FULL ANALYSIS

York (Regional Municipality of)

Issuer Credit Rating
AAA/Stable/—

Primary Credit Analysts:
Paul Judson
CFA
Toronto
(1) 416-507-2523
paul_judson@
standardandpoors.com

Secondary Credit Analysts:
Stephen Ogilvie
Toronto
(1) 416-507-2524
stephen_ogilvie@
standardandpoors.com

RatingsDirect
Publication Date
June 10, 2010

Major Rating Factors

Strengths:

- Strong operating results
- Solid liquidity support
- Robust economy

Weaknesses:

- High and increasing debt burden
- Large growth-driven capital spending requirements

Rationale

The rating on the Regional Municipality of York, in the Province of Ontario (AA-/Stable/A-1+), reflects Standard & Poor's Rating Services' opinion of the following strengths:

- York has posted sound operating results in an environment of sustained cost pressures due to rapid economic development. Its operating surplus averaged 13% of operating revenue from 2001-2008, as the region used development charges (DCs), other growth-related operating revenues, and strict spending control to address strong demand for new and expanded municipal soft services and infrastructure. While local development activity has slowed from its peak in 2007, we think York's continued focus on cost control, alongside savings from the phase-out of certain provincially mandated social programs should keep its operating results in line with historical levels in the near term.
- The region has what we view as a solid liquidity profile. Its cash and investment holdings (minus deferred revenues) stood at C$734 million, or 76% of operating expenditures, at the end of 2008. York also had access to C$477 million in development charge reserves, which

it could access to address short-term liquidity demands. Although the region faces significant cost pressures, we believe its adherence to internal policies governing capital reserving should provide support to its liquidity position.

- We believe York has a highly diversified, dynamic economy that is well-integrated within the broader economy of the Greater Toronto Area (GTA). Like elsewhere in Canada, however, the region has felt the recession's effects. Its unemployment rate climbed to 7.7% in 2009, from 6% in 2008. What's more, its housing starts fell 31% to 6,343 units last year. Nevertheless, we believe York's diversification across business sectors should provide long-term stability. Its top private sector employers include IBM Canada Inc., Magna International Inc., AMEX Canada Ltd. Canada's Wonderland, CGI Information Systems, and United Parcel Systems Canada Ltd.

The following weaknesses mitigate the above strengths:

- York has a high debt burden compared with that of 'AAA' rated domestic and international peers. Its direct debt stood at about C$950 million, or 84% of operating revenue, in 2008. We expect its debt burden to trend upward in the medium term, as the region plans to continue using debentures to finance significant growth-related expenditures. We estimate its direct debt as a percent of operating revenue could reach 117% by 2011. This is similar to our previous debt forecast, in which we foresaw York's burden reaching about 115% by 2010.
- While the region's rapid development is a testament to the strength of its economy, it also creates significant demand for municipal infrastructure, which has contributed to persistently weak after-capital results and substantial debt-financing requirements. York's latest 10-year capital plan calls for C$7.6 billion in gross capital expenditures, of which more than 80% are growth-related. In our opinion, the region's need to install certain infrastructure (such as water and sewer mains) ahead of development exposes it to an element of economic risk. In particular, unexpected economic cycles or a sharp cooling in the housing market could produce slower-than-expected development activity and, in turn, a temporary shortfall in DC collections. In such circumstances, York could be subject to a prolonged period of excess municipal infrastructure capacity, and might have to temporarily redirect property tax revenue or other funds to help service its DC-funded debentures, which could hinder financial flexibility. However, we assume the region would defer growth-related projects in response to deteriorating economic prospects, although we believe some projects, particularly joint water and sewer initiatives with neighboring municipalities, would likely proceed. Furthermore, we understand York can update its development charge background study to incorporate sudden changes in the economic landscape into its capital plans and DC rates as needed. We also take comfort in the region's past success in managing its finances and DC reserves through periods of economic stress.

Outlook

The stable outlook reflects our expectation that York's debt burden will not exceed our current forecast peak. We also expect its local economy to stabilize after the downturn. We further expect its operating results to remain close to the historical average, and its after-capital results to improve steadily in the long term. An increase in forecast debt metrics or a failure to meet any of the other expectations would put downward pressure on the rating.

Economy

York is in the northern part of the GTA. It's the sixth-most populous municipality in Canada, with a population of 1.03 million in 2009. The region consists of nine lower-tier municipalities whose service responsibilities are largely distinct from those of upper-tier York.

