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## Research Update:

# City of Thunder Bay 'AA-' Ratings Affirmed On Strong Continued Budgetary Performance

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## Research Update:

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## Overview

- We are affirming our long-term issuer credit and senior unsecured debt ratings on the City of Thunder Bay at 'AA-'.
- In part, the rating reflects our view of Thunder Bay's strong budgetary performance, moderate debt, and "very positive" liquidity.
- We believe average economic performance and somewhat limited budgetary flexibility offset these strengths.
- The stable outlook reflects our expectation that, in the next two years, the city will maintain very positive liquidity, healthy operating performance, and after-capital deficits of less than 10% of total revenues.

## Rating Action

On June 18, 2014, Standard & Poor's Ratings Services affirmed its 'AA-' long-term issuer credit and senior unsecured debt ratings on the City of Thunder Bay, in the Province of Ontario. The outlook is stable.

## Rationale

The ratings on Thunder Bay reflect Standard & Poor's opinion of the city's strong budgetary performance, moderate debt and liquidity that is "very positive" for creditworthiness. The ratings also reflect our view of the "predictable and well-balanced" institutional framework for Canadian municipalities, our assessment of the neutral impact that Thunder Bay's financial management has on its credit profile, and moderate contingent liabilities. We believe that somewhat mitigating these strengths are the city's average economic performance and somewhat limited budgetary flexibility, particularly on the expenditure side.

In our opinion, with an increased focus on addressing its infrastructure gap, Thunder Bay's after-capital budgetary performance will remain in a deficit of 5%-10% of total revenues in the next two years. Nevertheless, in our base-case forecast for 2012-2016, we also expect that the city will continue producing a strong operating surplus of greater than 5% of operating revenue. After incorporating TBayTel, Thunder Bay's wholly owned telephone utility, the city's 2013 consolidated operating surplus was about 6.3% of operating revenues, a moderate decline from 8.7% the previous year. Thunder Bay's overall budgetary position, which includes capital revenues and expenditures, remained relatively stable, compared with the previous year: its after-capital

spending deficit at fiscal year-end 2013 (Dec. 31) represented about 7.8% of total revenues (including TBayTel's operations).

In the next two years, we believe that, tax-supported debt (Standard & Poor's-defined) will remain moderate, and relatively stable, at about 40%-50% of consolidated operating revenues. We also expect that interest will remain below 2% of adjusted operating revenue. At fiscal year-end 2013, tax-supported debt modestly decreased to 40.5% of consolidated operating revenues, compared with 44.1% at fiscal year-end 2012.

In our opinion, contingent liabilities, stemming largely from standard future employee benefits and landfill postclosure liabilities, are modest. They represent about 20% of consolidated operating revenues at year-end 2013 and do not have a significant impact on the city's credit profile.

We believe Canadian municipalities benefit from a predictable and well-balanced local and regional government 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.

In our opinion, Thunder Bay's financial management has a neutral impact on creditworthiness. We believe that management has a financial plan that provides visibility and that the city's management of debt and liquidity are prudent. In addition, its financial statements are comprehensive and transparent. Thunder Bay's operating and capital budgets are limited to one year but the city does prepare 20-year capital forecasts.

We estimate the city's GDP per capita was close to, but slightly less than, the provincial average of about US\$49,000. Thunder Bay's economy focuses largely on the public sector (more than 20% of total employment), which provides it with a stable base. In addition, Bombardier Inc., a major player in the manufacturing sector, has secured long-term contracts to produce subway cars. In the past five years, the city has made some gains in diversifying its economy into other noncyclical fields, particularly in knowledge-based sectors such as biomedicine, research, and health care. Nevertheless, compared with those of other domestically rated peers, Thunder Bay has limited near-term growth prospects. According to the most recent Census, from 2006-2011, its population decreased at an annual compound rate of 0.15%. The city has increased its efforts at diversifying its economy into mining, a volatile sector. We believe that the sector could contribute to Thunder Bay's growth prospects in the medium term.

We expect that the city's budgetary flexibility will remain adequate in the next two years, with capital expenditures of greater than 15% of total

expenditures and modifiable revenues of greater than 70% of operating revenues. Nevertheless, in our opinion, Thunder Bay's limited ability to cut expenditures somewhat constrains its budgetary flexibility. With a greater focus on addressing its infrastructure deficit and maintaining a state of good repair, we believe that management has little ability to defer the capital program.

As well, similar to other Canadian municipalities, the city is constrained in its ability to meaningfully cut operating expenditures due to several factors, including provincially mandated service levels, labor contracts, inflation, and political pressures. Nevertheless, starting in 2010, it committed and was able to achieve C\$1.5 million in savings annually.

