Rating Report
First Nations Finance Authority

DBRS Morningstar
October 19, 2022

Contents

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Rating

Debt	Rating	Rating Action	Trend
Commercial Paper	R-1 (middle)	Confirmed	Stable

Rating Rationale

DBRS Limited (DBRS Morningstar) confirmed the First Nations Finance Authority's (FNFA or the Authority) Commercial Paper (CP) rating of R-1 (middle) with a Stable trend. 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 in 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 in 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 of June 30, 2022, FNFA's loan portfolio totalled approximately $1.66 billion, up from $1.53 billion at the time of DBRS Morningstar's last review. Loan sizes range between $0.5 million and $211.9 million, with an average loan size of approximately $20.8 million. Over the years, FNFA's portfolio has increasingly diversified, with borrowing members located across nine Canadian provinces and one territory.

As provided for under the First Nations Fiscal Management Act (FNFMA or the Act), First Nations governments 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 (herein referred to as other revenues).

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. 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. 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 $53.2 million credit enhancement fund provided by the federal government to supply immediate, temporary liquidity to DRFs. FNFA has a $400 million CP program that is used to fund the bridge financing program prior to loans being financed by long-term fixed-rate debentures. The CP 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.

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.

Issuer Description

FNFA is a not-for-profit, non-share capital corporation established through federal legislation and wholly owned by First Nation governments. However, it does not act as a Crown agent or benefit from a federal guarantee. FNFA's mandate is to provide cost-effective loans, capital planning advice, and investment options to First Nation communities within Canada. The FNFA is governed by borrowing members.

Rating Considerations

Strengths

1. Joint and several obligation of borrowing members to replenish DRFs

For each loan financed by the Authority to a First Nation, 5% of the gross loan value is withheld in either the other revenues DRF or property tax revenues DRF, depending on the type of revenue pledged as security for the loan. In the event that the balance of either DRF falls below the total amount contributed by 50% or more, the Authority must direct all members to pay amounts sufficient to replenish the funds which is required by the Act. FNFA's Board policy is that any DRF accessed will be replenished. This replenishment mechanism creates a joint and several obligation among borrowing members in either the other revenues or property tax revenues loan pools.

2. Revenue intercept through SRTA

For First Nations that secure loans with other revenues, the pledged revenues are deposited into an SRTA directly by the payor, pursuant to an irrevocable direction from the borrowing member that continues for the life of the loan. Revenues intercepted must equal or exceed the debt service coverage ratio (DSCR) established by FNFA, which varies depending on the perceived risk of each stream. For property tax revenues, SRTAs are not used, and funds are collected in segregated local revenue accounts in each First Nation community as prescribed by the First Nations Tax Commission (FNTC). Property tax revenue payments are then made directly to the Authority. In addition to approximately $189 million in intercepted revenues (as of June 30, 2022), roughly $1.6 billion in other revenues are available for quick capture if needed.

3. Sound underwriting practices and oversight

In order to become a borrowing member, a First Nation must at least meet the minimum underwriting criteria established by the First Nations Financial Management Board (FMB) and FNFA. The requirements include being a band named in the schedule to the Act; obtaining a Financial Performance Certificate from the FMB (based on five years of satisfactory financial performance); implementing a Financial Administration Law compliant with FMB standards; and, if leveraging property taxes, adopting a law compliant with FNTC standards. After meeting these requirements, unanimous consent of the FNFA Board of Directors is required to admit a new member. Similarly, unanimous consent of all borrowing members and full repayment of loans are required before a First Nation can cease to be a borrowing member and thus end its joint and several obligation to replenish the DRF. This creates an incentive among members to ensure credit quality of the pool is maintained. In addition, both the FMB and FNFA perform annual reviews of all borrowing members.

4. Direct intervention mechanism

The Act affords the Authority the right to direct the FMB to intervene in the financial management of any borrowing member and assume control of treasury functions if a First Nation defaults on a payment obligation or if the Authority judges there to be a serious risk of default. Intervention requests made by the Authority must be carried out by the FMB and may take the form of either a co-management or third-party management arrangement. During an intervention, the FMB or its delegates have the authority to act in place of Chief and Council to manage all property tax revenues or other revenues, even beyond those pledged against loans, to satisfy payment obligations to the Authority. DBRS Morningstar notes that some revenues are not available for intervention, including Crown-Indigenous Relations and Northern Affairs Canada (CIRNAC) health or housing-related transfers.

5. Credit enhancement fund

As of March 31, 2022, the credit enhancement fund (CEF) totals $53.2 million. The CEF was established through contributions from the federal government intended to provide temporary liquidity support to DRFs should they fall below the total amounts contributed by borrowing members. The CEF can be used to meet bondholder obligations or to make sinking fund contributions in the event of non-payment by one or more borrowing members. The CEF must be topped up within 18 months of the first drawdown of funds, using the same replenishment and intervention mechanisms described for DRFs. DBRS Morningstar notes, while the federal government continues to make ad hoc contributions to the CEF, there is no requirement for the CEF to grow in line with the portfolio and, therefore, this liquidity support may be diluted as the loan portfolio grows.

Challenges

1. Untested legal framework and limitations in financial transparency

The debt reserve replenishment and intervention mechanisms contemplated under the Act and associated regulations remain untested from a practical and legal standpoint, as no FNFA member has experienced a late or insufficient loan payment. FNFA and FMB oversight and underwriting standards contribute to a minimum level of financial competency; however, transparency and reporting among individual First Nation communities varies, making external validation and due diligence more challenging.

2. Potential changes in portfolio composition

The loan portfolio has increasingly diversified, with borrowing members located across nine Canadian provinces and one territory, with B. C. accounting for the majority at approximately 34% of borrowing members. This is in line with B.C. being home to a similar proportion of First Nations communities in Canada. By loan value, however, B.C. represents approximately 14% of FNFA's loan portfolio, with Nova Scotia representing the highest exposure to First Nation communities at 23% of total loan portfolio. Additionally, the loan portfolio is secured almost entirely by other revenue streams, although the use of property tax revenues is anticipated to grow, following legislative amendments proposed in Canada's 2021 budget. As its member base continues to grow, FNFA projects the loan portfolio will grow steadily over time (roughly $350 million growth estimated per year). While unlikely, there exists the potential that new borrowing members may only meet the minimum level of creditworthiness under the Authority's underwriting criteria, which could potentially lead to a gradual dilution in the quality of the pool.