The region's population has increased at one of the fastest rates in the country in the past 15 years. In 2009, the number of residents increased a solid 2%, although this was down from the 3%-5% annual growth rate since the late 1990s.

The GTA is the main economic engine of the province. Its economy is the deepest and most diversified in the county, and is home to more corporate head offices than any other city in Canada. Finance, manufacturing, and business professional services are the foundations of Toronto's economy. Locally, we believe York also benefits from a highly diversified economy.

Weathering the recession through 2009

Gauging from a second year of softening construction indicators, the global recession continued to weigh on York's economy in 2009. Housing starts fell 31% year-over-year in 2009. This was in addition to the notable 18% decline in 2008 (see table 1). The number of residential building permits issued in 2009 dropped 14% from the previous year, after falling 20% in 2008. Nevertheless, the absolute amount of building permits the region issued still ranks it as the third-largest issuer in Canada, behind Metro Vancouver and Toronto.

The downturn also hit the larger GTA economy, although to a lesser extent than Ontario as a whole. According to estimates provided to us, GDP for the Toronto census metropolitan area shrunk 2.8% in 2009; however, this was better than the provincial decline of 3.6% for the year. The recession took a toll on the GTA's labor force, although officials expect net job losses to be contained to 2009. Employment fell 1% in 2009, and the unemployment rate increased to 7.7% from 6% in 2008.

Nevertheless, the goods sector, which was hardest hit during the downturn, has improved since the end of 2009, with manufacturing and construction output both posting gains. We expect the service sector to improve in 2010, which points to rising employment overall. We expect Toronto to lead GDP growth in the province during the recovery, with forecast output expansion of 3.7% and 4.1% in 2010 and 2011, respectively.

Table 1

Regional Municipality of York—Economic Statistics

	—Year ended Dec. 31—				
(% change)	2008	2007	2006	2005	2004
Population	2.9	3.4	3.5	3.2	4.1
Employment*	2.0	2.3	1.4	2.2	1.0
Unemployment rate (%)*	6.9	6.8	6.6	7.0	7.5
Building permit values	(20.1)	12.4	6.7	14.2	(6.1)
Housing starts	(17.6)	12	4.8	(7.1)	(7.5)
Taxable assessment base	2.7	3.2	15.4	4.9	17.7

*Figures are for the Toronto census metropolitan area.

Budgetary Performance

To improve comparability across local and regional governments, Standard & Poor's adjusts the published figures of all cities to reflect their budgetary balances on a cash basis. This includes adjustments for certain major accruals and the increase in equity of government business enterprises, and the removal of one-time revenue influences and provincial pass-through income support grants.

Sound operating results

York tends to post above-average operating results. Its annual operating surplus averaged 13% of operating revenue from 2001-2007, and was 15% in 2008. By comparison, the median among 'AAA' rated local and regional governments was 10.3% in 2008.

The region's above-average operating performance has occurred against the backdrop of rapid local population growth and economic development, which have placed tremendous pressures on municipal services. This, in turn, has introduced significant expenditure requirements. From 2001-2007, the region's operating expenditures advanced at a compound annual growth rate (CAGR) of 11%, and grew 5% in 2008. Its primary service responsibilities, which include water and sewer, transit and rapid transit, police and emergency services, waste disposal, and social housing and assistance, accounted for the bulk of expenditures.

Nevertheless, York's rapid development has generated considerable new municipal revenue. Its operating revenue climbed a CAGR of 10% from 2001-2007, and increased 7% in 2008. Its total taxable assessment, excluding market value reassessments, expanded 40% from 1999-2008. Other population- or economically sensitive revenue streams, such as user fees, transit fares, building permits, and certain government transfers, also contributed to operating revenue growth.

York's near-term operating prospects appear favorable to us. The region's ongoing efforts to allocate more operating funds to capital reserves should buttress its operating margin and curb borrowing needs. This reflects council's 2006 policy that governs the use and management of reserves and reserve funds. Its objective is to fund reserves at levels covering the full cost of replacing or rehabilitating major assets according to a 50-year need horizon. The region will contribute C$22.6 million, equal to an estimated 2% of 2008 operating expenditures, to capital reserves for asset replacement in 2010. It also intends to allocate an extra 1% of the property tax levy to capital reserves to the extent the reserve policy dictates.

