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Financing Pools – Canada

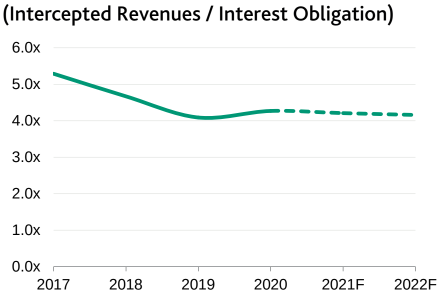
Financing pools show significant credit resilience during pandemic

Both the Municipal Finance Authority of British Columbia (MFABC, Aaa stable) and the First Nations Finance Authority (FNFA, Aa3 stable) reported strong credit metrics despite the pandemic last year, which reflect the stability of their borrowers' revenue bases, the willingness of provincial and federal governments to provide support, and improvements in their due diligence and loan monitoring. We believe these factors and the constraints imposed on borrowers will limit any pressure on asset quality from forecasted loan growth and allow these entities to continue to report strong credit metrics in 2020-2022 (see Exhibits 1 and 2). These trends reinforce the "low risk" categorization we forecasted for these financing pools at the onset of the pandemic.

The pandemic broadly increased the spending of both municipal and First Nations governments related to social and health care, personal and protective equipment and paramedic services. Despite these challenges, almost all[1] pool borrowers continued to make principal and interest payments due to MFABC and FNFA during the year.

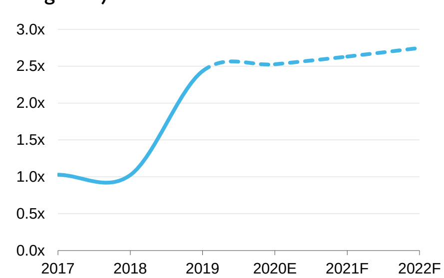
These strong results partly reflect the federal and provincial government support that municipalities and First Nations governments received last year, which in our view reduced the likelihood of any direct government support of MFABC and FNFA. The Government of Canada (Aaa stable) along with the Province of British Columbia (Aaa stable) provided the province's municipalities with approximately CAD1.5 billion in operating grants to support transit, COVID-19 relief, protective services and development CAD170 million in emergency capital grants to support infrastructure and community recovery projects.

Exhibit 1
Interest-coverage ratio will remain strong for FNFA...
(Intercepted Revenues / Interest Obligation)



Year ending March 31.
Sources: FNFA and Moody's Investors Service

Exhibit 2
..and continues to improve for MFABC
(Reserves + Available Liquidity / Interest Obligation)



Year ending December 31. Forecasts for 2020-2022 are based on Moody's projections.
Sources: FNFA and Moody's Investors Service

The federal government also provided CAD17.1 million in community relief to First Nations governments to support COVID-19 health and safety issues or other community priorities.

British Columbia also introduced legislation in 2020 to allow local municipal governments to borrow interest-free from existing capital reserves to meet operating needs, with repayment over five years. Municipalities which borrow from MFABC for short-term operating needs ("revenue anticipation") are now temporarily allowed more favourable repayment terms over two years rather by year-end, to ease potential fiscal pressures. Nevertheless, municipal borrowing from MFABC under revenue anticipation loans to date have not increased above typical levels, evidencing credit resilience within the municipal sector and therefore within MFABC's borrowing base.

