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CREDIT OPINION
17 September 2018

Update

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RATINGS

First Nations Finance Authority

Domicile	British Columbia, Canada
Long Term Rating	A2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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First Nations Finance Authority (FNFA) (Canada)

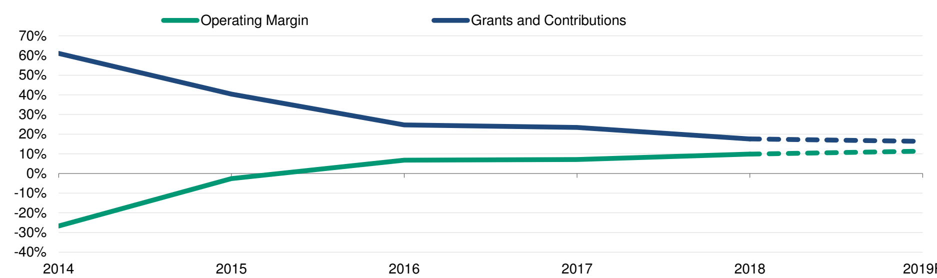
Update following affirmation of rating

Summary

The credit profile of FNFA (A2 stable) reflects continued strong operating performance and sound institutional framework and governance, and solid credit quality of its borrowing members. FNFA's institutional framework and governance and management structure provide debenture holder security, including structural mechanisms from a debt reserve fund (5% of outstanding borrowing), credit enhancement fund and sinking fund, and the joint and several obligation of borrowing members to replenish the debt reserve fund in case of a shortfall. FNFA's credit profile remains constrained by geographic and single-name concentration of the loan portfolio although showing consistent improvement, and a relatively modest history of borrowing and operations.

Exhibit 1

Operating improvement continues with gradually rising operating profitability and declining reliance on government grants and contributions



Source: Moody's Investors Service, FNFA financial statements

Credit strengths

» Strong oversight and intervention power support quality of loan portfolio

» Additional credit protection provided by growing reserve funds

» Solid governance and management structure

» Strong operating performance and increasing diversification of the loan portfolio

Credit challenges

» Rapid growth continues to pressure relative reserve levels

» Modest track record of operations with reliance on government grants

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Rating outlook

The outlook is stable, reflecting our expectations of FNFA's continued stable institutional framework, continued solid operating performance and ongoing diversification of the borrowing base.

Factors that could lead to an upgrade

Material improvements in the credit quality, size and diversity of the participant pool, or an improvement in liquidity (with cash and investment holdings exceeding 20% of net debt on a sustained basis) would result in upward pressure on the rating.

Factors that could lead to a downgrade

A deterioration of the size and diversity of the participant pool, leading to increased geographic or single name concentration, or lower credit quality of the pool members would put downward pressure on the rating. A reduction in liquidity and reserves (with cash and investment holdings below 20% of net debt on a sustained basis) or indications of lower support from the federal government would also result in downward rating pressure.

Key indicators

Exhibit 2

First Nations Finance Authority

(Year Ending 3/31)	2014	2015	2016	2017	2018
Total Direct Debt (C$000)	54,049	107,736	249,840	315,978	441,978
Loans Outstanding to Clients (C$000)	54,143	103,367	246,022	308,569	453,504
Total Cash and Investments (C$000)	13,597	19,820	33,008	59,319	88,476
Interest Income as % of Revenues	33.4	56.4	69.8	71.5	74.5
Net interest margin (%)	0.11	0.16	0.21	-0.03	0.03
Operating Margin as % of Revenues	-26.7	-2.6	6.8	7.2	9.9
Cash and Investments as % of Net Debt	30.9	21.4	14.7	22.1	24.0

Source: Moody's Investors Service, FNFA financial statements

Detailed rating considerations

The credit profile of FNFA, as expressed in its A2 stable rating, combines a baseline credit assessment (BCA) of baa1, and a strong likelihood of extraordinary support from the Government of Canada (Aaa stable) in the event that FNFA faced acute liquidity stress, should this unlikely scenario occur.

Baseline credit assessment

Strong oversight and intervention power supporting the loan portfolio

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 First Nations Fiscal Management Act (FNFMA) came into force on 1 April 2006 and established three institutions (1) First Nations Finance Authority (FNFA), (2) First Nations Tax Commission (FNTC) and (3) First Nations Financial Management Board (FMB).

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 First Nations. 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.

The quality of FNFA's loan portfolio is supported by a stringent qualification process for becoming a borrowing member, a revenue interception mechanism and debt coverage ratio covenants as well as strong intervention powers granted to the authority under the FNFMA.

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Once a borrowing agreement is signed with a borrowing member, an irrevocable intercept mechanism, a Secured Revenues Trust Account (SRTA), is put in place to capture the revenue stream used to support the First Nation's loan. 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.

Stringent qualification process for membership and strong oversight of members

A First Nation must first request to the Minister of Indigenous Services Canada 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. 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 FMB conducts regular monitoring and oversight of borrowing members and has the power 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 capital infrastructure when borrowing is supported by property tax, and for economic and community infrastructure when borrowing is supported by other revenues, such as for capital infrastructure and land.

Additional credit protection provided by growing reserve funds

FNFA maintains two important reserve funds: five percent of all loan requests are held in the Debt Reserve Fund (DRF) and the Canadian government has provided funding to a Credit Enhancement Fund (CEF) which acts as a backstop to the DRF.