We also think the province's stated plan to eliminate the GTA Pooling Program and upload the Ontario Disability Support Program (ODSP) to the provincial level by 2013 will provide York material fiscal relief. We estimate the programs' gradual phase-out will save the region close to C$90 million per year, equal to an estimated 9% of 2008 operating expenditures, by 2013 compared with 2008 levels.

While York's operating results should remain what we consider sound, we think its operating revenues and expenditures are poised to slow in tandem with a moderation in the pace of local development. The region is assuming its total taxable assessment will rise 1.7% in 2010, and hover around 1.8%-2.0% per year from 2011-2013. Although these rates stack up well to those of peers, they would mark a departure from the region's rapid rates of about 3%-5% per year from 2005-2009. What's more, while senior governments have been forthcoming in recent years with the Goods and Services Tax rebate, gas tax sharing, and fiscal stimulus, they have accumulated large fiscal deficits that, in our opinion, could hamper their ability to extend new funding commitments to the municipal sector. Nevertheless, we think savings from the gradual phase-out of GTA pooling and the ODSP will give York the flexibility to manage its fiscal pressures in a potentially slower revenue growth environment. So, too, would a moderation in demand for new and expanded municipal services that we assume would accompany a moderation in local development activity. Moreover, we think the region has scope to raise property tax rates as needed. Currently, York assumes it will need to raise the property tax levy 3.5%-3.9% per year from 2011-2013 to maintain budget equilibrium. Although these increases are slightly above the region's levy increases from 2005-2009, they are in line with those at other Ontario municipalities.

Weak after-capital results

York has a record of below-average after-capital results. Its annual after-capital balance averaged about negative 13% of total revenue from 2001-2007, and was negative 10% in 2008 (see table 2). In contrast, the median after-capital balance among 'AAA' rated local and regional governments was close to zero in 2008.

This below-average performance reflects York's use of debt to finance infrastructure needed to accommodate future expected development. As an upper-tier municipality, the region is responsible for the bulk of the area's heavy municipal infrastructure; in York's case, this means water and sewer, transit and rapid transit, and regional roads. Expansion, as opposed to life-cycle maintenance, is the region's predominant capital pressure, given that York welcomes about 30,000 new residents per year. The region estimates its 2010 gross capital expenditure at about C$1 billion, of which nearly 90% is for growth. Water and sewer upgrades and expansion constitute the majority of growth projects. Generally speaking, York must undertake these, as well as certain transit and road projects, before development can occur. The region uses DCs to fund most of its growth-related projects. It levies DCs from developers on a full cost recovery basis (for residential since 2007; retail since 2008; and commercial, industrial, and institutional starting June 2010) under the province's 2007 Development Charges Act. Given the timing mismatch between the upfront cost of certain growth-related projects and the subsequent imposition and collection of DCs, York issues debentures to finance construction, and uses DCs to fund debt servicing. This debt-financing activity has been a major contributor to the region's persistent after-capital deficits and recent growth in direct debt.

We expect York to post further after-capital deficits in the near term, reflecting its plan to continue debt-financing various growth-related capital projects. The region's 10-year capital budget calls for gross capital expenditures of about C$7.6 billion. Of this, nearly 50% relate to water and sewer, 19% to roads, and 19% to transit and rapid transit. Key nonrecurring projects include the Spadina line subway expansion with the City of Toronto (York's estimated cost is C$1.1 billion); joint water projects with Toronto and the Regional Municipality of Peel (York's estimated costs are C$410 million and C$365 million, respectively); the York Durham Sewage System Duffin Creek Plant (the region's estimated cost is C$587 million); the York Durham Sewage System Southeast Collector (its estimated cost is C$546 million); and light rail transit (C$340 million). The region expects to finance 47% of its 10-year plan with debt, 19% with direct DCs, 17% with senior government grants, 14% with property taxes and reserves, 4% with user fees, and the rest with other sources.

Table 2

Regional Municipality of York—Financial Statistics

	—Year ended Dec. 31—				
(%)	2008	2007	2006	2005	2004
Operating balance/operating revenue	14.6	12.5	10.0	13.0	14.1
After-capital spending balance/total revenues	(10.3)	(7.7)	(15.7)	(25.1)	(35.1)
Operating revenues (% change)	7.3	4.5	12.2	11.4	12.9
Operating expenditures (% change)	4.7	1.6	16.1	12.9	10.0
Direct debt/operating revenues	83.9	97.4	92.0	87.0	73.8
Interest costs/operating revenue	4.6	4.7	4.2	3.8	3.1

Liquidity

York's liquidity position is in line with those of other 'AAA' rated international local and regional governments, although it's somewhat below those of other 'AAA' rated domestic municipalities. Its free cash and investment balance (net of deferred revenue) was C$734 million, or 76% of operating expenditures in 2008. While capital expenditure pressures could cause liquidity to decline in the near term, we expect the region's efforts to build capital reserves will buttress its liquidity position in the next decade.