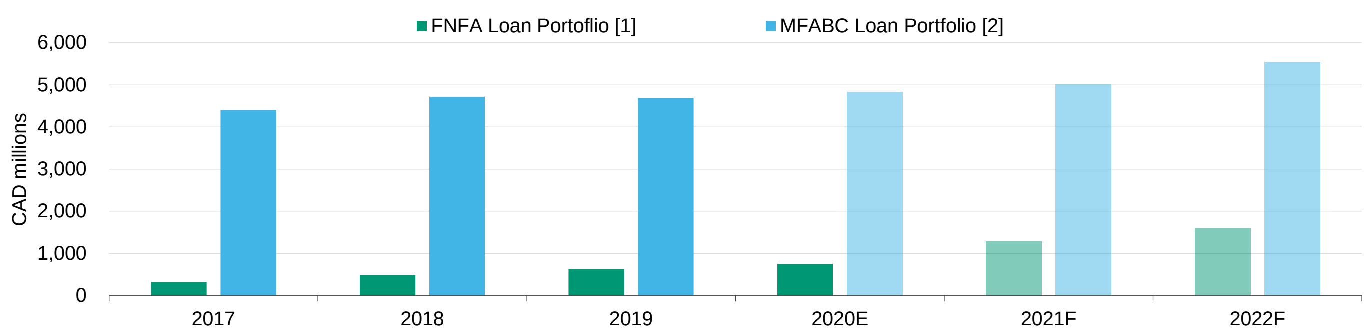
The Bank of Canada also provided liquidity support to public authorities via the Commercial Paper Purchase Program and access to its master repo facility. These measures foster efficient money market and capital market activity and mitigate both short-term and long-term refinancing risk, further supporting the entities' cash flow needs should additional liquidity be necessary.

In addition to government support which has reduced short-term revenue uncertainty during the pandemic, British Columbia's municipal sector and First Nations governments continue to generate most of their revenue from relatively stable sources. For the former, this includes property and other taxes and user fees, which tend not to fluctuate with economic changes. First Nations governments generate income from leases, royalties, and government transfers that - with the exception of some revenue sources like casino revenues which were unfavouably impacted by the pandemic - are also relatively insulated from economic stress. Loan portfolio quality is further safeguarded by requirements that municipalities present balanced budgets, can only borrow long-term for capital spending and borrowing is subject to a comprehensive approval process, and must operate within debt-service limits.

Both MFABC and FNFA also strengthened their already robust monitoring procedures[2] during the pandemic to ensure that any credit stress of a borrowing member could be detected well in advance. For example, MFABC is modernizing its IT infrastructure and cybersecurity and enterprise architecture to increase awareness of the pandemic's impacts. It also increased its engagement with local government finance professionals to ensure early detection of stresses. FNFA hired more staff in 2020 to improve the effectiveness of its member outreach and monitoring, improve document processing efficiency, and enhance business analysis.

We anticipate further growth in MFABC's investment and loan portfolios as MFABC continues to provide low-cost investment to its members and loan support for their capital infrastructure needs including roads, water and wastewater infrastructure, protective services, and recreation projects. FNFA's loans will also grow to support an increasing set of borrowing members and to support First Nations' long-term capital needs and economic projects, which include social infrastructure for education, community health and safety, housing, and protection infrastructure (see Exhibit 3). However, revenue stability, improved loan monitoring and our expectations that further public support to municipalities and First Nation governments would be forthcoming if needed will limit any associated increase in credit risks.

Exhibit 3
The pandemic has not slowed our projection of loan growth



[1] Year ending March 31 for FNFA. 2020 is based on actual data.
[2] Year ending December 31 for MFABC. Forecasts for 2020-2022 are based on Moody's projections.
Sources: MFABC, FNFA and Moody's Investors Service

Moody's related publications

» **Issuer In-Depth:** FNFA - Loan growth highlights critical social role without compromising credit quality, 13 August 2020

» **Credit Opinion**: Municipal Fin. Authority of British Columbia (Canada), 22 May 2020

» **Credit Opinion**: First Nations Finance Authority (Canada), 19 May 2020

» **Sector Comment**: Sub-Sovereign – Canada: Public sector entities face differing risks from coronavirus and oil price shocks, 27 March 2020

Endnotes

1 Two of FNFA's borrowing members requested deferrals on intra-year loan principal payments in 2021 following provincial lockdown orders, but both continued to make good on all revenue intercept obligations. In addition, because the deferrals should be covered within the same fiscal year, FNFA's interest coverage ratios should be unaffected.

2 Both MFABC and FNFA maintain stringent guidelines for monitoring their loan borrowers' credit quality through the onboarding, approval and monitoring process. This process has ensured robust monitoring of the pool participants' credit quality to ensure borrowers' timely cash flow payment of debt service obligations.

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