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Research Update:

City of Thunder Bay 'AA' Ratings Affirmed; Outlook Remains Stable

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Overview

- We believe the City of Thunder Bay will produce robust operating balances and modest negative after-capital balances in the outlook horizon, supported by prudent financial management practices.
- Thunder Bay's healthy liquidity cushion will allow the city to advance on its capital needs while maintaining a low debt burden over 2018-2020.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the city.
- The stable outlook reflects our expectation that, in the next two years, the city's healthy budgetary performance results will help it to maintain a robust liquidity position and a decreasing debt burden.

Rating Action

On June 26, 2018, S&P Global Ratings 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 remains stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, Thunder Bay will maintain strong budgetary results, with modest after-capital deficits around 2% of total revenues, supported by prudent financial management practices. We also expect the city will maintain a low debt burden and a healthy liquidity position.

Downside scenario

We could lower the ratings over the next two years if weaker-than-expected economic growth and rising operating pressures were to cause sustained negative after-capital results of more than 5% of total revenues, and eroded the liquidity balances to less than 1x debt service coverage.

Upside scenario

We could raise the rating in the next two years if the city demonstrated consistent political willingness to further improve its long-term planning and budget sustainability, while maintaining sufficient internal capital funding.

In conjunction, if the tax-supported debt burden fell below 30% of consolidated operating revenue we could take a positive rating action.

Rationale

The ratings reflect the city's strong budgetary performance expected throughout 2018-2020, supported by prudent financial management practices. We expect that over the next two years, capital spending will trend higher but will not require significant issuance of net new debt given Thunder Bay's efforts to increase its ongoing internal contributions to capital funding. Additionally, we expect that the city's experienced and well-qualified administration will facilitate stability through the change in council that will follow the municipal election set for October 2018.

Healthy operating balances will keep a low debt burden.

Our base-case scenario considers the city's strong budgetary performance that results from modest operating revenue growth around 2% through 2020, and effective cost controls. We expect that operating balances will remain around 15% of operating revenues over 2018-2020. These robust surpluses facilitate the city's ability to internally finance its capital plan and prevent a significant increase in Thunder Bay's debt. Also, we project the city's after-capital balances will show moderate deficits averaging 2% of total expenditures in 2018-2020, given Thunder Bay's capital plan, which calls for higher capital spending in the next several years.

The city has indicated that average capital spending in 2018-2020 could hover around C\$115 million, equivalent to 20% of total expenditures, with the majority of the tax-supported plan designated for maintenance-related road work, facilities renewal, and fleet and equipment replacement. The forecast also includes the capital plan of Tbaytel, the city's wholly owned and fully consolidated telecommunications company.

The high level of modifiable revenues (totaling almost 90% of adjusted operating revenues on average in our 2016-2020 forecast period) grants the city substantial budgetary flexibility, in our view. However, in line with our view of other Canadian municipalities, we believe that Thunder Bay has limited ability to materially cut spending due to a high degree of municipal services that the provinces mandate and that leaves local governments little discretion concerning the costs. Wages and benefits account for more than half of operating expenditures and are often subject to collective agreements, which can further limit budgetary flexibility.

In 2018-2020, we expect the city will borrow close to C\$85 million in gross debt, about half of which will help finance the expansion of Tbaytel's fiber optic network. However, given large principal payments due over the same period, we expect Thunder Bay's tax-supported debt burden to decline to 38.9% of operating revenues by 2020 from 42.8% in 2017. At the same time, we expect interest costs to remain around 1.5% of operating revenues in the outlook

horizon.

Thunder Bay's credit profile is bolstered by what we view as a solid liquidity position. We estimate its free cash and liquid assets (S&P Global Ratings-adjusted) will total C\$98 million on average in 2018 and will be enough to cover more than 2x the estimated debt service for the year. Although we view this level of coverage to be healthy, it remains weaker than that of domestic peers, which tend to carry large liquid balances. In our view, Thunder Bay generates robust internal cash flow, as measured by its operating balance (before interest) exceeding twice its annual debt service requirements. We believe Thunder Bay's access to external liquidity is satisfactory through its access to a strong and diversified pool of domestic banks.