3. Potential erosion from existing members' growing appetite for debt

Most approved borrowing members exhibit a meaningful amount of unused borrowing capacity as calculated by FNFA. DBRS Morningstar believes that this may lead existing members to increase leverage, especially in light of the increased availability of cost-effective financing provided through FNFA. As a result, the credit metrics of individual borrowers may experience erosion, weakening the overall quality of the pool. However, DBRS Morningstar notes that additional loan requests will be subject to the same underwriting criteria and approval by FNFA. Further, the Authority remains in discussions with Canada regarding the former's proposal to adopt monetization, which will allow borrowing members access to leverage federal funding streams to accelerate financing for qualifying infrastructure projects.

4. Asset and liability mismatches

Given the range of loan terms made available to First Nation borrowers, there is the likelihood of a mismatch between the term to maturity of FNFA's assets and its liabilities. While borrowing members are able to hedge interest rate risk by locking in longer-term fixed rates through a swap contract, the Authority itself may be exposed to potential refinancing risk should it lose market access. FNFA ensures the revenue streams pledged for the loans will flow for the entire term of the loan or longer.

Operating Performance

Growth in the lending portfolio has rendered FNFA’s operations substantially self-supporting, thereby reducing the Authority's reliance on federal operating grants. Interest from loan programs is the primary source of revenue, accounting for around 79% of total revenues in 2021–22.

The Authority also receives operating funding provided by the federal government through Indigenous Services Canada, accounting for 9.5% of total revenues in 2021–22. This federal funding includes two agreements that are reviewed annually:

1. The Grant Agreement allows for an annual allotment of up to $1.0 million (increased from $0.5 million as at March 31, 2022) and is intended to support core operating costs and miscellaneous expenses (including expenses to maintain credit ratings). The agreement was recently renewed until March 31, 2023 and will continue until requested otherwise by FNFA; and
2. The Comprehensive Funding Arrangement, which is used for the delivery of specific programs and services, amounting to $4.3 million in 2021–22. FNFA expects funds available through this agreement to gradually wind down in light of its programs having achieved self-sufficiency.

FNFA has posted sustained positive results driven by a steadily improving operating performance over the last few years. For the year ended March 31, 2022, FNFA recorded a surplus from operations of $6.1 million, or 12.2% of revenues, compared with a surplus of $2.5 million, or 6.9%, the previous year. In line with Canada's commitment to maintain the fund at around $50 million and following some additional funding to support FNFA's credit profile in a challenging operating environment for borrowing members, CEF contribution increased by $7.7 million in 2021–22 (from $3.0 million in the previous year). As at March 31, 2022, the fund totalled $53.2 million.

In 2021–22, total revenues increased by 37.6% to $50.4 million. Growth in lending activity and an expanding portfolio of borrowing members resulted in an increase in interest from loan programs, which rose by 35.3%. Revenues across other categories also improved, including higher federal grants (+18.6%), investments (+133.6%), and debenture issuance premium amortization (+22.8%). Investment income has grown in relevance as an earnings contributor over the years (5.9% of revenues in F2022). Generally higher interest rates supported revenue from investments, which are limited to high-quality securities as elaborated under the Act.

Total expenditures rose by 29.8% in 2021–22, primarily driven by interest expenses on financing, which comprised the largest component of operating costs at approximately 78%, with modest increases across other expenditure categories.

Net financial assets increased by $5.7 million, mainly driven by the higher annual operating surplus after adjusting for changes to nonfinancial assets—largely, one-time Contingency Fund contributions and the higher CEF contribution.

Outlook

DBRS Morningstar anticipates that FNFA will continue to achieve healthy operating results in the medium term, benefitting from continued growth in its member base and lending activity, investment income supported by higher interest rates, and, to a lesser extent, ongoing support through federal grants, given the funding agreements in place.

Loan Portfolio

Exhibit 1 Geographic Distribution (As a Percentage of Total Loan Portfolio)

Exhibit 1a Borrowing Members

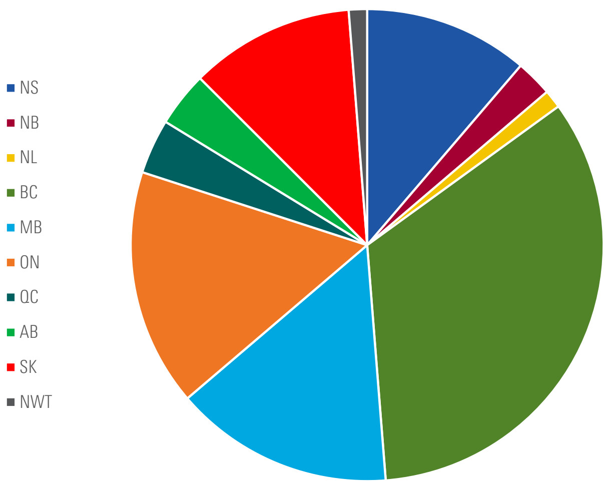
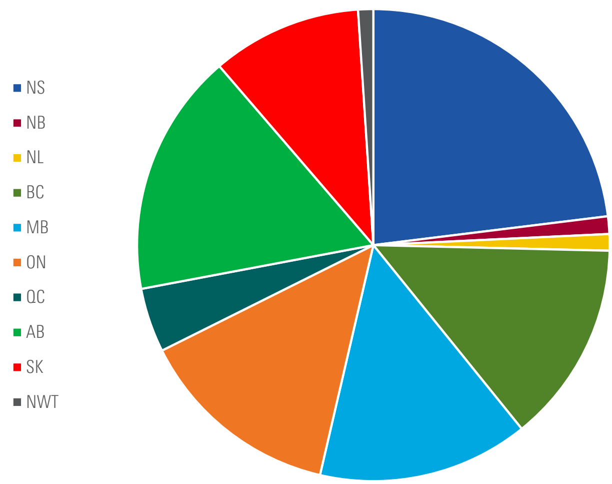


Exhibit 1b Loan Values



Source: DBRS Morningstar.

