S&P Global Ratings

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First Nations Finance Authority

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First Nations Finance Authority

Credit Highlights

Issuer Credit Rating
A+/Stable/--

Strengths	Weaknesses
• Strong support from the federal government, given First Nations Finance Authority's (FNFA's) important public policy mandate to facilitate access to capital by First Nations • Strong liquidity and very high capitalization aided by rising annual surpluses • History of prudent risk management underscored by conservative risk tolerances, and revenue intercept mechanisms	• Institutional framework under which First Nations operate in Canada remains somewhat weaker than that of other local and regional governments • FNFA's market share, albeit growing, is still somewhat limited due to a shorter operating record than that of other rated public-sector funding agencies (PSFAs) • High dependence on the government for ongoing support in the form of operational funding and capital transfers to support lending capacity

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the authority's loan book and market position will continue to expand steadily in the next two years and reinforce the importance of its public policy role to the federal government. We believe the federal government will continue to support FNFA's lending activities, injecting capital as required so that the authority's capitalization levels remain high. We also expect that the authority's liquid assets will continue to cover maturing liabilities even in a stress scenario without market access and that access to Canada's deep and diversified bond market will remain unfettered. We believe that risk management practices will remain prudent.

Downside scenario

We could lower our ratings over the next two years if we revised the likelihood of extraordinary support from the federal government to low in scenarios where the importance of the authority's policy role to the government diminished, or the government's oversight of the authority lessened. A material decline in capitalization or significantly deteriorating asset quality that suggests persistently weak underwriting decisions and a lower management and governance assessment could also lead to a downgrade. However, we view these scenarios as unlikely over the outlook horizon.

Upside scenario

On the other hand, we could raise our ratings over the next two years if FNFA's growing loan book leads to the authority financing a substantial portion of the First Nations sector's funding needs and a lengthening record of fulfilling its public policy mandate of lending to the sector in Canada and if higher net income materially reduces the authority's ongoing dependence on the federal government. As well, we could raise our ratings if we were to revise the likelihood of extraordinary support from the federal government to high or greater because of the increased importance of the FNFA's public policy role or strong direction by the federal government in the authority's strategy development and day-to-day operations.

Rationale

Our 'A+' rating on FNFA reflects its capitalization, strong liquidity cushion, prudent risk management, and the presence of several structural mechanisms like revenue intervention, which we expect will anchor its credit quality over the two-year outlook horizon. The rising need for infrastructure building in Canada's First Nations communities coupled with FNFA's unique public policy mandate and expertise in providing affordable financing to First Nations will aid loan growth and strengthen the authority's market share over the next few years. Annual surpluses should continue to increase and lessen FNFA's dependence on the federal government for ongoing support, including operational funding and capital transfers.

The ratings further reflect our belief that FNFA benefits from a moderately high likelihood of receiving extraordinary support from the federal government, resulting in a one-notch uplift to the SACP for the final 'A+' rating. We believe the authority has a strong link with the federal government, which the government's funding support for its operations demonstrates. We also believe FNFA plays an important role for the government via its statutory mandate and public policy role to facilitate access to capital by First Nations. Also supporting our assessment of the authority's important role is the political visibility of First Nations' issues generally, and the considerable need for capital in First Nations communities.

The authority is a financial intermediary that supports access to credit for First Nations in Canada. It borrows in the capital markets and on-lends the proceeds to its borrowers, who are exclusively First Nations. Borrowers use the loan proceeds to build social and economic capital infrastructure on their lands and secure the loan with a pledged revenue stream. The authority began lending to First Nations in 2012 and issued its inaugural bond in 2014. Although it was created via federal legislation, FNFA is not an agent of the Government of Canada. Nevertheless, we believe the authority benefits from a strong and supportive relationship with Canada.

Enterprise risk profile: Prudent risk management and solid structural creditor protection mechanisms will support FNFA's expanding market share

- Despite higher economic disparities and the historically unbalanced, although improving, institutional framework of the Canadian First Nations sector, our assessment of FNFA benefits from Canada's low financial system risk and the sector's low leverage risk.
- We expect that FNFA's growing loan book and market position will strengthen revenue stability and bolster the authority's business position, despite a shorter lending history.
- FNFA's expanding staff will continue to implement strong risk management policies and sufficient strategic positioning, in our view.

We believe that the authority will continue to benefit from solid underlying asset quality. It lends exclusively to First

Nations communities in Canada. There are more than 600 First Nations in the country with capital needs that some have estimated are more than C$20 billion. Those needs are typical of all Canadian communities: infrastructure (water and roads), community-owned housing, equipment, and economic development. FNFA's market position improved meaningfully in 2020 as participating borrowing rose to 74 as of March 2021, up from 59 at year-end 2020, despite a rigorous and stringent qualification process for membership. FNFA currently has over 320 scheduled and pending members, which reflects about half of all the First Nations communities across Canada.

