MOODY'S
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Credit Opinion: First Nations Finance Authority Inc.

Global Credit Research - 10 Mar 2014

Kelowna, British Columbia, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	A3
Senior Unsecured -Dom Curr	A3

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Key Indicators

First Nations Finance Authority Inc. (Year Ending 3/31)	2009	2010	2011	2012	2013
Total Direct Debt (C$000)					20,776
Loans Outstanding to Clients (C$000)					20,778
Total Cash and Investments (C$000)	891	559	10,690	11,638	12,237
Interest Income as % of Revenues					19.2
Net interest margin (%)					0.10
Operating Margin as % of Revenues	8.9	-18.1	85.9	33.9	-30.1
Cash and Investments as % of Net Debt					119.1

Opinion

SUMMARY RATING RATIONALE

The A3 issuer and debt ratings assigned to the First Nations Finance Authority (FNFA) reflect a strong institutional framework and governance and management structure, the oversight of borrowing members by the First Nations Financial Management Board (FMB) and strong support from the federal government. The strong institutional framework and governance and management structure provide debenture holder security, including the establishment of debt reserve funds and credit enhancement fund as well as a debt reserve fund replenishment requirement of all borrowing members. This is supported by extensive membership and borrowing criteria, balanced by the presently small pool size of small borrowers, limited diversity and limited track record. The ratings also incorporate a strong likelihood of extraordinary support from the federal government.

Credit Strengths

Credit strengths for the FNFA include:

- Strong institutional framework, including debt reserve fund replenishment requirement of all borrowing members

- Oversight and monitoring of borrowing members by First Nations Financial Management Board with powers of intervention

- Liquidity provided by debt reserve fund and credit enhancement fund

Credit Challenges

Credit challenges for the FNFA include:

- Presently small portfolio concentrated in a small number of issuers predominantly located in the Province of British Columbia

- Relatively new organization with limited track record

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

Material improvement in the credit quality, size and diversity of the participant pool along with an increase in liquidity could put upward pressure on the rating.

What Could Change the Rating - Down

A deterioration of the size, diversity or credit quality of the loan portfolio and borrowing members and a reduction in reserves could put downward pressure on the rating. Indications of lower support from the federal government could also put downward pressure on the rating.

Issuer Profile

The First Nations Finance Authority (FNFA) is a non-profit organization without share capital that serves First Nation governments. It is one of three First Nation led national institutions legislated under the First Nations Fiscal Management Act by the Government of Canada. The FNFA acts as a central borrowing agency for financing capital requirements and economic and social development projects of member First Nations. In addition to providing long-term capital financing for member First Nations, the stated objectives of the Authority include the provision of interim financing and short-term investment opportunities for investing First Nations. These investment programs provide investing First Nations with mechanisms for investing excess cash. FNFA is not an agent of the crown nor a crown corporation; obligations of FNFA are not obligations of Canada and are not guaranteed by the federal government.

DETAILED RATING CONSIDERATIONS

The ratings of FNFA reflect the application of Moody's Joint Default Analysis rating methodology for government-related issuers. In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA), which represents FNFA's stand-alone or intrinsic credit strength, and then considers the likelihood of extraordinary support from the Government of Canada (Aaa, stable) in the event that FNFA faced acute liquidity stress, should this extreme situation ever occur.

Baseline Credit Assessment

FNFA's BCA of baa2 reflects the following factors:

Institutional Framework

The First Nations Fiscal Management Act (FNFMA) came into force on 1 April 2006 and established three institutions:

- First Nations Finance Authority (FNFA)

- First Nations Tax Commission (FNTC)

- First Nations Financial Management Board (FMB)

The FNFA was created for the purpose of issuing debentures on behalf of member First Nations. Membership in the FNFA is voluntary and in order for a First Nation to become a borrowing member, several steps must be taken. A First Nation must first request to the Minister of Aboriginal Affairs and Northern Development Canada (AANDC) to be Scheduled to the FNFMA, which sets out its obligations including obligations to FNFA. A potential member must then pass a band council resolution to apply to become a member and satisfy certification requirements with the FMB, which is responsible for financial management system certification for First Nations. As part of this certification process, FMB analyzes the financial performance of the First Nation, including analyzing debt ratios, liquidity and fiscal performance. FMB also aids the First Nation in developing a Financial Administration Law, which outlines the decision making, management, monitoring and reporting with respect to financial administration of the First Nation. Moreover, in addition to the requirement of FMB certification, a First Nation must also gain unanimous approval of the FNFA board before becoming a member. This multi-step membership process aids in maintaining the credit quality of borrowing members and by extension, the loan portfolio.

The FNFMA also grants FNFA the authority to withhold 5% of the amount of any loan into a Debt Reserve Fund (DRF), which could provide liquidity in the event of non-payment by a participating First Nation. Assets in the DRF are invested primarily in relatively liquid securities. In addition to this, the FNFA received C$10 million from the Government of Canada to establish a Credit Enhancement Fund (CEF). The CEF can be used to temporarily offset shortfalls in the DRF, adding another layer of protection for bondholders.

Should there be a non-payment on an obligation, the FNFA would work to recover the payment but can also tap into the DRF. As debt coverage ratios are set above required debt service payments, this allows FNFA to replenish the DRF directly from the Secured Revenue Trust Account (explained below). If there were a shortfall in the DRF, under the Debt Reserve Fund Replenishment Regulations, all borrowing members would be required to replenish the DRF without limit; as such the DRF links all borrowing members together.

