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## Research Update:

# Regional Municipality of York Outlook Revised To Positive From Stable On Stronger Financial Management

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## Research Update:

# Regional Municipality of York Outlook Revised To Positive From Stable On Stronger Financial Management

## Overview

- We have completed our review of the ratings on the Regional Municipality of York following the release of our "Methodology For Rating Local And Regional Governments Outside Of The U.S." criteria (published July 15, 2019).
- York's diverse and growing economy supports the region's increasing revenues, while lower levels of capital spending are resulting in sustained after-capital surpluses and declining debt.
- In the face of slowing-but-positive population growth, York's financial management has adapted its capital planning to better address changing population projections.
- Accordingly, we are revising our outlook to positive from stable and affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on York.
- The positive outlook reflects the possibility that, in the next two years, the region's commitment to fiscal sustainability and improved capital planning will result in solid budgetary surpluses and reduced debt issuance, potentially leading to an average interest burden of less than 5% of revenues.

## Rating Action

On July 29, 2019, S&P Global Ratings revised its outlook on the Regional Municipality of York 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 the region.

## Outlook

The positive outlook reflects the growing possibility that, in the next two years, we could raise the rating to 'AAA' should economic growth support a larger assessment base and that a high level of growth-related capital revenues supports York's evolving capital program. Under these circumstances, York could maintain its strong after-capital surpluses and reduce the need for external financing such that its tax-supported debt burden stays below 120% of consolidated operating revenues through 2021, potentially leading to an

average sustainable interest burden of less than 5%. We would also expect the region to carefully monitor growth and development charge collections to ensure capital spending remains consistent with population growth, and to amend its capital plan if necessary, before considering a positive rating action.

We could revise the outlook to stable if, in the next two years, management's commitment to fiscal sustainability weakened in the face of slower economic growth or a desire for elevated capital spending, resulting in weaker-than-expected operating balances, sustained after-capital deficits, or a rising debt burden that kept interest expenses above 5% of revenues.

## **Rationale**

We base the outlook revision on our view of York's strengthened financial management and decreasing interest burden, which we believe could fall below 5% of revenues in the next two years. In recent years, the region's management has bolstered fiscal sustainability by better aligning infrastructure development with the timing and allocation of population growth. After a period of rapid population growth in the early-to-mid 2000s, which led to significant capital spending and rising debt, population growth has fallen to more manageable levels. This led York to develop a fiscal strategy that limits its use of debt exclusively to finance growth, while collecting taxes and user rates sufficient to build asset-replacement reserves for nongrowth-related infrastructure. The region's slowing accumulation of debt and careful, more flexible capital management supports our improved assessment of financial management.

Our ratings on York also reflect the region's diverse and expanding economy, and increasing population, which have supported strong revenue collections. York's robust operating balances and ongoing after-capital surpluses, which the region transfers into reserves, further support our ratings. Those reserves, along with the region's portfolio of financial investments, support its exceptional liquidity. The ratings also reflect our view of York's high debt burden, which we expect will decline.

### **A strong economy supports York's revenue growth; very strong management and institutional framework also boost the ratings.**

Our very strong economic assessment reflects our belief that York's strong and growing economy will continue to support GDP per capita growth in line with that of Canada. York's economy benefits from its proximity to and integration with the City of Toronto. The region boasts the sixth-largest municipal population in Canada, with an estimated 1.2 million residents in 2018, as well as a sizable employment base of 637,000 jobs. Recent population growth has been manageable, in the 1%-2% range per year. Building activity and assessment growth have been robust and will continue to support revenue growth. Furthermore, York's well-diversified economy should continue to support revenue growth throughout the business cycle, in our view. Assessment growth

has averaged about 2% over the past five years.

We believe York's financial management is very strong and in line with that of regional peers. York's long-term capital plan has evolved in the past several years, reflecting both revised growth estimates and greater financial discipline, and we believe management demonstrates the flexibility to appropriately align capital plans with fluctuations in population growth. The region produces a multiyear budget that matches the term of council and from which management develops annual budgets with achievable revenue and expenditure targets. Moreover, the region has an established commitment to fiscal sustainability through its fiscal strategy process, which successive regional councils have endorsed.