There are a total of 634 First Nations recognized across Canada, of which 335 First Nations/self-governing communities are included in the FNFMA schedule and operate under the requirements of the Act, which is the first step to becoming an approved borrowing member. FNFA's loan portfolio continues to expand considerably, supported by a growing number of participating First Nations (as defined under the Indian Act). FNFMA amendments are being proposed to allow FNFA to lend to authorities that are funded by the federal government, and to treaty/self-governing bands that operate under the provinces. As part of a phased approach, extending FNFA lending to federally funded nonprofit authorities that cater to a specific need (such as health, utilities, etc.) in First Nations communities is currently underway.

As of June 30, 2022, FNFA's loan portfolio totalled approximately $1.66 billion. Loan sizes range between $0.5 million and $211.9 million, with an average loan size of approximately $20.8 million and a weighted-average remaining term of 24.3 years for the portfolio. Increasingly, many communities are using these loans to identify and support economic opportunities, in addition to community infrastructure.

Over the years, FNFA's portfolio has increasingly diversified, with borrowing members located across nine Canadian provinces and one territory. The majority of the 80 borrowing members are located in B.C.

(34%), Ontario (16%), Manitoba (15%), Saskatchewan (11%), and Nova Scotia (11%), with fewer numbers of borrowing members in Québec, Alberta, New Brunswick, Newfoundland and Labrador, and the Northwest Territories. The location of the borrowing communities has been factored into DBRS Morningstar's assessment of the loan portfolio, with communities in considerably smaller, more remote locations being scored lower on that factor, compared with those that are closer to large urban centres. This approach reflects DBRS Morningstar’s view that First Nations communities that are more centrally located are likely to exhibit relatively greater economic resilience and have access to a wider, more diverse set of revenue sources.

An assessment of the approved borrowing members reveals that most demonstrate credit characteristics consistent with BB- to BBB-range local governments, followed by some members rated in the A (low) range. A large proportion of the portfolio exhibits reasonable fiscal performance and moderate debt burdens and debt servicing requirements in relation to revenues available for interception. An extensive certification process is required for a borrower to be approved as a member by the FNFA, and the oversight and intervention framework facilitated through the Act further influence this view on the credit profiles of participating entities. Furthermore, DBRS Morningstar’s assessment of the individual revenue streams being pledged and the quality of the corresponding payors suggests most to be from investment-grade sources.

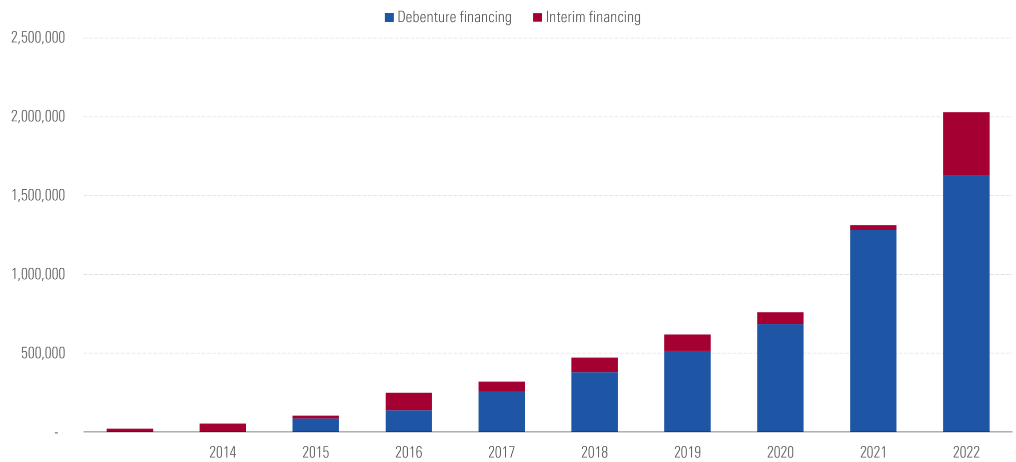
Outlook

The Authority anticipates that the demand for loans will grow as the number of borrowing members continues to grow. Approximately 140 additional First Nations are currently at various stages in the FMB certification process. The Authority is projecting loan growth of roughly $250 million over the next six to eight months, and an annual growth of around $350 million over the medium term.

DBRS Morningstar believes that the requirements established under the Act to qualify to become a borrowing member are sufficiently comprehensive, such that acceptance of additional First Nations members will not necessarily dilute the creditworthiness of the pool. Furthermore, DBRS Morningstar takes comfort in the continual monitoring and oversight by FNFA and the FMB to ensure First Nations governments remain compliant with all requirements of the program.

Debt and Liquidity

Exhibit 2 FNFA Debt (thousands)



Source: FNFA.

At March 31, 2022, the Authority had a total debt of $2.0 billion (F2021: $1.3 billion), which has been used to finance the loan portfolio. Debt comprises $1.6 billion in secured debenture financing and a $400 million CP and revolving credit facility outstanding at YE2022. Following the launch of the CP program in 2021, FNFA has maintained CP outstanding at the program limit, with any unused proceeds being invested in high-quality short-term assets.

Secured Credit Facility

FNFA has a secured revolving credit facility of $400 million, with an additional $50 million accordion feature. The credit facility was historically used to finance loan requests on an interim basis until long-term bonds were issued but is now used to backstop the CP program.

CP Program

FNFA has a $400 million CP program that is used to fund the bridge financing program. The commercial paper program complies with the *DBRS Morningstar Criteria: Commercial Paper Liquidity Support for Nonbank Issuers* because the program is backstopped by the secured credit facility with a syndicate of seven chartered banks and provides for same-day availability in the event that it is required to repay CP. DBRS Morningstar notes there is healthy investor demand for FNFA's CP largely coming from pension funds, asset managers, money market funds, with some demand from corporate, government, and other investors.