While borrowing members presently consist of a pool of small issuers, which generates risks, this is somewhat mitigated by the positive financial results, relatively low debt and strong oversight of borrowers. The FMB conducts regular monitoring and oversight of borrowing members and the FNFMA grants the FMB powers to intervene and arrange a co-management arrangement or third-party management of a First Nation's revenues if necessary. The FNFA also has the power to request intervention by the FMB if the First Nation fails to make a payment or fulfill an obligation under its Borrowing Agreement. The FMB has the power to take control over the treasury functions of a borrowing member that has received a loan and then has access to all revenue streams of that borrowing member.

Furthermore, the FNFMA outlines the uses for which a First Nation can borrow. Namely, it states that members can borrow for infrastructure when borrowing supported by property tax and for economic and community infrastructure tied to social and economic development when borrowing supported by other revenues, such as for capital infrastructure and land.

Financial Position

The FNFA presently receives most of its revenues through grants and contributions (over 60%) from Aboriginal Affairs and Northern Development Canada (AANDC). It also receives investment income (around 10%) and management fees from the Municipal Finance Authority of British Columbia (<1%), who operates their short-term pooled investment funds. FNFA has been managing its pooled investment funds since 1996. While the FNFA has had a limited existence and is only recently developing its borrowing program, it has generally posted positive operating balances. While a deficit was recorded for 2012-13, surpluses averaged around 16% of revenues from 2008-09 through 2012-13. As the FNFA builds its loan portfolio, revenues from interest income from loans to clients are expected to account for a growing and eventually majority share of FNFA's revenues.

As of February 2014, 19 out of 33 approved borrowing members are anticipated to participate in the authority's first debenture issuance. These First Nations communities from across Canada , while relatively small, recorded an average surplus of around 8% of total revenues in the five years to 2012.

Debt and Liquidity

In 2012-13, FNFA began issuing loans to its borrowing members. As at 31 March 2013, it had issued C$20.8 million in loans to members through a financing facility with a Canadian chartered bank. It also received interest payments in 2012-13 of C$299,000 on these loans compared to C$276,000 in interest paid for financing. These loans were provided on an interim basis in anticipation of the FNFA issuing its first debenture, at which time, these loans would roll over into fixed-rate long-term debenture loans.

While the FNFA may issue debentures with bullet maturities, the amortizing structure of loan agreements with borrowing members whereby repayments made by borrowers include amounts designated for principal and interest, provides security for debenture holders. Accordingly, funds paid to the FNFA in excess of immediate debt service requirements are allocated to investments. The Authority's total debt is expected to increase to roughly C$110 million at early 2014 to meet loan requests from borrowing members.

In addition to the liquidity provided by FNFA's reserve funds (DRF and CEF), the Authority also earns income through its pooled investment activities that could be used and has access to revolving bank credit facilities with a Canadian chartered bank. As at 31 March 2013, FNFA held cash and investments of C$12.2 million.

Moreover, once a borrowing agreement is signed with a borrowing member, an irrevocable intercept mechanism, a Secured Revenue Trust Account (SRTA), on the First Nation's revenue streams used to support the loan is put in place. The trust account diverts the gross revenues of those revenues that will be used against borrowing following minimum debt coverage ratios (DCR); anything in excess of that needed for the borrowing is then diverted back to the First Nation. These DCRs depend on the type of pledged revenues in support of the loan, i.e. higher debt coverage ratios are required for higher risk revenues such as land benefit agreements versus government transfers. Invoicing is also based on revenue frequency, so if revenue streams are received monthly, monies toward repayment will be collected monthly and prior to debt service payments. This allows extra time to resolve any issues prior to any debt service payments.

Given its nascent status, the FNFA is presently comprised of only a small number of First Nation borrowing members, which themselves tend to be relatively small in size. Given the currently small size, the loan portfolio is concentrated, both in terms of number of members and by geography; around 80% of members are located in British Columbia. With the ongoing membership negotiations, we expect that the portfolio will both grow in size and diversify in terms of geographic membership. First Nations wishing to access the FNFA must first request to be scheduled under the FNFMA and presently, over 100 First Nations are scheduled. Despite the small portfolio size and the concentration of loans, current members benefit from both generally positive operating results and oversight by and intervention powers of the FMB.

Governance and Management Factors

There are two types of members: borrowing members and investing members. Borrowing members are First Nations that have applied to and have been accepted by the Authority's Board as a borrowing member. Investing Members are First Nations that have invested in the Authority's Pooled Investment Funds. Investing Members cannot be elected to the Board. Borrowing members, however, have the right to be members of the board.

There is a Board of Directors, currently nine directors, but can be a maximum of 11, including a Chair and Deputy Chair. Going forward, the Board will continue to be elected by members (there is an implicit goal of geographical representation throughout Canada). The terms are one year and renewable. Corporate and financial administration is the responsibility of a small professional staff employed by the Authority.

The Act restricts the spectrum of allowed investments to fixed-income securities issued or guaranteed by Canadian governments or Canadian chartered banks or savings institutions. No equity investments are allowed. FNFA has conservative debt and investment management policies, which limits its exposure to market-related risks.

Furthermore, there is an extensive credit approval process. First Nations borrowing through the Authority must meet financial certification requirements and each loan requested from the Authority must be reviewed by the Board and Members of the Authority and receive unanimous approval prior to funding. The annual operating budget is also approved by the Board.

Extraordinary Support Considerations

The Joint-Default Analysis methodology also considers the likelihood of extraordinary support coming from the Government of Canada (Aaa, stable) to prevent a default by the FNFA. Moody's assigns a strong likelihood of support, reflecting the creation and support of FNFA and supporting institutions by Canada through legislation as well as the important government-defined mandate of the FNFA in providing financing for First Nations in Canada.

Moody's also assigns a very high default dependence level between FNFA and the Government of Canada, reflecting the two entities' shared exposure to common economic and financial risks.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in October 2012 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 -70%), high (71 - 90%) and very high (91 - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

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