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CREDIT OPINION
4 July 2023

Update

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RATINGS

First Nations Finance Authority

Domicile	Kelowna, British Columbia, Canada
Long Term Rating	Aa3
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 (Canada)

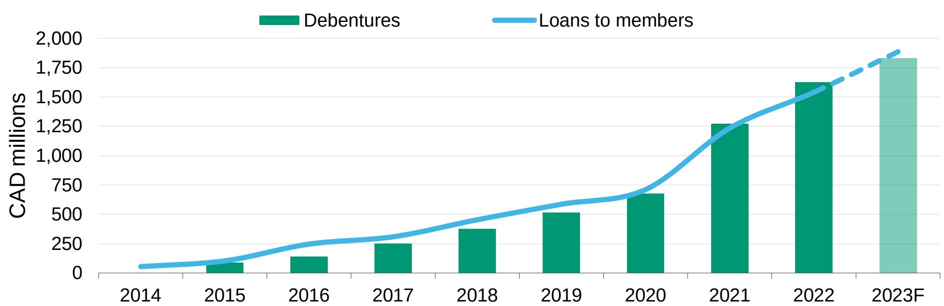
Update to credit analysis

Summary

The credit profile of the First Nations Finance Authority (FNFA, Aa3 stable) reflects a growing loan portfolio with improving member diversification. FNFA's stringent monitoring process and robust structural mechanisms ensures that the credit quality of borrowing members remains strong. Very high levels of intercepted revenues, which gives FNFA priority over cash flows, ensures strong interest and debt service coverage ratios. FNFA's credit profile also reflects both the direct and implicit support of the Government of Canada (Aaa stable). The credit profile is constrained by the challenges of monitoring a dynamic and growing pool of borrowing member financials, and by some volatility in investment returns.

Exhibit 1

Continued loan growth will necessitate rising borrowing
Year ending March 31



Sources: FNFA and Moody's Investors Service

Credit strengths

» Stringent review of pool participants' credit quality enhance loan portfolio quality

» Robust structural credit protection mechanisms support high cash flow coverage

» Additional backstops provide bondholder protection

» Continued member growth and diversity of pool composition

Credit challenges

» Risk monitoring challenges amid rapid loan growth

» Market changes create some volatility in investment returns

Rating outlook

The stable outlook on FNFA's rating reflects the robust institutional framework and governance structure, continued diversification of borrowing members, and our expectation of solid operating results despite market pressures.

Factors that could lead to an upgrade

A material improvement in the credit quality and default tolerance of the pool participants, together with improving diversity of the borrower member pool could lead to upward pressure on the rating. Evidence that continued growth of the member pool does not pose an undue burden on FNFA's risk monitoring capability, which would support a strengthening of our opinion of FNFA's overall governance, could also lead to upward rating pressure. Additional improvements in liquidity above our current expectations could also result in upward rating pressure.

Factors that could lead to a downgrade

A deterioration of the credit quality and default tolerance, size and diversity of the participant pool (such as increased geographic or borrower concentration) could put downward pressure on the rating. A material weakening in liquidity and reserves, or indications of lower support from the federal government including adverse changes to FNFA's Act would also result in downward rating pressure.

Key indicators

Exhibit 2

First Nations Finance Authority

(Year Ending 3/31)	2018	2019	2020	2021	2022	2023F
Total Direct Debt (CAD millions)	469.7	619.5	752.8	1,303.2	2,026.0	2,231.0
Loans Outstanding to Clients (CAD millions)	453.5	586.0	711.0	1,234.8	1,540.5	1,885.9
Total Cash and Investments (CAD millions)	88.5	115.1	157.0	222.0	728.9	583.5
Interest Income as % of Revenues	74.5	76.4	75.2	83.6	81.6	80.5
Net interest margin (%)	0.03	0.17	0.16	0.15	0.24	0.17
Operating Margin as % of Revenues	9.9	11.3	13.8	7.4	14.4	12.7
Cash and Investments as % of Net Debt	22.3	22.0	25.3	19.9	41.8	30.8

Sources: FNFA and Moody's Investors Service

Detailed rating considerations

The credit profile of FNFA, as expressed in its Aa3 stable rating, combines a Baseline Credit Assessment (BCA) of a1, and a strong likelihood of extraordinary support from the Government of Canada in the event that FNFA faced acute liquidity stress, should this unlikely scenario occur.

Baseline credit assessment

Stringent review of pool participants' credit quality enhance loan portfolio quality

FNFA acts as a central borrowing agency for financing capital requirements and economic and social infrastructure development projects of member First Nations. In addition to providing long-term capital financing for member First Nations, FNFA includes the provision of interim financing and short-term investment opportunities for First Nations.