Debt Reserve Fund

The Authority is required to withhold 5% of the amount of any loan secured by borrowing members and deposit it into a DRF. The DRFs are intended to be sufficient to cover 24 months of interest obligations of the FNFA. DRF member contributions are only repaid at the later of when a member has fully repaid its loan or when the Authority's debenture matures. The DRF replenishment mechanism is the primary means by which the benefit of the joint and several obligation of borrowers is transmitted to the credit. While in theory, one could assume replenishment calls could be made repeatedly following defaults by members, DBRS Morningstar believes that the limited fiscal capacity of each individual borrower limits the number of times this mechanism can reasonably be expected to be applied successfully. To mitigate this risk, FNFA strives to maintain a diversified loan portfolio, so that no one member would be required to contribute a material amount. The DRF balance stood at $86.8 million as at March 31, 2022.

Credit Enhancement Fund

In addition to liquidity available through the SRTA and DRFs, the Authority is required to maintain the CEF ($53.2 million as at March 31, 2022) established through an agreement with the federal government, which can be used to temporarily offset any shortfalls in the DRFs and/or strengthen FNFA's credit profile.

Sinking Funds

All long-term financing provided by FNFA to approved borrowing members will be in the form of amortizing loans with repayment terms ranging from five to 30 years. All borrowing members in receipt of long-term loans are required to make principal repayments that will be deposited into a sinking fund maintained by the Authority to satisfy the Authority’s own repayment obligations upon debt maturity. At March 31, 2022, sinking fund assets totalled $110.9 million (up from $73.2 million in the prior fiscal year).

However, DBRS Morningstar notes that the term mismatch between FNFA’s own obligations and the loans it provides to borrowers will leave it exposed to refinancing risk. To minimize refinancing risk, FNFA ensures revenue streams pledged for the loans will flow for the entire term of the loan or longer.

Contingency Fund

Established in F2022 following an agreement with CIRNAC, the $32.5 million contingency fund is meant to provide short-term relief to borrowing members in the event of widespread economic shocks arising because of federal mandates (such as pandemic-related restrictions) or similar senior government guidelines that adversely affect pledged revenues to FNFA. Funds are held in a deposit account and can be requested by affected borrowing members semi-annually to cover existing loan interest payments up to a maximum period of 24 months.

Outlook

FNFA funds its long-term loans to borrowing members through the issuance of senior secured bonds. In order to accumulate critical mass for further debenture issuance, the Authority historically used its revolving credit facility to finance interim loan requests; however, this has been replaced with a CP program that is backed by the similarly sized credit facility.

On behalf of First Nations, FNFA has proposed certain recommendations to the federal government, including piloting monetization to replace annual federal allocations toward capital projects (that support the transition from diesel fuel) with a mechanism widely used by Canadian provincial and municipal governments to finance infrastructure. To achieve monetization, FNFA will raise debt in capital markets at current rates and service it annually with federal monies—essentially accelerating infrastructure financing in these communities.

Underwriting/Loan Approval Process

FNFA's primary objective is to make public financing available to as many First Nations in Canada that qualify as borrowing members, without discrimination based on size, location, economic, or social conditions. However, to qualify as a borrowing member, there are several hurdles that must be overcome, which help to ensure that each First Nation seeking financing through FNFA demonstrates a reasonable track record of financial performance and a minimum degree of management sophistication, thereby limiting credit risk. A First Nation must first apply to the federal government to be added to the FNFMA schedule—a voluntary process that signals the First Nation's request to be bound by the Act and recognition that it will operate under Canada's contract laws. The First Nation must then obtain a Financial Performance Certificate or Financial Management Systems Certificate from the FMB. The Financial Performance Certificate requires that applicants meet seven pre-defined financial ratio tests based on five years of audited financial statements and adoption of a Financial Administration Law approved by FMB, and the ratios can be revisited upon request from FNFA. The Financial Management Systems Certificate must be obtained within 36 months of becoming a borrowing member and renewed every three years thereafter. While FNFMB's website states that the Financial Management Systems Certification allows borrowing members to remain in good standing with FNFA, FNFA notes it performs ongoing financial analysis of its borrowing members once they have accessed financing therefore the certificate is not a requirement to remain in good standing but is considered beneficial for communities to achieve.

Once a First Nation becomes a borrowing member, the First Nation must identify the revenue streams it intends to leverage and provide all the supporting documentation to FNFA to determine potential borrowing capacity. An eligible revenue stream can only be leveraged up to 75% of the potential borrowing capacity. Moreover, for loans supported by other revenues, minimum DSCRs ranging from 1.23 times (x) to 4.00x are applied, resulting in the SRTA collecting a greater amount than is required to fulfill an individual borrowing member's loan obligations. The extent of excess coverage varies depending on FNFA's perceived risk of the revenue stream. FNFA intercepts the full amount of the revenue stream from the payor, therefore actual revenues received into the SRTA are much greater than the minimum requirement.

At June 30, 2022, board-approved SRTA intercepted revenues (pledged revenues) were $189 million compared with the interest obligation of $45.7 million, providing an interest coverage ratio of 4.14 times. Actual SRTA revenue flow was higher at $247 million. In F2022, FNFA recorded a prepaid amount totalling $42.5 million following a strong recovery in interceptable revenues above pre-pandemic levels.

Although FNFA's rate increase assumptions are materially conservative compared with actual interest rate hikes in recent months, with FNFA incorporating two modest hikes of 0.5% each into its assessment of revenue stream pledges. In addition to the $247 million in intercepted revenues mentioned above, FNFA has indicated that approximately $1.6 billion in other revenues remain available to it, if needed.