York also maintained C$477 million in a DC reserve and a C$10 million line of credit with a schedule I Canadian financial institution. We expect the region will use a substantial portion of its DC reserve to service debt or fund capital expenditures on a pay-as-you-go basis.

Debt

York's debt burden has increased dramatically in the past decade. At the end of 2008, its direct debt (excluding social housing mortgages) stood at C$952 million, or 84% of operating revenue. By comparison, the median ratio among 'AAA' rated local and regional governments was about 26% in 2008.

We expect York's debt burden to continue rising in the medium term, given the large size of its 10-year capital plan. According to our estimates, the region's direct debt could reach a peak of 117% of operating revenue by 2011. However, this is little changed from our previous forecast of 115% by 2010.

The region's interest bite has risen in tandem with debt. Its interest expense represented about 5% of operating revenue in 2008. We believe this will continue increasing. However, York's development forecast suggests DCs will cover the bulk of the incremental debt service costs, thereby mitigating the impact of the new debt on the region's other revenue sources. Nevertheless, the region's forecasted debt servicing obligations could potentially exceed the provincially-legislated annual debt repayment ceiling, which is equal to 25% of net own source revenues less net debt charges and contractual commitments. We note that the province's definition of net operating revenues in the calculation of its debt limit does not include DCs, which the region relies upon to service a notable portion of its debt burden. We understand that, in order for the region to exceed the provincial debt repayment limit, it would need to obtain approval from the Ontario Municipal Board.

Contingent liabilities

York's other liabilities are relatively minor. Its sick leave, vacation pay, injured workers' compensation, early retirement benefits, and other benefit-related liabilities totaled C$84 million at the end of 2008. The region is also contingently liable for the debt of overlapping entities (for instance, school boards), which totaled C$142 million in 2008.

Peer Comparison

York's immediate peer group consists of the Canadian Regional Municipalities of Durham (AAA/Stable/—), Halton (AAA/Stable/—), and Peel (AAA/Stable/—); the Canadian cities of Brampton (AAA/Stable/—), Mississauga (AAA/Stable/—), and Saskatoon (AAA/Stable/—); the Royal Borough of Kensington and Chelsea (AAA/Negative/A-1+) in the U.K.; the Australian city of Melbourne (AAA/Stable/A-1+); the New Zealand city of New Plymouth (AA+/Stable/A-1+); and Paris (AAA/Stable/—).

In general, York lags its peer group in many key financial indicators. Its economy, however, compares very well with those of its peers. The region has been one of the fastest-growing municipalities of the group. While its population growth moderated in 2008, it remained above all peers with reported figures, save Brampton and Halton. York's unemployment rate tends to remain fairly close to that of the GTA, and of its peer group.

York's operating surplus was slightly better than the 'AAA' rated median in 2008, although it was below those of Durham, Halton, Melbourne, Peel, and Saskatoon. The comparison worsened for after-capital results, as the region's deficit was weaker than all those in its peer group, except Brampton and Mississauga. York's capital expenditures as a share of total expenditures were higher than all of its peers except Saskatoon in 2008.

Its reliance on transfers ranks in the middle of the group: Adjusted transfers from senior governments were lower than those of Durham, Halton, Kensington and Chelsea, Peel, and Paris. York's debt and interest burden remain substantially higher than the 'AAA' medians and the entire peer group.

Ratings Detail (As Of 10-Jun-2010)*		
York (Regional Municipality of)		
Issuer Credit Rating		AAA/Stable/—
Senior Unsecured (27 Issues)		AAA
Issuer Credit Ratings History		
13-Dec-2007	Foreign Currency	AAA/Stable/—
03-Nov-2005		AAA/Negative/—

Ratings Detail (As Of 10-Jun-2010)* (cont.'d)		
29-Jul-2002		AAA/Stable/—
13-Dec-2007	Local Currency	AAA/Stable/—
03-Nov-2005		AAA/Negative/—
15-Mar-2001		AAA/Stable/—

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.