FNFA is one of three First Nation-led national institutions legislated under the First Nations Fiscal Management Act by the Government of Canada. It is not an agent of the crown and its obligations are not guaranteed by the federal government, although the federal government continues to provide direct support to FNFA. 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) the First Nations Financial Management Board (FMB), which is responsible for financial management system certification for First Nations.

FNFA's rating is supported by the pool program management attributes inherent in FNFA's structure and the stringent qualification process for becoming a borrowing member. This includes a comprehensive onboarding process and FNFA's regular monitoring of the pool participants' credit quality to ensure borrowers' timely cash flow payment of debt service obligations. FNFA also has intervention powers granted to the authority under its Act.

A First Nation must first request to the Minister of Crown-Indigenous Relations and Northern Affairs Canada to be scheduled to the FNFMA, pass a band council resolution, and satisfy certification requirements with the FMB. 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, a First Nation must also gain unanimous approval of the FNFA board before becoming a member.

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 can access all revenue streams of that borrowing member.

Robust structural credit protection mechanisms support high cash flow coverage

FNFA's structure includes robust mechanisms that ensure cash flow provides for high coverage of debt service through the life of the loans. 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. Any non-performing revenue stream must be replaced with a performing revenue stream. The trust account diverts the gross revenues of those revenues that will be used against borrowing following minimum coverage ratios; anything in excess of that needed for the borrowing is then diverted back to the First Nation.

FNFA's objective is to have intercepted revenues that at any given time provide at least 2x debt service coverage and 4x interest coverage (2.4x and 4.1x, respectively, at June 20, 2023). We consider these coverage levels to be high, which also reflect the stability of the borrowers' revenue bases despite the pandemic environment, and some improvements in FNFA's due diligence and loan monitoring.

These coverage ratios 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. FNFA has not experienced payment issues related to the pandemic to date.

Additional backstops provide bondholder protection

FNFA maintains two important reserve funds which provide credit protection to bond investors: 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 was set up to enhance FNFA's creditworthiness and act as a backstop to the DRF. Should there be a non-payment on an obligation, 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.

The DRF continues to grow in proportion with the loan portfolio growth, reaching CAD99 million at January 31, 2023, with continued increases projected as the aggregate loan amount increases. The DRF can be used for debt service in the event of non-payment by a borrowing member. Assets in the DRF are invested mostly in liquid securities.

The CEF has grown to CAD53 million at January 31, 2023 following multiple direct contributions by the Government of Canada, and evidencing the federal government's strong support of FNFA. The CEF could 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.

During the 2022 fiscal year, FNFA also received CAD32.5 million from the federal government for a contingency fund, in order to provide 0% loans to FNFA's members in case their revenue streams become adversely impacted due to future federal policies. The contingency fund has grown modestly to CAD33.4 million at January 31, 2023 and borrowing under the contingency fund is not subject to members' joint and several obligations.

FNFA also maintains a CAD400 million commercial paper (CP) program for financing loans to borrowing members. Usage of the CP program exposes FNFA to some rollover risk in the current high interest rate environment, although increases in CP rates are offset by higher short-term lending rates. In addition, the CP program is backstopped by a CAD400 million syndicated revolving credit facility syndicated across several Canadian chartered banks. Borrowing under the CP program and the credit facility is jointly limited to CAD400 million, limiting aggregate exposure.

Continued member growth and diversity of pool composition

We anticipate continued strong First Nations interest across Canada to borrow through FNFA and benefit from FNFA's favourable lending rates. FNFA's borrowing base has grown significantly over the last eight years, with the number of borrowing first nations growing to 87 in March 2023 from only 13 borrowers of its 2014 debenture issuance. FNFA now has scheduled or approved members across all ten Canadian provinces and the Northwest Territories, with 151 members at March 31, 2023 and 342 scheduled members. Concurrently, loans to members grew to an estimated CAD1,541 million at 31 March 2022 with further growth projected to CAD1,886 million at March 31, 2023.

The distribution of borrowing composition continues to diversify with the growth of FNFA's loan portfolio, exhibiting solid credit quality of the pool of borrowing members. The loan portfolio continues to diversify away from a previous significant concentration in the province of British Columbia, which in 2014 accounted for 65% of borrowers, removing some of the geographic concentration risk of the agency's lending portfolio. Over the last seven years, borrower concentration has significantly improved, with borrowers across 9 provinces and 1 territory. However, the loan concentration to the top five borrowers, which stood at 40% in April 2023, creates some concentration risk.