Approval of a loan then requires the unanimous approval of the FNFA Board of Directors, which gives consideration to the preservation of FNFA's credit rating in all its decisions. Only the Authority, and not the borrowing members, can instruct the SRTA manager regarding the allocation and payment of funds out of the SRTA, thus providing an element of liquidity as excess funds can be used to satisfy FNFA's obligations. An SRTA does not apply in the case of loans supported by property tax revenues; however, monies owed by individual members to a property tax revenue account will be collected at least seven days in advance of any corresponding liabilities to FNFA bondholders.

Both the FNFA and FMB perform annual reviews of all borrowing members, thus helping to identify any early signs of financial stress. For those communities that chose to borrow against property tax revenues, legislation requires the review and approval of local revenue laws by the FNTC and that each member's budget provide for the amounts required to satisfy its obligations to the Authority during the budget period.

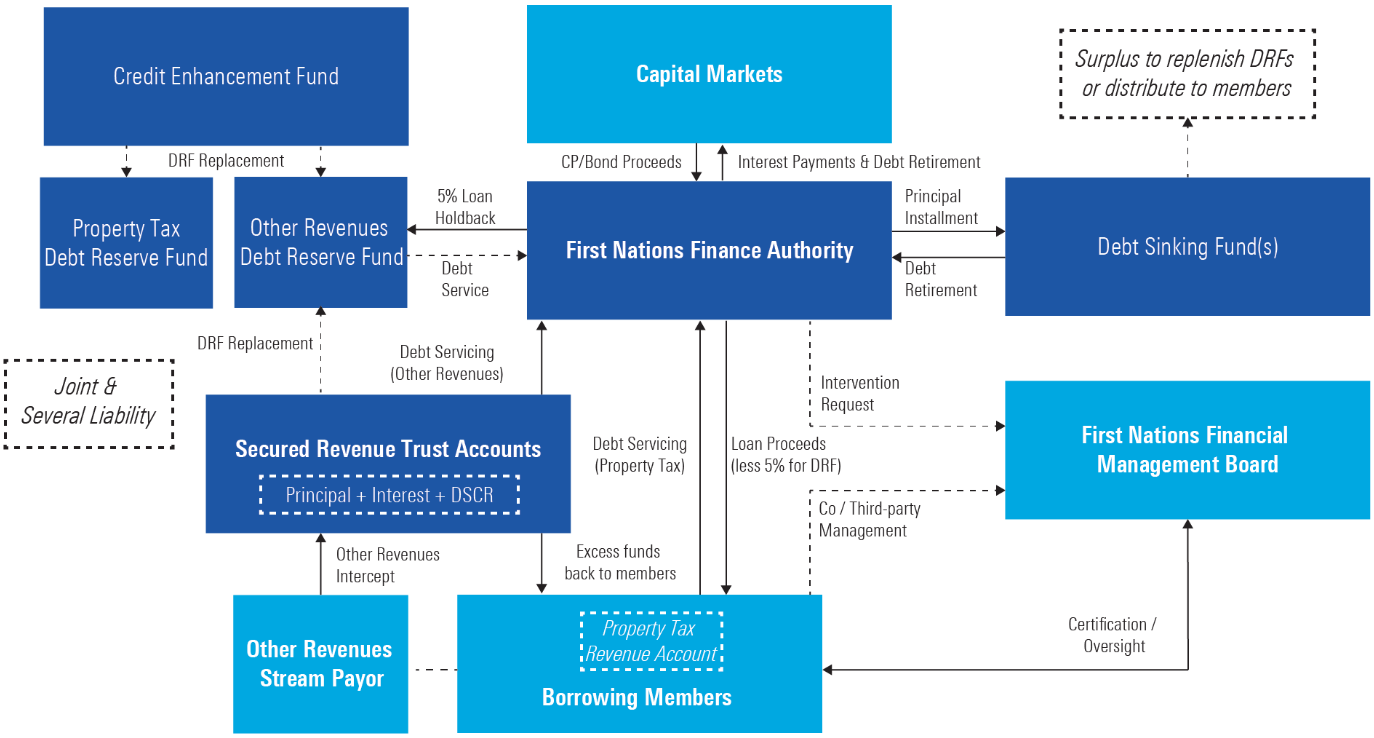
Organizational Structure

The FNFA is a not-for-profit, non-share capital corporation established under the FNFMA, whose purpose is to provide low-cost loan financing, investment management, and capital planning advisory services to First Nations communities in Canada. The Authority is not a Crown Agent or Crown Corporation, nor does it benefit from any guarantees from the Government of Canada. The FNFA is independently governed by a Board of Directors comprising at least five and up to 11 members who are elected to one-year terms by representatives of First Nations that are borrowing members. The Board is responsible for approving all new members and loans and approval requires unanimous agreement, given the joint and several nature of member obligations. This ultimately mitigates potential erosion in the FNFA's credit profile. In order for a borrowing member to leave the pool, all other members borrowing against the same type of revenue must also unanimously agree, even if all loan obligations have been repaid.

In fall 2022, the Authority will welcome four new members (representatives of participating First Nations), bringing the composition of the Board composition to 11 members, aiming for geographic diversity and economic inclusion of First Nations across most Canadian provinces and one territory.

Under the Act and associated regulations, the Authority can lend to a First Nation against revenues from local property tax on reserve lands, from interest in reserve lands, or from rights to occupy, possess, or use lands. The Authority can also lend on the basis of other revenues, including non-property taxes and fees, royalties payable under the First Nations Oil and Gas and Moneys Management Act or First Nations Land Management Act, revenues from leases or permits on reserve lands, contract revenues (e.g., from Crown power corporations, independent power producers, provincial gaming authorities), revenues from band businesses, government transfers (if permitted), and interest earned on deposits, investments, and loans.

Exhibit 3 Operational Structure of Lending Activities



Sources: FNFA and DBRS Morningstar.