In our view, the institutional framework under which First Nations in Canada operate has historically been weaker than that of other local and regional governments in the country. The frequency and extent of reforms affecting the division of responsibility and revenues between First Nations and other levels of government in Canada have been evolving for over a century. The historical and existing fiscal and legal structures have led to large socioeconomic gaps between First Nations and Canada, in part due to weak equalization mechanisms. Therefore, in our view, the sector's economic resilience is somewhat weaker than that of Canada overall, particularly given the disparities in income per capita across First Nations.

Nevertheless, we believe the institutional framework for First Nations is improving. Reflecting this, the federal government established longer-term 10-year grants available to First Nations as of April 2019, which provide funding that is more predictable than the previous one- and five-year funding agreements. This initiative is part of the new fiscal relationship between the federal government and the Assembly of First Nations that seeks to address some of the system's historical weaknesses and strengthen fiscal self-sufficiency. A prudent legislative framework is in place for FNFA borrowers. Under this framework, First Nations that would like to borrow from the authority must receive a Financial Performance Certificate from the First Nations Financial Management Board indicating compliance with certain financial ratios, among other requirements. In addition, borrowers pledge revenue streams that FNFA prudently discounts to support loan repayments. The sources of these streams directly deposit them in a secured revenues trust account that FNFA uses to repay debt. Over 70% of these revenues come from the federal or provincial governments.

FNFA's business position continues to improve, although we believe it is still somewhat limited by the authority's shorter record relative to that of most other PSFAs. The loan book and market position grew in 2021 and we expect that this will continue, leading ultimately to the authority's dominance as a lender to the sector. The authority's loans to First Nations rose steeply to C$1.23 billion as of March 31, 2021 (up from C$710 million last year).

The authority's solid competitive position will support healthy customer base growth in the next several years, continuing a trend that began when FNFA started lending. We expect that loans will continue to increase anywhere between 10%-20% each year, reflecting members' strong need for capital. According to FNFA, Canada's First Nations communities are standing by with more than C$1 billion in projects that are shovel-ready and need financing. Historically, access to capital has been a challenge for many First Nations. In recent years, access has improved, but some impediments to lenders remain, such as security or lenders' mandates. By statute, land or buildings on First Nations territories cannot be pledged as collateral. We believe that the authority has a strong market position relative to commercial lenders in the First Nations lending space. Over half of the authority's growth was reflected in a C$250 million loan to Mi'kmaq First Nations in January 2021, for the purchase of offshore fishing licenses as part of the C$1 billion purchase of Clearwater Seafoods, the largest seafood company in North America. Despite such a brisk pace of loan growth, we expect FNFA's strategic positioning and organizational effectiveness have remained satisfactory, underscored by strong member due diligence and monitoring procedures, prudent risk management and underwriting policies, and solid governance and member outreach. The authority's management prepares an annual budget and internal loan portfolio and liquidity forecasts. During the pandemic, FNFA hired more staff in its Montreal and Ottawa offices to enhance monitoring, outreach, and analytics capabilities. Although the authority is not subject to banking regulations or equivalent regulatory oversight, we believe that management has instituted strong financial and risk management policies that mitigate key risks.

Financial risk profile: Adequate funding and liquidity, aided by structurally high capitalization, support our favorable view

- FNFA's capital adequacy remained strong in 2021 despite high loan growth, reflecting a proportionate rise in the debt reserve fund (DRF) to C$68.5 million.
- A borrower-funded DRF bolsters liquidity while providing a first-loss cushion for debt service nonpayment.
- Strong liquidity ratios and the structural stability of funding offset some funding concentration.

FNFA's capitalization was very strong in 2021 (year ended March 31) and we expect it will remain so over the next two years. As of the year ended March 31, 2021, the risk-adjusted capital (RAC) ratio before capital adjustments was 184.4%, which was close to last year's metric. The RAC ratio after adjustment was 29.1%, up slightly from the previous year. The main adjustment we make to the after-adjustment RAC ratio is for concentration and that adjustment increased in 2020 as portfolio concentration rose. FNFA's 10 largest borrowers represented 53% of the loan portfolio in 2021, up from 48% in the previous year. Still, we believe the authority's capitalization compares favorably with that of peers, given its low risk profile with an established revenue intervention mechanism.

FNFA's credit enhancement fund (CEF) is one of the two main sources of capital and can be used to temporarily support any shortfall in the DRF; as of year ended March 31, 2021, it was C$45.5 million, up from C$42.5 million a year earlier. The federal government injected C$2.9 million into the CEF in 2021, following a C$12 million injection in 2020 and C$530,000 in 2019. We expect that the federal government will continue to provide capital to FNFA approximately commensurate with the growth of the loan book. We also consider the authority's C$68.5 million DRF to be loss absorbing. FNFA withholds 5% of each member's loan request in the DRF, such that the funding has risen faster annually than its interest obligations at current rates.

