trajectory of financial metrics given these factors.

KEY ASSUMPTIONS

Qualitative Assumptions

Risk Profile: Stronger

Revenue Robustness: Stronger

Revenue Adjustability: Stronger

Expenditure Sustainability: Stronger

Expenditure Adjustability: Stronger

Liabilities and Liquidity Robustness: Stronger

Liabilities and Liquidity Flexibility: Stronger

Debt Sustainability: aaa

Budget Loans (Notches): N/A

Ad-Hoc Support (Notches): N/A

Asymmetric Risks (Notches): N/A

Rating Cap: N/A

Rating Floor: N/A

Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2017-2021 audited figures and 2022-2026 projected ratios. The key assumptions include the following:

For the 2022-2026 projection period, economic forecast data is based on the spring 2022 federal budget, Fitch's March 2022 Global Economic Outlook, British Columbia's 2022 budget forecast, and information from MFABC.

The base case assumes that MFABC's cost of debt rises in step with federal budget expectations for 10-year government bond rates. Long-term debt increases at the low end of MFA's forecast range in 2022 and 2023, before rising thereafter at nominal GDP. Short-term debt remains at the 2021 actual level.

The rating case assumes more conservative economic growth and assumes that MFABC's cost of debt rises in step with Fitch's expectation for increases in Canada's policy rates.

Long-term debt increases at the high end of MFA's forecast range in 2022 and 2023, before rising thereafter at nominal GDP. Short-term debt outstanding remains at the 2021 policy cap.

Both the base and rating cases assume investment income and loan interest is based on the cost of debt, and loans to clients represent about 58% of outstanding long-term debt, approximating the level over the 2017-2021 period.

The rating case additionally assumes that property tax revenue provision is triggered at a level sufficient to ensure all interest payments on all bonds, including those necessary to refund short-term debt, a scenario far more severe than expected under a rating case but otherwise illustrating the essentially unlimited nature of MFABC's taxing authority. This adjustment skews the results of the rating case metrics relative to historical metrics, but reflects a more complete picture of MFABC's ability to withstand the disruptions of a typical economic cycle.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable for a 'AAA' rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Unrestricted Liquidity Levels: Erosion of ample unrestricted liquidity at least equal to one year of debt service, in the form of cash, cash equivalents and credit facilities from highly-rated counterparties, sufficient to bridge the time between a borrower's failure to pay and the receipt of MFABC tax levies.

--Taxing Power and Economic Base: Any change in the robust institutional framework, including to the authority's independent and unlimited taxing power, or a structural shift in the long-term growth trajectory of British Columbia's economy and MFABC's property tax base could affect the credit quality.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

MFABC's direct debt is used solely to fund loans to borrower governments. While direct debt is forecast to increase in the rating case, which is similar to the base case and the authority's projections for 2022 and 2023, it will be matched with borrower loans, with debt service and loan payment dates and amounts also aligned.

Loans outstanding, both long- and short-term, typically represent a 55%-58% of outstanding debt, with the balance consisting of investments, typically accumulated sinking fund deposits and earnings. Loan terms often exceed the maturity of associated debt, with loan repayments subject to reset when maturing debt is refunded.

Under Fitch's calculation, direct debt stood at CAD9.8 billion in 2021, consisting of CAD9.3 billion in long-term debentures and CAD500 million in short-term CP notes at year-end. Net adjusted debt stands at just under CAD5 billion, after netting CAD4.8 billion in cash, cash equivalents, and investments, chiefly the sinking funds noted above. MFABC has no contingent liabilities.

ISSUER PROFILE

Created in 1970, MFABC is the authorized borrower for most municipalities and regional districts in the Province of British Columbia. MFABC provides loans to local and regional governments primarily for capital purposes and issues long-term debentures to fund those loans. While borrowers' loan repayments support MFABC's debt service, the failure to pay by a borrower triggers a requirement that MFABC levy a province-wide property tax to support debt repayment. Over MFABC's 52-year history there have been no instances of local government failure to repay loans. More recently, pandemic disruptions in 2020-2021 and the severe fires and floods in 2021 in the province's interior had no impact on MFABC.

MFABC is governed by regional governments in the province. While authorized under provincial law, MFABC operates autonomously, its financial statements and debts are not consolidated with the province's, and there is no provincial guarantee of MFABC borrowing. MFABC benefits from a strict system of oversight of local governments by

British Columbia. Local governments may not budget for deficits, have broad operating flexibility to adjust their finances, and are subject to borrowing limits that include capping principal and interest at 25% of recurring revenues and requiring voter, regional government and MFABC approval for new issuance.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Municipal Finance Authority of British Columbia	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
senior unsecured	LT	AAA	Affirmed	AAA

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Municipal Finance Authority of British Columbia	EU Endorsed, UK Endorsed

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