For loans secured by property tax revenues, proceeds are permitted to be used for long-term capital infrastructure to provide services on reserve lands, or for short-term financing for cash flow requirements related to operations or capital, including to refinance short-term debt incurred for capital purposes. For loans secured by other revenues, proceeds can be used on or off reserve for any purpose that promotes the economic or social development of the First Nation, including capital infrastructure; rolling stock; land; shares or any other ownership interest in a power-generating, waste, wastewater, or public utility corporation; or short-term financing to meet cash flow requirements for capital purposes or to refinance short-term capital-related debt.

For First Nations that secure loans with other revenues, irrevocable instructions are given to third-party payors to make payments into a lock-box SRTA, with an SRTA Manager managing funds in the accounts at the sole discretion of the Authority. Loans are sized based on a targeted DSCR, which varies depending on FNFA's perceived risk of each revenue stream used as security. For loans backed by property tax revenues, SRTAs are not used, and funds are collected in segregated property tax revenue accounts by each First Nation as prescribed by the FNTC. Property tax revenue payments are then made directly to the Authority.

On an interim basis, the Authority provides short-term financing for up to five years at variable rates. These can then be converted into long-term, fully amortizing loans ranging between five and 30 years at fixed rates. For each loan made by the Authority, 5% of the gross amount is held back and placed in a DRF to service obligations to bondholders in the event of non-payment or default by any borrower. Property tax revenues are separated from other revenues within the operational structure, with each revenue type having a separate reserve fund. The Authority can request replenishment of a DRF at any time, but should a reserve fund fall below 50% of the level necessary for either of the two loan portfolios, replenishment is automatically triggered. Replenishment can be achieved by drawing on additional funds already captured in the SRTAs or by giving borrowing members at least 90 days' notice to direct additional sums into SRTAs or local revenue accounts based on a predetermined formula. Borrowing members are jointly and severally liable to replenish only the DRF of the loan portfolio they have borrowed against. DBRS Morningstar notes that the joint and several nature of membership promotes discipline in the future expansion of the pool as existing members will be mindful of not tying themselves to unduly weak borrowers.

Through multiple contributions from the federal government, a CEF of $53.2 million as of March 31, 2022 (up from $45.5 million in the prior fiscal year because of unbudgeted federal supports) is available that can be used to offset shortfalls in the DRFs and to meet FNFA's debt-servicing obligations.

The Act creates a forceful, though untested, intervention mechanism, which can be activated by any of the three entities—FNFA, FMB, or FNTC—if there is a serious risk of default by a borrowing member or if default occurs. The FMB would intervene to assume control of treasury functions, via either a co-management or a third-party management arrangement, to ensure financial obligations are met and financial viability is restored. This provides an incentive to borrowing members to remain current on their obligations or risk loss of autonomy and additional protection to bondholders. FNFA has confirmed that DBRS Morningstar will be notified in the event of default or risk of default requiring FMB intervention.

At the time of this report, the Authority remains confident that identified revenue streams are sufficient for debt servicing and notes no material concerns regarding any of its borrowing members.

In the event of an insolvency of a borrowing member, the Act grants the Authority priority over those creditors of the First Nation whose claim was created after the date on which the First Nation requested financing from the Authority for loans secured by other revenues. Loans backed by property tax revenues may only be secured through the FNFA, ensuring there are no other creditors with a claim on these revenues.

Rating Approach

The complete rating approach is described in more detail in DBRS Morningstar's *General Corporate Methodology Appendix 4 – Canadian Government Pooled Lending Vehicles*. Below is a summary of the approach.

DBRS Morningstar assesses each borrowing member's fiscal position, debt burden, and debt service requirements (as a share of revenues that FNFA can access to service the loan obligations) to arrive at a band rating for each borrowing member.

DBRS Morningstar evaluates the quality of the existing revenue streams that are pledged for FNFA loans. In cases where a revenue stream comes from a highly rated entity, DBRS Morningstar may provide one rating category of uplift to the individual borrowing member's score.

DBRS Morningstar uses a modified collateralized loan obligation (CLO) approach to assist in its determination of the credit quality of the underlying pool of receivables on a consolidated basis. The final rating is determined by considering the available credit enhancement (incorporating replenishable funds in a debt service reserve) and other qualitative considerations.

The commercial paper program is then assessed using the DBRS Morningstar Criteria: Commercial Paper Liquidity Support for Nonbank Issuers. FNFA's CP program is backstopped by the secured credit facility and provides for same-day availability in the event that it is required to repay CP.

Key Sections of the FNFMA and Regulations

Based on a comprehensive review of the commercial and legislative framework in place as it relates to First Nations subject to the FNFMA, and who thereby qualify as borrowing members, DBRS Morningstar understands that such First Nations are generally subject to Canadian contract law. The Act was designed to provide a framework under which First Nations could access capital markets and provide a number of safeguards to investors through a centralized lending authority. Although not intended to be comprehensive, the list below highlights the key sections of the Act and regulations relevant to FNFA and First Nations.

The Authority

The purpose of the Authority is to (s.74):

- Secure financing for its borrowing members through the use of property tax revenues or other revenues.
- Secure the best possible credit terms for its borrowing members.
- Provide investment services to members.

Borrowing Power

- By way of Board resolution, the Authority may borrow money, issue securities, lend securities, and enter into agreements for risk management purposes (s.75).

Priority

- If a First Nation is insolvent, the Authority has priority over all other creditors:
    - For any moneys that are authorized to be paid to the Authority under a borrowing law with the exception of debts to the Crown (s.78).
    - For any debt that arises after the date on which the First Nation requests financing to be secured by other revenues (s.16 of the Financing Secured by Other Revenues Regulations).

Debt Reserve Fund

- The Authority shall withhold 5% of the amount of any long-term loan to a borrowing member and deposit it in a DRF (s.84).
- If payments from the DRF reduce its balance by less than 50% of the total amount contributed, FNFA may require all members to pay amounts sufficient to replenish the fund. If payments from the DRF reduce its balance by 50% or more of the total amount contributed, FNFA shall require all borrowing members to pay amounts sufficient to replenish the fund.
- For the property tax revenues DRF, the amount a non-defaulting member will be called upon to replenish is based on its share of annual property tax revenues relative to total annual property tax revenues of all non-defaulting members (Debt Reserve Fund Replenishment Regulations).
- For the other revenues DRF, the amount a non-defaulting member will be called upon to replenish is proportionate to their initial contribution to the DRF (Financing Secured by Other Revenues Regulations).