On June 20, 2023 an amendment to the FNFMA (Bill C-45) became law, which expanded the definition of "borrowing member" as defined within the FNFMA, enabling FNFA to extend loans to non-profit organizations that provide indigenous public services including healthcare and utilities, and Treaty Bands. The expanded definition enhances the potential borrower base for FNFA and will likely result in additional loan growth.

Risk monitoring challenges amid rapid loan growth

FNFA targets continued strong growth of its loan portfolio over the next several years which creates some governance and monitoring challenges and requires enhanced due diligence. Despite the robustness of the onboarding process, in our view this level of growth has put some pressure on FNFA's due diligence and its risk monitoring capability, including its capacity to review and prudently analyze the fiscal health of current and pending members including a large number of documents and agreements.

The monitoring process is also challenged by late financial reporting by some of the existing borrowing members, which makes evaluating the fiscal and credit health of borrowers more difficult. However, it is FNFA's practice to deny new loans to these borrowing members until the requested financial statements are produced.

Market changes create some volatility in investment returns

FNFA earns investment returns on its various funds, with investment income growing in size and relative importance over the last six years (13.8% of total revenue projected for 2022-23). However, market volatility - related to macroeconomic events that result in market destabilizations - has created some volatility and could pressure investment returns. For example, investment returns dropped 57% year-over-year in 2020-21 due to market stresses, while 2021-22 investment returns were largely unchanged relative to 2019-20 levels.

Investment returns could be adversely impacted by heightened global macroeconomic volatility that could weigh on asset price appreciation and dividend income. Nevertheless, FNFA's conservative debt and investment management policies which limit investments to highly rated securities, which limits its exposure to market-related risks. Its Act restricts the spectrum of allowed investments to fixed-income securities issued or guaranteed by Canadian governments or Canadian chartered banks or savings institutions. Equity investments are not allowed.

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.

ESG considerations

How environmental, social and governance risks inform our credit analysis of FNFA

Moody's takes into account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of FNFA, the materiality of ESG to the credit profile is as follows:

The exposure to environmental risks is low. FNFA's limited operations as a financial authority do not expose it to natural capital, water management or other environmental risks. Although some of the borrowing First Nations bands may be exposed to environmental risks including wildfires or flood risk, disaster relief from the provincial and federal governments mitigate this risk.

The exposure to social risks is low. FNFA's exposure to social risks, such as demographics and health and safety related risks, is indirect through the pressure these may have on the borrowing members' financial health and in turn their ability to pay their loan obligations to FNFA.

FNFA's governance risk is moderate. The institutional framework is strong with a stringent member onboarding process and strict guidelines on lending and monitoring borrowers' credit quality. The constantly changing borrower pool landscape presents some governance challenges, including administration capacity constraints evaluating a high volume of member applications while needing to monitor member credit quality.

Further details are provided in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology 'General Principles for Assessing Environmental, Social and Governance Risks'.

Rating methodology and scorecard factors

The assigned BCA of a1 is close to the scorecard-indicated BCA of aa3. For details about our rating approach, please refer to the Public Sector Pool Programs and Financings Methodology (April 2020) and Government-Related Issuers Methodology (February 2020).

Exhibit 3

First Nations Finance Authority - 2022 Scorecard

Public Sector Pool Programs and Financings Methodology

Baseline Credit Assessment (BCA) – Scorecard	Base Weight	Sub Factor	Score
Factor 1: Credit Strength and Default Tolerance (50%)			
Credit Quality and Default Tolerance Score	50%	Aa	Aa
Factor 2: Diversity of Portfolio (20%)			
Number of Borrowers	10%	87	Aa
Percentage of Loan Principal to Borrowers that Represent Less than 1% of the Pool	5%	27.34%	Aa
Percentage of Loan Principal to the Top 5 Borrowers	5%	39.54%	Aa
Factor 3: Debt Structure (30%)			
Cash Flows	20%	Aa	Aa
Counterparties	10%	A	A
Notching Factors			
Unusually Strong or Weak Management		-1	
Concentration of Pool Participants in a Volatile Sector		0	
Total Notching Adjustments		-1	
Scorecard-Indicated BCA Outcome			aa3

Financial year-end 31 March 2022

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
FIRST NATIONS FINANCE AUTHORITY	
Outlook	Stable
Baseline Credit Assessment	a1
Issuer Rating -Dom Curr	Aa3
Senior Secured -Dom Curr	Aa3

Source: Moody's Investors Service

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