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Research Update:

City of Thunder Bay Outlook Revised To Positive From Stable On Expected Decrease In After-Capital Deficits

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Research Update:

City of Thunder Bay Outlook Revised To Positive From Stable On Expected Decrease In After-Capital Deficits

Overview

- We are revising our outlook on the City of Thunder Bay to positive from stable.
- We are also affirming our 'AA-' long-term issuer credit and senior unsecured debt ratings on Thunder Bay.
- The outlook revision reflects our opinion that, in the next two years, the city will continue to demonstrate healthy operating balances, decreasing after-capital deficits, a low debt burden, and exceptional liquidity balances.
- The ratings on Thunder Bay reflect S&P Global Ratings' opinion of the city's strong budgetary flexibility, low debt burden, average and improving budgetary performance, and exceptional liquidity.

Rating Action

On June 20, 2016, S&P Global Ratings revised its outlook on the City of Thunder Bay, in the Province of Ontario, to positive from stable. At the same time, S&P Global Ratings affirmed its 'AA-' long-term issuer credit and senior unsecured debt ratings on Thunder Bay.

Rationale

The outlook revision reflects our opinion that, in the next two years, the city will continue to demonstrate healthy operating balances and decreasing after-capital deficits of less than 5% of adjusted total revenues, a low debt burden, and exceptional liquidity balances such that the overall credit profile would be consistent with a higher rating.

The ratings on Thunder Bay reflect S&P Global Ratings' opinion of the city's strong budgetary flexibility, low debt burden, average and improving budgetary performance, 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, satisfactory financial management practices, and low contingent liabilities.

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.

Following a number of years of growing after-capital deficits, Thunder Bay demonstrated improving results in the past two years, with deficits declining to 7.0% of adjusted total revenues in 2015 from 9.3% in 2013. In our base-case forecast, we expect after-capital deficits to strengthen further in the next two years, averaging about 5.5% of adjusted total revenues in 2014-2018. Operating balances are healthy and stable and we expect these to average about 9% of adjusted operating revenues during that period.

Thunder Bay's budgetary flexibility is strong, in our view, with high modifiable revenues of about 85% of adjusted operating revenues. Modifiable revenues consist primarily of property taxes, fees, and user charges, and we expect these to remain stable in the outlook horizon. We also expect capital expenditures to average about 17% of adjusted total spending, in 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, management has little ability to defer the capital program, in our view. 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 Thunder Bay benefits from a low debt burden and we expect this to be stable in the two-year outlook horizon. Tax-supported debt represented 42% of consolidated operating revenues in 2015 and we expect it to decline modestly to 37% by 2018. Interest costs are low and we expect these to remain below 2% of adjusted operating revenues in the medium term.

Contingent liabilities are low and consist partially of standard future employee benefits and liabilities, landfill postclosure costs, and a number of ongoing litigations, in the normal course of business. 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.

We view Thunder Bay's financial management practices as satisfactory. The experienced management team adheres to prudent financial policies and follows goals outlined in its five-year financial plan. We believe annual budgets reflect realistic assumptions, although these require moderate revisions during the year. While there have been a few departures from the senior management team in the past year, we don't expect significant interruptions and will continue to monitor continuity within the team. Furthermore, the city administration benefits from a strong relationship with the council.

Thunder Bay has a strong economy with a focus on the public sector, which adds a level of stability, in our view. We estimate the city's nominal GDP per capita to be largely in line with that of Ontario of about US\$45,500, based on its income levels and higher value-added of the local industries. We believe that the declining and aging population constrains Thunder Bay's economic profile and could hinder revenue growth and expenditure needs. The labor market results worsened in 2015, mainly stemming from weakness in the commodities market and softening activity in western Canada. We expect recovery in employment to be in line with growth in commodities prices.

Liquidity

We expect Thunder Bay to maintain an exceptional liquidity profile, with free cash and liquid assets averaging about C\$63 million in the next 12 months and covering 160% of the estimated debt service. While we view this level of coverage to be healthy, it has declined notably in the past 10 years. In our view, Thunder Bay has satisfactory access to external liquidity.