We expect FNFA's strong liquidity will continue to support creditworthiness over the rating horizon. In addition to its other liquid funds and about C$20.5 million in cash and cash equivalents, the authority held about C$73 million (up from C$49.5 million last year) in sinking funds as of March 31, 2021. The undrawn portion of FNFA's committed C$300 million revolving credit facility further boosts liquidity and lifts the funding and liquidity ratios. With the undrawn portion of the facility included, FNFA's one-year liquidity ratio with disbursement of all scheduled loans was 1.16x in 2021; with only 50% of loans disbursed, the ratio was 1.8x and with no loan disbursement, it was 4.2x. At the same time, the funding ratio (with loan disbursements) was about 1.2x. FNFA uses the credit facility to bridge timing differences and make loan aggregation more efficient; the facility's undrawn amount can vary substantially throughout the year as a result. The authority announced the potential launch of its commercial paper (CP) program sometime in

2021; the program will replace the credit facility as a funding source for interim financing. When complete, interim loans will be funded by FNFA's CP issuance, which will then be termed out by a long-term bond issue, as happens currently. The federal government is funding the costs associated with the transfer. The authority's credit facility would transition to a backstop to the CP program once the program is up and running.

The Canadian bond market, which we consider deep and diversified, provides 100% of FNFA's funding, making the authority's funding sources somewhat concentrated. Investor diversification is improving, however, based on investor type and domicile. As well, in our view, FNFA's funding versus lending commitments is relatively stable. Although loan terms extend as long as 30 years while bonds mature in a shorter time frame, the authority has sought to mitigate this mismatch through adjustments to its relending rates upon debt refinancing, sinking funds, and revenue intercept mechanisms, among other strategies.

We believe that the authority will continue to benefit from strong risk management practices that will minimize potential losses in the future. It has never experienced defaults or arrears by borrowing members. Its intercept mechanisms, conservative risk tolerances, solid underwriting standards, and intervention powers enhance asset quality, in our opinion. FNFA has intervention power under the First Nations Fiscal Management Act. If a First Nation is unable or unwilling to meet its debt service obligations under its loan agreement or replenish any shortfalls in the DRF, the authority can invoke the statutory intervention provision. If invoked, FNFA, together with the First Nations Financial Management Board, can remove and replace the council of the defaulting First Nation, thereby gaining access to the nation's revenues, including those that cannot be pledged.

Moderately high likelihood of support from the federal government in a stress scenario

We view the likelihood that the Canadian federal government would provide timely and sufficient extraordinary support to the authority in the event of financial distress to be moderately high. We base this assessment on our view of FNFA's:

- Strong link with the federal government, which the government's ongoing financial support for the authority's operations demonstrates, in our view; and
- Important role via FNFA's statutory mandate and public policy role to facilitate access to capital by First Nations. Also supporting our assessment of the authority's important role is the political visibility of First Nations' issues generally, and the considerable need for capital on First Nations' land.

Key Statistics

First Nations Finance Authority -- Selected Indicators

	--Year ended March 31--				
(Mil. C$)	**2021**	**2020**	**2019**	**2018**	**2017**
Business position					
Total adjusted assets	1,475	884	724	543	368
Customer loans (gross)	1,235	711	586	454	309
Growth in loans (%)	73.7	21.3	29.2	47.0	25.4
Net interest revenues	1.8	1.2	1	0	(0)

First Nations Finance Authority -- Selected Indicators (cont.)					
	--Year ended March 31--				
(Mil. C$)	**2021**	**2020**	**2019**	**2018**	**2017**
Noninterest expenses	4.9	4.6	4.2	2.8	2.5
Capital and risk position					
Total liabilities	1420	832	688	510	347
Total adjusted capital	114	83	63	55	36
Assets/capital	12.9	10.6	11.5	10.0	10.2
RAC ratio before diversification	184.4	110.7	97.4	118.7	N.A.
RAC ratio after diversification	29.1	35.0	30.8	32.0	N.A.
Gross nonperforming assets/gross loans	-	-	-	-	-
Funding and liquidity					
Liquidity ratio with loan disbursement (one year)*	1.2	1.8	1.2	0.8	N.A.
Liquidity ratio without loan disbursement (one year)*	4.2	3.3	1.5	1.3	N.A.
Funding ratio without scheduled loans(one year)*	4.2	3.6	1.4	1.1	N.A.

RAC--Risk-adjusted capital. N.A.--Not available. *Includes undrawn portion of credit facility.

Ratings Score Snapshot

Issuer Credit Rating: A+/Stable/--

SACP: a

Enterprise Risk Profile: Adequate (3)

- PICRA: Adequate (3)
- Business Position: Moderate (4)
- Management & Governance: Adequate (3)

Financial Risk Profile Strong (2)

- Capital Adequacy: Very Strong (1)
- Funding and Liquidity: Strong (2)

Support

- GRE Support: +1
- Group Support: 0

Additional Factors: 0

Related Criteria

- Criteria - Governments - International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018

- Risk-Adjusted Capital Framework Methodology, July 20, 2017
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- S&P Global Ratings Definitions, Jan. 5, 2021
- Public-Sector Funding Agencies Risk Indicators: May 2019, May 13, 2019
- Credit FAQ: A Closer Look At The New Public-Sector Funding Agencies Criteria, May 22, 2018

Ratings Detail (As Of August 24, 2021)*	
First Nations Finance Authority	
Issuer Credit Rating	A+/Stable/--
Senior Secured	A+
Issuer Credit Ratings History	
03-Aug-2018	A+/Stable/--
18-Dec-2014	A-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.