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Research Update:

City of Thunder Bay 'AA-' Ratings Affirmed On Exceptional Liquidity And Low Debt Burden; Outlook Stable

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Overview

- We are affirming our 'AA-' long-term issuer credit and senior unsecured debt ratings on the City of Thunder Bay.
- In part, the rating reflects our view of the city's strong budgetary flexibility, low debt burden, and exceptional liquidity.
- The stable outlook reflects our expectation that, in the next two years, Thunder Bay will maintain exceptional liquidity, it will maintain a low debt burden, and its budgetary performance will remain average, with operating surpluses above 5% of operating revenues and after-capital deficits below 10% of total revenues.

Rating Action

On June 17, 2015, 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 flexibility, low debt burden, and exceptional liquidity. The ratings also reflect our view of Thunder Bay's strong economy, the "very predictable and well-balanced" institutional framework for Canadian municipalities, our assessment of the neutral impact that the satisfactory financial management has on the credit profile, and low contingent liabilities. We believe that somewhat mitigating these strengths is its average, albeit improving, budgetary performance.

In our opinion, Canadian municipalities benefit from a very 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.

Thunder Bay's budgetary flexibility is strong, in our view, with high

modifiable revenues, primarily from taxes, fees, and user charges, accounting for about 84% of operating revenues. We expect them to remain above 70%, on average, in our base-case scenario. We also expect capital expenditures to average about 17% in the scenario, for 2013-2017. 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, collective agreements with employees, inflation, and political pressures.

We believe that tax-supported debt (Standard & Poor's-defined) will remain low and relatively stable in the next two years, at 35%-40% of consolidated operating revenues. We also expect that interest will remain below 2% of adjusted operating revenue. At fiscal year-end 2014 (Dec. 31), tax-supported debt modestly decreased to 38.3% of consolidated operating revenues, compared with 40.5% at fiscal year-end 2013.

In our opinion, contingent liabilities, stemming largely from standard future employee benefits and landfill postclosure liabilities, are low. They represent about 20% of consolidated operating revenues at year-end 2014 and do not have a significant impact on the city's credit profile. We believe that in the event of financial stress at TBay Hydro (Thunder Bay's government-related enterprise), the city's support would be limited to less than 5% of its operating revenues.

In our opinion, and similar to many of its peers, Thunder Bay's financial management is satisfactory and has a neutral impact on creditworthiness. We believe that management has a financial plan that provides visibility on revenues and expenditures, and that the city's management of debt and liquidity is 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 is close to the provincial average of almost US\$50,000. Thunder Bay's average economy focuses largely on the public sector (health care, school boards, municipal and provincial administrations) which accounted for more than 20% of total employment in 2014 and provides it with a stable base. Manufacturing, retail, and mining sectors also contribute to local economic activity. In our opinion, declining population and the resulting weaker demographic profile constrain its long-term growth prospects. According to the most recent Census, from 2006-2011, Thunder Bay's 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. Nevertheless, we believe that the sector could contribute to medium-term growth prospects.

Thunder Bay's average budgetary performance has improved in the past year. Its

operating surplus was 7.8% of adjusted operating revenues, and the after capital deficit was smaller, at 6.6% of total revenues. However, with an increased focus on addressing its infrastructure gap, we expect that the city's after-capital budgetary performance will remain in a deficit of 5%-10% of total revenues, on average, in our 2013-2017 base case. Nevertheless, we forecast that Thunder Bay will continue producing a healthy operating surplus of greater than 5% of operating revenue.

Liquidity

Standard & Poor's expects that free cash and liquid assets will remain exceptional and above 100% of 12 months' debt service in the next two years. At fiscal year-end 2015, forecast free cash and liquid assets of C\$59 million (Standard & Poor's-adjusted) will cover about 170% of next 12-months debt service. In our view, Thunder Bay has satisfactory access to external liquidity.

Outlook

The stable outlook reflects our expectation that, in the next two years, Thunder Bay will maintain exceptional liquidity, with free cash and liquid assets in excess of 100% of next 12 months' debt service. The outlook also reflects our expectation that the city's budgetary performance will remain average, with operating surpluses of above 5% of operating revenues and after-capital deficits close to current levels. A positive rating action is possible if strong revenue growth and significant cost containment result in a five-year average after-capital deficit smaller than 5%. Although unlikely, downward pressure on the ratings could result from a significantly weaker economic profile; 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.

Key Statistics

Table 1

City of Thunder Bay -- Economic Statistics			
	--Fiscal year ended Dec. 31--		
(%)	2012	2013	2014
Population (total)	108,199	108,040	107,878
Population growth	(0.15)	(0.15)	(0.15)
Unemployment rate	5.0	6.0	5.3

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 2

City of Thunder Bay -- Financial Statistics						
	--Fiscal year ended Dec. 31--					
(Mil. C\$)	2012	2013	2014	2015bc	2016bc	2017bc
Operating revenues	503	508	520	530	541	553
Operating expenditures	460	484	480	490	501	512
Operating balance	43	24	40	40	40	41
Operating balance (% of operating revenues)	8.5	4.7	7.8	7.5	7.4	7.4
Capital revenues	16	23	25	29	31	33
Capital expenditures	98	96	101	93	98	103
Balance after capital accounts	(39)	(49)	(36)	(23)	(27)	(29)
Balance after capital accounts (% of total revenues)	(7.6)	(9.3)	(6.6)	(4.2)	(4.8)	(5.0)
Debt repaid	22	27	26	25	27	25
Balance after debt repayment and onlending	(62)	(77)	(62)	(49)	(54)	(55)
Balance after debt repayment and onlending (% of total revenues)	(11.9)	(14.5)	(11.4)	(8.7)	(9.4)	(9.3)
Gross borrowings	33	11	20	30	27	22
Balance after borrowings	(29)	(66)	(43)	(19)	(27)	(33)
Operating revenue growth (%)	3.9	1.0	2.4	1.9	2.0	2.3
Operating expenditure growth (%)	5.1	5.2	(0.9)	2.2	2.2	2.2
Modifiable revenues (% of operating revenues)	83.4	84.4	84.0	84.5	84.9	85.2
Capital expenditures (% of total expenditures)	17.6	16.5	17.5	15.9	16.4	16.8
Direct debt (outstanding at year-end)	222	206	199	204	211	207
Direct debt (% of operating revenues)	44.1	40.5	38.3	38.5	38.9	37.4
Tax-supported debt (% of consolidated operating revenues)	44.1	40.5	38.3	38.5	38.9	37.4
Interest (% of operating revenues)	1.7	1.7	1.5	1.5	1.5	1.5
Debt service (% of operating revenues)	6.1	7.1	6.5	6.3	6.4	6.1

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 case.

Ratings Score Snapshot

Table 3

City of Thunder Bay -- Ratings Score Snapshot	
Key rating factors	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Strong
Financial Management	Satisfactory
Budgetary Flexibility	Strong
Budgetary Performance	Average
Liquidity	Exceptional

Table 3

City of Thunder Bay -- Ratings Score Snapshot (cont.)	
Debt Burden	Low
Contingent Liabilities	Low

Note: Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, March 31, 2015. Interactive version available at <http://www.spratings.com/sri>

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

Related Research

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Feb. 5, 2015
- 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 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

Thunder Bay (City of)	
Issuer credit rating	AA-/Stable/--
Senior unsecured debt	AA-

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