Outlook

The positive outlook reflects S&P Global Ratings' expectations that we could raise the rating in the next two years if Thunder Bay meets the conditions under our upside-case scenario. Specifically, if the city demonstrates strong budgetary performance, with after-capital deficits averaging less than 5% of adjusted total revenues, while maintaining a low debt burden, and an exceptional liquidity profile, with free cash and liquid assets exceeding 100% of next 12 months' debt service, an upgrade is possible. We could revise the outlook to stable if budgetary performance were to weaken through slower-than-expected revenue growth and high capital expenditures, resulting in after-capital deficits greater than 5% of adjusted total revenues.

Key Statistics

Table 1

City of Thunder Bay -- Economic Statistics					
	--Fiscal year ended Dec. 31--				
(%)	2011	2012	2013	2014	2015
Population (total)	108,359	108,199	108,040	107,878	107,716
Population growth	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Unemployment rate	6.9	5.0	6.0	5.3	5.2

Note: The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices.

Table 2

City of Thunder Bay -- Financial Statistics									
--Fiscal year ended Dec. 31--									
(Mil. C\$)	2013	2014	2015	2016bc	2017bc	2018bc	2016uc	2017uc	2018uc
Operating revenues	508	520	539	546	556	568	549	561	575
Operating expenditures	484	480	487	494	503	514	494	503	514
Operating balance	24	40	52	52	53	54	55	58	61
Operating balance (% of operating revenues)	4.7	7.8	9.7	9.5	9.5	9.5	10.0	10.3	10.6
Capital revenues	23	25	17	22	24	23	22	24	23
Capital expenditures	96	101	108	100	106	101	100	106	101
Balance after capital accounts	(49)	(36)	(39)	(26)	(30)	(25)	(23)	(25)	(17)
Balance after capital accounts (% of total revenues)	(9.3)	(6.6)	(7.0)	(4.5)	(5.1)	(4.2)	(4.0)	(4.2)	(2.9)
Debt repaid	27	26	28	31	30	32	31	30	30
Balance after debt repayment and onlending	(77)	(62)	(67)	(57)	(60)	(56)	(54)	(55)	(48)
Balance after debt repayment and onlending (% of total revenues)	(14.5)	(11.4)	(12.0)	(10.0)	(10.3)	(9.5)	(9.4)	(9.4)	(8.0)
Gross borrowings	11	20	29	29	23	19	29	23	19
Balance after borrowings	(66)	(42)	(38)	(28)	(37)	(37)	(25)	(32)	(29)
Operating revenue growth (%)	1.0	2.4	3.6	1.2	1.9	2.1	1.8	2.2	2.5
Operating expenditure growth (%)	5.2	(0.9)	1.4	1.4	2.0	2.1	1.4	2.0	2.1
Modifiable revenues (% of operating revenues)	84.4	84.0	85.3	85.4	85.6	85.9	85.5	85.8	86.1
Capital expenditures (% of total expenditures)	16.5	17.5	18.1	16.9	17.4	16.4	16.9	17.4	16.4
Direct debt (outstanding at year-end)	206	199	224	221	213	211	221	213	211
Direct debt (% of operating revenues)	40.5	38.3	41.5	40.5	38.2	37.2	40.3	37.9	36.7
Tax-supported debt (% of consolidated operating revenues)	40.5	38.3	41.5	40.5	38.2	37.2	40.3	37.9	36.7
Interest (% of operating revenues)	1.7	1.5	1.5	1.7	1.7	1.6	1.7	1.7	1.5
Debt service (% of operating revenues)	7.1	6.5	6.8	7.4	7.1	7.1	7.4	7.1	6.8

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

Ratings Score Snapshot

Table 3

City of Thunder Bay -- Rating Score Snapshot	
Key rating factors	Assessment
Institutional Framework	Very predictable and well-balanced

Table 3

City of Thunder Bay -- Rating Score Snapshot (cont.)

Key rating factors	Assessment
Economy	Strong
Financial Management	Satisfactory
Budgetary Flexibility	Strong
Budgetary Performance	Average
Liquidity	Exceptional
Debt Burden	Low
Contingent Liabilities	Low

Note: S&P Global Ratings' ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P's Global Ratings' "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, May 3, 2016. 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
- Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, April 21, 2016
- Global Credit Conditions Weaken Broadly Amid Increasing Market Volatility, April 19, 2016

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

Outlook Revised To Stable

	To	From
Thunder Bay (City of) Issuer credit rating	AA-/Positive/--	AA-/Stable/--

Rating Affirmed

Thunder Bay (City of) Senior unsecured	AA-
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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