Thunder Bay's contingent liabilities are low and are not a significant credit risk, in our opinion. The city has exposure to litigations, the operations of Thunder Bay Hydro Corp. (a wholly owned provider of regulated and unregulated electric utility services and complementary commercial services), and standard future employee benefits and liabilities and landfill postclosure costs (the latter items total about 10% of operating revenues and the city has reserves in places to cover a portion of these liabilities). We believe that in the unlikely event of financial stress at the utility, the city's support would be limited to less than 5% of its operating revenues.

Institutions remain broadly supportive, and a very strong economy, grounded by a large public-sector presence, helps to mitigate broader economic challenges.

We do not expect significant policy shifts following the upcoming municipal election in October 2018, in part due to the high degree of institutional stability the city enjoys. In our view, the government framework under which Thunder Bay, like other Canadian municipalities, operates 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. 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 exhibits disciplined financial management practices largely in line with those of similarly rated peers. The experienced management team has a good relationship with council, which has exhibited broad political consensus on fiscal policies in the past several years, specifically those aimed at increasing sustainable capital funding and reducing in-year budgetary volatility. The city's annual operating and capital budgets, which we view as realistic, reflect the broad goals outlined in the five-year financial plan. Thunder Bay adheres to prudent debt and liquidity

management policies, and monitors cash flows on a daily basis.

Thunder Bay is the center for many government services for northwestern Ontario and thus its economy focuses largely on the public sector (health care, school boards, and municipal and provincial administration), which acts as a stabilizing force, in our view. The manufacturing, retail, and mining sectors also contribute to the local economy. While GDP data are not available at the local level, we believe the city would generate nominal GDP per capita largely in line with the provincial three-years average of US\$44,200, based on its income levels and higher value-added of some local industries.

We believe that a weaker demographic profile, characterized by a declining population and a larger proportionate number of elderly residents, constrains its economic profile and could affect revenue growth and expenditure needs in the future. According to the 2016 Census, Thunder Bay's population was 107,909, a decline of 0.4% since 2011. The city's proportion of residents aged 65 and over was 20.0%, compared with 16.7% in Ontario, reflecting Thunder Bay's aging population.

Key Statistics

Table 1

City of Thunder Bay -- Selected Indicators					
(Mil. C\$)	--Year ended Dec. 31--				
	2016	2017	2018bc	2019bc	2020bc
Operating revenues	530	532	542	553	564
Operating expenditures	451	450	460	472	484
Operating balance	80	82	81	81	80
Operating balance (% of operating revenues)	15.0	15.4	15.0	14.6	14.2
Capital revenues	18	16	23	23	24
Capital expenditures	85	85	112	113	118
Balance after capital accounts	12	12	(7)	(9)	(14)
Balance after capital accounts (% of total revenues)	2.2	2.3	(1.3)	(1.5)	(2.3)
Debt repaid	29	28	29	32	32
Gross borrowings	35	26	34	34	18
Balance after borrowings	18	11	(3)	(7)	(28)
Modifiable revenues (% of operating revenues)	87.6	87.7	88.2	88.5	88.7
Capital expenditures (% of total expenditures)	15.9	15.9	19.5	19.2	19.6
Tax-supported debt (outstanding at year-end)	230	228	232	234	220
Tax-supported debt (% of consolidated operating revenues)	43.3	42.8	42.8	42.3	38.9
Interest (% of operating revenues)	1.5	1.4	1.5	1.5	1.5
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A

Table 1

City of Thunder Bay -- Selected Indicators (cont.)					
	--Year ended Dec. 31--				
(Mil. C\$)	2016	2017	2018bc	2019bc	2020bc
National GDP per capita (single units)	56,129	58,418	59,938	61,829	63,688

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-Base case

Ratings Score Snapshot

Table 2

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	Strong
Liquidity	Exceptional
Debt Burden	Low
Contingent Liabilities	Low

S&P Global Ratings bases its ratings on local and regional governments on the eight main rating factors listed in the table above. Section A of S&P 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, April 10, 2018. Interactive version available at <http://www.spratratings.com/sri>

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For 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

- Americas Economic Snapshots--May 2018, May 26, 2018
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local and Regional Government Default Study and Rating Transitions, May 8, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Canadian Municipalities, Dec. 1, 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

Ratings Affirmed

Thunder Bay (City of)
Issuer Credit Rating
Senior Unsecured

AA/Stable/--
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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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