Date of Release: September 9, 2021

DBRS Morningstar Assigns Commercial Paper Rating of R-1 (middle), Stable Trend, to First Nations Finance Authority

Industry Group: Governments
Subindustry: Sub-Sovereign Governments
Region: Canada

DBRS Limited (DBRS Morningstar) assigned a Commercial Paper (CP) rating of R-1 (middle) with a Stable trend to the First Nations Finance Authority (FNFA or the Authority). FNFA is a not-for-profit, non-share capital corporation with a mandate to provide cost-effective financing, capital planning, and investment management services to First Nations communities within Canada. The rating is predicated on the strength of the legislative framework that provides FNFA with (1) the ability to intercept generally high-quality revenues provided as security through the establishment of secured revenue trust accounts (SRTA), (2) the ability to replenish debt reserves through a joint and several obligation of all borrowers, (3) the right to require third-party intervention into a borrowing member's finances, and (4) credit characteristics of the underlying borrowers. Constraining the rating, however, are the FNFA's untested nature of the intervention and debt reserve fund (DRF) replenishment mechanisms, as well as uncertainty regarding the future composition of the portfolio.

As provided for under the First Nations Fiscal Management Act (the Act), First Nations can borrow against two types of revenues: (1) property tax revenues or (2) revenues that can come from a variety of eligible sources, including royalty payments, leases on reserve lands, contract revenues, band businesses, provincial or municipal transfers, and interest income. Loan proceeds can be used for a range of purposes, including capital infrastructure projects, refinancing existing debt, or for other social and economic development initiatives.

The Authority's lending process is supported by underwriting standards and oversight undertaken in concert with the First Nations Financial Management Board and First Nations Tax Commission (when loans relate to property tax) to ensure a minimum level of creditworthiness and management sophistication among borrowers, as well as the stability and viability of revenue streams pledged as security. DBRS Morningstar notes that the majority of approved borrowers currently exhibit credit characteristics consistent with BB- to BBB-range ratings. In addition, sound underwriting practices are intended to ensure that the quality of the borrowing pool is not materially diluted over time. An eligible revenue stream can only be leveraged up to 75% of the potential borrowing capacity as determined by FNFA. In addition, the FNFA applies different debt service coverage ratio requirements to the different revenue streams supporting the loans, which vary based on the amount of perceived risk. For each loan financed by the Authority to a First Nation, 5% of the gross loan value is withheld in a DRF, subject to replenishment on a proportional basis should the fund balances fall below the total amount contributed by 50% or more, which is required by the Act. FNFA's Board policy is that any DRF accessed will be replenished. The replenishment comes from the additional revenues that flow through the SRTA. This replenishment mechanism creates a joint and several obligation among borrowing members. The credit profile also benefits from a $45.5 million credit enhancement fund provided by the federal government to supply immediate, temporary liquidity to DRFs.

FNFA has established a $400 million commercial paper program that will be used in place of the secured credit facility to fund the bridge financing program prior to loans being financed by long-term fixed-rate debentures. The commercial paper program complies with the "DBRS Morningstar Criteria: Commercial Paper Liquidity Support for Nonbank Issuers."

DBRS Morningstar notes that the number of First Nation borrowers and the size of the associated loan portfolio are expected to grow steadily over time, providing the pool with greater fiscal capacity to support the joint and several obligation to replenish the DRFs. However, there exists the risk that new borrowing members may only meet the minimum established underwriting criteria, which could potentially lead to a gradual dilution in the quality of the pool over time. FNFA has acknowledged this concern and gives consideration to the preservation of its credit rating when reviewing and approving new loans.

RATING DRIVERS

A negative rating action could arise from (1) a material deterioration in the quality of the underlying loan portfolio; (2) a material reduction in funds available for credit enhancement relative to the overall portfolio size; and/or (3) evidence that structural features, such as the DRF replenishment mechanisms, oversight, and intervention of borrowers, do not work as intended. A positive rating action is highly unlikely as FNFA lacks broad revenue-raising ability and access to exemplary liquidity typically available to higher-rated government entities.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/373262.

Notes:

All figures are in Canadian dollars unless otherwise noted.

The principal methodologies are General Corporate Methodology – Appendix 4 – Canadian Government Pooled Lending Vehicles (April 30, 2021; https://www.dbrsmorningstar.com/research/377784), and DBRS Morningstar Criteria: Commercial Paper Liquidity Support for Nonbank Issuers (March 9, 2021; https://www.dbrsmorningstar.com/research/375001), which can be found on dbrsmorningstar.com under Methodologies & Criteria. Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (February 3, 2021; https://www.dbrsmorningstar.com/research/373262).

For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: https://www.dbrsmorningstar.com/research/357883.

The related regulatory disclosures pursuant to the National Instrument 25-101 *Designated Rating Organizations* are hereby incorporated by reference and can be found by clicking on the link under Related Documents or by contacting us at info@dbrsmorningstar.com.

The rated entity or its related entities did participate in the rating process for this rating action. DBRS Morningstar had access to the accounts and other relevant internal documents of the rated entity or its related entities in connection with this rating action.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are resolved within a 12-month period. DBRS Morningstar trends and ratings are under regular surveillance.

The full report providing additional analytical detail is available by clicking on the link under Related Documents below or by contacting us at info@dbrsmorningstar.com.

For more information on this credit or on this industry, visit www.dbrsmorningstar.com or contact us at info@dbrsmorningstar.com.

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Issuer	Debt Rated	Rating Action	Rating	Trend
First Nations Finance Authority	Commercial Paper	New Rating	R-1 (middle)	Stable

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