Like other Canadian municipalities, York operates under a very predictable and well-balanced institutional framework. The provincial government imposes fiscal restraint through legislative requirements to pass balanced operating budgets. At the same time, provincial-municipal relationships have been more dynamic than the federal-provincial one, largely because municipal governments are established through provincial statute and not the constitution. In that regard, we expect York's relationship with Ontario will continue to be supportive. Recently, the provincial government launched a review of regional governments, including York Region. We will continue to monitor this review and its implications for York's credit ratings.

**Strong revenue generation and related budgetary surpluses support creditworthiness, while we expect debt burden to decline in the next two years.**

York typically generates large operating surpluses, propelled by its rising population and assessment values. We expect the region to continue generating strong and stable operating balances at about 20% of operating revenues in our base-case scenario for 2017-2021. Furthermore, these surpluses should support York's capital plans and result overall in after-capital surpluses of more than 10% of total revenues. The region has allocated some of its surpluses to asset replacement, to minimize related debt issuance. We view York as having high budgetary flexibility, owing to its above-average household incomes and relatively low tax rates, which we think would support additional regional revenue generation, if necessary.

We expect annual surpluses and strong reserves will help fund the region's capital plan and reduce its reliance on debt funding. We expect capital spending to average about \$570 million per year through 2021, with spending focused on roads, transit, and, to a lesser degree, water and waste water. The current 10-year capital plan allocates C\$6.6 billion to capital projects, of which 27% will be debt-financed. Management expects reserves to contribute the bulk of capital funding. We expect York's debt burden (net of sinking funds) to continue falling, reaching 97.2% of consolidated operating revenue in 2021. Interest currently averages 5.2% of operating revenues.

York demonstrates exceptional liquidity, with liquidity balances that significantly exceed debt servicing requirements. We believe that total cash

and investment balances (excluding long-term net sinking funds and deferred revenue) will total almost C\$2.4 billion in the next 12 months, sufficient to cover over 860% of the total debt service forecast. We believe York's access to external liquidity is strong, in part because of its frequent issuance and its practice of maintaining benchmark issues that bolster liquidity for its debt in the secondary markets. Although the region's capital expenditure plans could cause near-term liquidity to fluctuate, we expect ongoing efforts to build capital reserves will support the liquidity position in the next two years.

## Key Statistics

**Table 1**

Regional Municipality of York--Selected Indicators						
	--Fiscal year ended Dec. 31--					
(Mil. C\$)	2016	2017	2018	2019bc	2020bc	2021bc
Operating revenues	2,169	2,240	2,381	2,513	2,615	2,728
Operating expenditures	1,547	1,707	1,892	1,990	2,093	2,202
Operating balance	622	533	489	523	522	526
Operating balance (% of operating revenues)	28.7	23.8	20.5	20.8	20.0	19.3
Capital revenues	120	207	306	390	436	393
Capital expenditures	621	643	344	744	591	542
Balance after capital accounts	122	96	451	169	367	377
Balance after capital accounts (% of total revenues)	5.3	3.9	16.8	5.8	12.0	12.1
Debt repaid	152	191	161	162	170	179
Gross borrowings	333	300	40	198	103	176
Balance after borrowings	302	206	329	205	300	374
Direct debt (outstanding at year-end)	2,943	3,044	2,898	2,855	2,742	2,653
Direct debt (% of operating revenues)	135.7	135.9	121.7	113.6	104.8	97.2
Tax-supported debt (outstanding at year-end)	2,943	3,044	2,898	2,855	2,742	2,653
Tax-supported debt (% of consolidated operating revenues)	135.7	135.9	121.7	113.6	104.8	97.2
Interest (% of operating revenues)	6.6	6.1	5.6	5.1	4.9	4.7
National GDP per capita (single units)	56,169	58,607	59,879	60,943	62,586	64,363

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable. N.A.--Not Available. N.M.--Not meaningful.

## Ratings Score Snapshot

Table 2

Regional Municipality of York--Ratings Score Snapshot	
Key rating factor	Assessment
Institutional framework	2
Economy	1
Financial management	1
Budgetary performance	1
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa+
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

## Key Sovereign Statistics

Sovereign Risk Indicators, July 11, 2019. An interactive version is available at

<http://www.spratings.com/sri>

## Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Public Finance System Overview: Canadian Municipalities, July 18, 2018
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Guidance | Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

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; Outlook Action

	To	From
York (Regional Municipality of) Issuer Credit Rating	AA+/Positive/--	AA+/Stable/--

Ratings Affirmed

York (Regional Municipality 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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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