Credit Enhancement Fund

- The Authority shall establish a fund for the enhancement of the Authority's credit rating, which can be used to offset any shortfalls in the DRF (s.85).

Intervention

- After having given notice to the council of a First Nation, the FMB may require the First Nation to enter into a co-management (s.52) or third-party management (s.53) arrangement if there is a serious risk of default on obligations to the FNFA or by request to do so by the FNTC or FNFA (s.12 and 13 of the Financing Secured by Other Revenues Regulations also apply).

First Nations

Legal Capacity of First Nations

- For greater certainty, a borrowing member has the capacity to contract, to sue, and to be sued (s.12).

Local Revenues

- A law regarding the expenditure of local revenues shall not be authorized unless the borrowing member's budget provides for the payment of all amounts payable to the Authority during the budget period (s.11).
- Local revenues of a First Nation shall be placed in a local revenue account, separate from other moneys of the First Nation, and shall be audited at least once a year (s.13 and 14).
- The Authority shall not make a long-term loan to a borrowing member unless the FNTC has approved the member's borrowing law (s.79). A borrowing member shall not obtain long-term financing secured by property tax revenues from any person other than FNFA (s.80).

Terminating Membership

- A First Nation may only cease to be a borrowing member with the consent of all other borrowing members (s.77).

Statement of Operations **($ thousands)**					
Revenue	**2022**	**2021**	**2020**	**2019**	**2018**
Grants and contributions (from CIRNAC)	4,810	3,939	4,147	3,655	2,930
Interest from members	38,796	28,672	22,932	18,603	12,403
Debenture issuance premium amortization	2,888	2,351	1,622	1,182	1,190
Investment income	2,981	1,276	2,937	1,712	1,015
Management fees[1]	811	381	441	386	205
Other	132	23	20	–	–
Subtotal	**50,418**	**36,642**	**32,099**	**25,538**	**17,743**
Nonrecurring items[2]	40,838	(983)	12,432	355	10,106
Total Revenues	**91,256**	**35,569**	**44,531**	**25,893**	**27,849**
Expenses					
Interest expenses	34,397	26,891	21,677	17,538	12,263
Discount or premium amortization	357	353	354	214	56
Debenture issuance costs amortization	1,177	924	700	609	523
Interim financing fees amortization	-	110	104	264	249
Financing fees	1,220	820	541	517	530
Professional fees	840	496	395	368	386
Travel and workshops	211	100	512	355	272
Salaries and benefits	3,084	2,302	1,984	1,579	1,141
Operation and management	524	475	507	408	276
Investment income due to members	2,312	1,535	1,089	873	490
Amortization and depreciation	166	104	43	51	19
Total Expenses	**44,287**	**34,110**	**27,906**	**22,778**	**16,206**
Surplus (Deficit) from Operations	**6,131**	**2,532**	**4,193**	**2,760**	**1,537**
Nonrecurring items[2]	40,838	(983)	12,432	355	10,106
Surplus (Deficit) as Reported	**46,968**	**1,549**	**16,625**	**3,115**	**11,643**

1. Related to fees earned for the management of pooled investment funds.
2. In 2021-22, 2020–21, 2019–20, 2018–19, 2017–18, and 2016–17, includes $7.7 million, $3 million, $12 million, $0.5 million, $10 million, and $10 million contribution from CIRNAC to credit enhancement fund, respectively. 2021-22 also includes a one time Contingency Fund contribution amounting to $32.6 million.
3. In 2017–18 includes $103,422 Goods and Services Tax recovery.
4. In 2021-22, 2020–21, 2019–20, and 2018–19 also includes net realized remeasurement gains and losses of $0.7 million, ($4.0) million, $0.4 million, and ($0.2) million, respectively.

	As at March 31				
Balance Sheet ($ thousands)	**2022**	**2021**	**2020**	**2019**	**2018**
Assets					
Cash and cash equivalents	405,117	20,555	14,348	9,259	6,356
Credit enhancement fund	53,163	45,500	42,529	30,529	30,000
Contingency fund	32,550	–	–	–	–
Accounts receivable	–	–	–	–	1
Prepaid expenses	494	342	306	483	409
Sinking fund investments	110,870	73,179	49,517	34,084	19,101
Debt reserve fund Investments	86,795	68,535	40,853	32,610	24,496
Loans to members	1,540,542	1,234,793	711,000	585,977	453,504
Restricted cash and cash equivalents[1]	60,204	30,779	25,562	30,787	8,521
Tangible capital assets	1,986	1,047	234	178	85
Total Assets	**2,291,722**	**1,474,730**	**884,349**	**723,906**	**542,474**
Liabilities					
Accounts payable and accrued liabilities	878	380	306	253	186
Accrued interest payable	12,728	9,411	6,475	5,277	3,646
Deferred contributions	–	115	199	610	606
Due to members (debt reserve fund)	86,795	68,535	40,853	32,610	24,496
Funds held due to members	19,834	16,589	15,829	22,149	-
Interim financing	400,000	31,239	74,803	104,470	92,663
Debenture financing	1,629,652	1,279,793	684,353	513,934	379,886
Principal and interest payments received in advance	40,046	13,866	9,409	8,313	8,093
Total Liabilities	**2,189,933**	**1,419,928**	**832,227**	**687,616**	**509,576**
Accumulated surplus (deficit)	101,789	54,802	52,122	36,290	32,898
Total Liabilities & Equity	**2,291,722**	**1,474,730**	**884,349**	**723,906**	**542,474**

1. Includes members' capital of $324,000 for all years contributed by a predecessor organization, FNFA Inc., on April 1, 2006. Upon dissolution of the FNFA, contributions shall be first distributed to public bodies having an interest in members capital. Since 2014, also includes principal and interest payments received in advance and funds held due to members since 2019.