The DRF has grown in proportion with the loan portfolio growth. As of August 31, 2018, the DRF grew to CAD28.4 million, and will continue to increase as the aggregate loan amount increases. The DRF provides liquidity in the event of non-payment by a borrowing member. Assets in the DRF are invested mostly in liquid securities. Should there be a non-payment on an obligation, the FNFA would first work to recover the payment but can also tap into the DRF. In case of a shortfall in the DRF a joint and several obligation of borrowing members requires them to replenish the DRF without limit. As debt coverage ratios are set above required debt service payments, this allows FNFA to replenish the DRF directly from the SRTA.

After an initial contribution of CAD10 million to the CEF following FNFA's initial debenture issuance in 2014, the Canadian government has twice increased this amount to CAD30 million during fiscal year 2018. The CEF can be used to temporarily offset shortfalls in the DRF, which provides additional protection to bondholders. The explicit federal support benefits FNFA's credit profile and we anticipate that the federal government would provide additional funding to the CEF as the loan portfolio grows.

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In addition to the liquidity provided by these two reserve funds, FNFA also earns income through its pooled investment activities and has access to CAD220 million revolving credit facility (recently increased from CAD175 million) syndicated across several Canadian chartered banks for financing loans to borrowing members.

Solid governance and management structure

FNFA's Board of Directors currently consists of ten directors. The Board is elected by borrowing and investing members, but only borrowing members can be elected to the Board. The terms are one year and renewable. With the latest election in July 2018, geographical representation of the Board continued to be diversified, which was a key objective of FNFA.

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.

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.

Strong operating performance and increasing diversification of the loan portfolio

FNFA's operating margin rose to 9.9% of revenue in 2017/18 from 7.2% in 2016/17 due to strong interest revenue and federal grants and contributions. We anticipate that the operating margin will remain strong around 10-12% of revenue over the next two years from ongoing strong federal funding and rising interest, investment and management fee income.

The distribution of FNFA's borrowing portfolio continues to diversify with the growth of its loan portfolio, exhibiting improving diversification with solid credit quality of the pool of borrowing members. Loans to members grew to CAD454 million in 2017/18, more than three times its loan portfolio of CAD103 million in 2014/15. We expect that the loan portfolio could grow between approximately CAD100-150 million annually to support strong demand for capital from first nations. Participating borrowing members reached 49 in 2018, up from 13 in the original 2014 debenture issuance. FNFA now has 84 approved members (borrowing and non-borrowing) with more than 170 scheduled and pending membership. The continued increase in FNFA's borrower base and lending activity will help it realize strong operating performance over the next few years.

Although some geographic and single-name concentration remains with the largest share of members in British Columbia, this concentration risk has eased in recent years. FNFA now has scheduled or approved members across all ten Canadian provinces and one territory, with especially robust growth expected in Ontario, Saskatchewan and Manitoba.

Rapid growth continues to pressure relative reserve levels

FNFA targets continued strong growth of its loan portfolio and debenture issues over the next several years. Since completing its first debenture issue (CAD90 million in 2014), FNFA's aggregate debenture size will rise to CAD512 million with the anticipated new issuance of up to CAD135 million. The rapid growth of its borrowing portfolio imposes challenges on FNFA in maintaining adequate reserve levels relative to total outstanding borrowing.

By structure FNFA will continue to transfer 5% of all loan proceeds into the DRF. As a result, the DRF will increase as FNFA's loan portfolio increases. In addition, we expect that the CAD19 million sinking fund will increase over the medium-term as borrowers continue to repay principal under their amortizing loans well in advance of the first debenture maturity in 2024. However, as the loan portfolio grows, the CAD30 million CEF will represent a gradually declining portion of borrowing. Therefore although the absolute level of liquidity will increase in the medium term, in the absence of additional growth in the CEF, the relative level of liquidity could represent a gradually declining share of borrowing over the medium-term.

Modest track record of operations with reliance on government grants

FNFA has a limited track record of operating as a specialized lender, which is reflected in negligible net interest margins as well consolidated deficits prior to 2015/16. FNFA receives a significant portion of its revenues through federal grants and contributions from Indigenous Services Canada. The relative share of federal grants as a component of total revenue has been gradually falling, from over

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70% in 2012/13 to less than 18% in 2017/18 - a trend we expect will continue as the loan portfolio grows - while at the same time the importance of interest revenue from borrowing members has grown. Nonetheless, grants and contributions remain an important component of revenues, and reflects FNFA's ongoing reliance on these funds and support from the federal government to FNFA for its operations.

We project that FNFA will see improved net interest margins over the next several years as it is able to realize greater efficiencies with the expansion of its loan portfolio. As FNFA continues to build its loan portfolio, we expect that it will be able to achieve modest improvements in its operating performance and modest surpluses going forward.

Extraordinary support considerations

Moody's assigns a strong likelihood of extraordinary support from the Government of Canada to prevent a default by the FNFA and 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.

Ratings

Exhibit 3

Category	Moody's Rating
FIRST NATIONS FINANCE AUTHORITY	
Outlook	Stable
Issuer Rating -Dom Curr	A2
Senior Unsecured -Dom Curr	A2

Source: Moody's Investors Service

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