## Liquidity

Standard & Poor's expects that free cash and liquid assets will remain very positive and above 100% of 12 months' debt service in the next two years. At fiscal year-end 2013, free cash and liquid assets covered about 200% coverage of 2014 debt service and stood at about C\$64.4 million (Standard & Poor's-adjusted). In our view, Thunder Bay has satisfactory access to external liquidity as the city can access Infrastructure Ontario for term debt financing.

## Outlook

The stable outlook reflects our expectation that, throughout the two-year outlook horizon, Thunder Bay will maintain very positive liquidity, with free cash and liquid assets in excess of 100% of next 12 months debt service. We also expect that the city's average after-capital deficits will remain stable, at close to current levels. Downward pressure on the outlook or ratings could result from a material deterioration in budgetary performance, such that the city produces after-capital deficits of greater than 10% of total revenues and a material decrease in liquidity to less than 100% of the next 12 months' debt service. Although unlikely within the next two years, we could revise the outlook to positive or raise the ratings in the next two years if strong revenue growth and significant cost containment result in after-capital surpluses.

## Published Rating Factor Scores

Table 1

City of Thunder Bay -- Summary Of Published Rating Factor Scores*	
Rating factor	Score
Institutional Framework	Predictable and well-balanced
Financial Management	Neutral
Liquidity	Very positive

**Table 1**

**City of Thunder Bay -- Summary Of Published Rating Factor Scores\* (cont.)**

\*Standard & Poor's ratings on local and regional governments are based on, among other things, a scoring system that covers eight main rating factors, as further explained in our criteria (see below). We publish our scores for the three rating factors above.

## Key Statistics

**Table 2**

**City of Thunder Bay -- Economic Statistics**

	--Fiscal year ended Dec. 31--				
(%)	2009	2010	2011	2012	2013
Population	108,679	108,519	108,359	108,199	108,040
Population growth	(0.15)	(0.15)	(0.15)	(0.15)	(0.15)
Unemployment rate	8.40	6.60	6.90	5.00	6.00

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include Statistics Canada.

**Table 3**

**City of Thunder Bay -- Financial Statistics**

	--Fiscal year ended Dec. 31--					
(Mil. C\$)	2011	2012	2013	2014bc	2015bc	2016bc
Operating revenues	484	503	508	518	529	541
Operating expenditures	438	460	476	487	499	510
Operating balance	46	43	32	31	31	31
Operating balance (% of operating revenues)	9.59	8.49	6.31	5.95	5.78	5.68
Capital revenues	30	16	23	22	22	21
Capital expenditures (capex)	95	98	96	97	98	93
Balance after capital accounts	(18)	(39)	(41)	(44)	(45)	(42)
Balance after capital accounts (% of total revenues)	(3.48)	(7.61)	(7.76)	(8.17)	(8.14)	(7.39)
Debt repaid	33	22	27	24	24	24
Balance after debt repayment and onlending	(51)	(62)	(69)	(68)	(69)	(65)
Balance after debt repayment and onlending (% of total revenues)	(9.94)	(11.86)	(12.93)	(12.52)	(12.57)	(11.61)
Gross borrowings	16	33	11	34	27	27
Balance after borrowings	(36)	(29)	(58)	(34)	(42)	(38)
Operating revenue growth (%)	11.61	3.87	1.00	1.99	2.14	2.17
Operating expenditure growth (%)	17.02	5.13	3.42	2.38	2.32	2.29
Modifiable revenues (% of operating revenues)	84.59	83.40	84.40	84.71	85.05	85.37
Capital expenditures (% of total expenditures)	17.77	17.56	16.75	16.59	16.39	15.48
Direct debt (outstanding at year-end)	211	222	206	216	219	222
Direct debt (% of operating revenues)	43.68	44.14	40.48	41.72	41.33	41.12
Tax-supported debt (% of consolidated operating revenues)	43.68	44.14	40.48	41.72	41.33	41.12
Interest (% of operating revenues)	1.86	1.71	1.66	1.60	1.42	1.20

**Table 3**

City of Thunder Bay -- Financial Statistics (cont.)						
Debt service (% of operating revenues)	8.73	6.09	7.06	6.14	6.03	5.59

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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. Base case reflects Standard & Poor's expectations of the most likely scenario. Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with an upgrade. bc--Base cae.

## Key Sovereign Statistics

Sovereign Risk Indicators, March 24, 2014

## Related Criteria And Research

### Related Criteria

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

### Related Research

International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

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 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.

## Ratings List

Ratings Affirmed

Thunder Bay (City of)

*Research Update: City of Thunder Bay 'AA-' Ratings Affirmed On Strong Continued Budgetary Performance*

Issuer credit rating	AA-/Stable/--
Senior unsecured debt	AA-

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