Debt & Liquidity ($ thousands)

	Year ended March 31						
Debt Outstanding	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**
Commercial paper	400,000	–	–	–	–	–	–
Series 2014-1 Bonds	251,000	251,000	251,000	251,000	251,000	251,000	140,000
Series 2017-1 Bonds	427,000	427,000	427,000	264,000	126,000	–	–
Series 2020-1 Bonds	594,000	594,000	–	–	–	–	–
Series 2022-1 Bonds	354,000	–	–	–	–	–	–
Secured credit facility	–	31,239	74,803	104,470	92,663	64,978	109,840
Total Debt	**2,026,000**	**1,303,239**	**752,803**	**619,470**	**469,663**	**315,978**	**249,840**

Debt Maturity Profile	Year ended March 31						
(As at March 31, 2022; $ thousands)	**2023**	**2024**	**2025**	**2026**	**2027**	**Thereafter**	**Total**
Commercial paper	400,000						**400,000**
Series 2014-1 Bonds			251,000				**251,000**
Series 2017-1 Bonds						427,000	**427,000**
Series 2020-1 Bonds						594,000	**594,000**
Series 2021-1 Bonds						354,000	**354,000**
Total debt	400,000		251,000			1,375,000	**2,026,000**
% of total debt	**19.7%**	**0.0%**	**12.4%**	**0.0%**	**0.0%**	**67.9%**	**100.0%**

Debt Outstanding

(As at March 31, 2022; $ millions)	**Maturity**	**Amount**
Commercial paper		400.0
Series 2014-1 Bonds	26-Jun-24	251.0
Series 2017-1 Bonds	1-Jun-28	427.0
Series 2020-1 Bonds	16-Jun-30	594.0
Series 2022-1 Bonds	1-Jun-32	354.0
Total Debt		**2,026,000**

Liquidity	**Limit**	**Used**	**Available**
(As at March 31, 2022; $ thousands)			
Cash and cash equivalents			405,117
Sinking fund investments			110,870
CEF			53,163
DRF			86,795
Total			**655,945**

1. Subsequent to fiscal year-end, the credit facility maturity date has been extended to October 9, 2024.

ESG Credit Risk Considerations

Environmental

There were no environmental factors that had a relevant or significant effect on the credit analysis. For more details about which environmental factors could have an effect on the credit analysis, please refer to the following checklist.

Social

There were no social factors that had a relevant or significant effect on the credit analysis. For more details about which social factors could have an effect on the credit, please refer to the following checklist.

Governance

There were no governance factors that had a relevant or significant effect on the credit analysis. For more details about which governance factors could have an effect on the credit analysis, please refer to the following checklist.

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/396929.

ESG Factor		ESG Credit Consideration Applicable to the Credit Analysis:	Y/N**	Extent of the Effect on the ESG Factor on the Credit Analysis: None (N), Relevant (R) or Significant (S)*
Environmental		Overall:	N	N
	Emissions, Effluents, and Waste	Do the costs or risks result in changes to a government's financial standing or relationship with other governments, and does this affect the assessment of credit risk?	N	N
	Carbon and GHG Costs	Does a government face coordinated pressure from a higher-tier government or from numerous foreign governments as a result of its GHG emissions policies, and does this affect the assessment of credit risk?	N	N
		Will recent regulatory changes have any adverse impact on economic resilience or public finances?	N	N
	Resource and Energy Management	Does the scarcity of key resources impose high costs on the public sector or make the private sector less competitive?	N	N
		Is the economy reliant on industries vulnerable to import or export price shocks?	N	N
	Land Impact and Biodiversity	Is there a risk to a government's economic or tax base for failing to effectively regulate land impact and biodiversity activities?	N	N
	Climate and Weather Risks	Will climate change and adverse weather events potentially destroy a material portion of national wealth, weaken the financial system, or disrupt the economy?	N	N
Social		Overall:	N	N
	Human Capital and Human Rights	Compared with regional or global peers, how competitive, flexible, and productive is the domestic labour force?	N	N
		Are labour and social conflicts source of economic volatility?	N	N
		Are individual and human rights broadly respected and in line with the population's expectations?	N	N
		Is the government exposed to heavy, coordinated international pressure as a result of its respect for fundamental human rights?	N	N
		Human Capital and Human Rights:	N	N
	Access to Basic Services	Does a failure to provide adequate basic services deter investment, migration, and income growth within the economy?		
Governance		Overall:	N	N
	Bribery, Corruption, and Political Risks	Does widespread evidence of official corruption and other weaknesses in the rule of law deter investment and contribute to fiscal or financial challenges?	N	N
	Bribery, Corruption, and	Bribery, Corruption, and Political Risks:	N	N
	Institutional Strength, Governance, and Transparency	Compared with other governments, do institutional arrangements provide a similar degree of accountability, transparency, and effectiveness?	N	N
		Are regulatory and oversight bodies protected from inappropriate political influence?	N	N
		Are government officials exposed to public scrutiny and held to high ethical standards of conduct?	N	N
		Institutional Strength, Governance, and Transparency:	N	N
	Peace and Security	Is the government likely to initiate or respond to hostilities with neighbouring governments?	N	N
		Is the government's authority over certain regions contested by domestic or foreign militias?	N	N
		Is the risk of terrorism or violence sufficient to deter investment or to create contingent liabilities for the government?	N	N
		Peace and Security:	N	N
		Consolidated ESG Criteria Output:	N	N

Rating History

	Current	2021	2020	2019	2018	2017
Commercial Paper	R-1 (middle)	R-1 (middle)	–	–	–	–

Previous Report

- First Nations Finance Authority: Rating Report, September 29, 2021.

Related Research

- DBRS Morningstar *General Corporate Methodology* - Appendix 4 - Canadian Government Pooled Lending Vehicles, March 2022.
- *DBRS Morningstar Criteria: Commercial Paper Liquidity Support for Nonbank Issuers*, March 1, 2022.

Notes:
All figures are in Canadian dollars unless otherwise noted.

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