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Research Update:

City of Guelph Outlook Revised To Positive On Expected Continued Good Liquidity

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Research Update:

City of Guelph Outlook Revised To Positive On Expected Continued Good Liquidity

Overview

- We are revising our outlook on the City of Guelph to positive from stable.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on Guelph.
- The positive outlook reflects Standard & Poor's expectation that throughout the two-year outlook horizon, Guelph will maintain robust liquidity levels, tax-supported debt will not materially exceed current levels (and should in fact decline slightly within several years), and after-capital deficits will not materially exceed 5% of total revenues.
- The ratings reflect our opinion of the city's stable economy, its strong liquidity, and a debt burden that we expect to moderate over the next several years.

Rating Action

On Aug. 24, 2012, Standard & Poor's Ratings Services revised its outlook on the City of Guelph, in the Province of Ontario (AA-/Negative/A-1+), to positive from stable. At the same time, Standard & Poor's affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on Guelph.

The outlook revision reflects our expectations that Guelph will maintain robust liquidity levels, tax-supported debt will not materially exceed current levels (and should actually decline slightly within several years), and after-capital deficits will not materially exceed 5% of total revenues.

Rationale

The ratings on Guelph reflects Standard & Poor's opinion of the city's stable economy, its strong liquidity, and a debt burden that we expect to moderate over the next several years. We believe that persistent-but-modest after-capital deficits and continuing exposure to the manufacturing sector, which has struggled in Ontario, constrain the ratings.

We believe Guelph's economy is relatively well-diversified for a city of its size. Its unemployment rate remains below the provincial average and is in fact, among the lowest in Canada. Manufacturing still accounts for a large portion of the labor base, and the region is host to several auto parts manufacturers. A strong, stable public sector with a large university, schools, hospitals, and municipal, county, and provincial government offices offset this concentration, in our opinion.

Guelph has maintained what we view as robust liquidity, with free cash and liquid assets as well as total reserves and reserve fund balances trending upwards in recent years (all figures Standard & Poor's-adjusted). Under our conservative base case scenario, which forecasts significant use of liquidity to fund capital, we believe that free cash and liquid assets will remain sufficient to cover more than 350% of total debt service throughout our two-year outlook horizon.

The city recently modified its capital plans to place more emphasis on infrastructure renewal and replacement, reduce debt-financed projects, and push some growth-related projects into later years. This has resulted in our expectation of debt moderating to closer to 30% of operating revenues by 2016 from almost 40%. This level is in line with that of domestic peers and should remain very manageable, in our view.

Guelph has generated what we view as healthy operating balances, but these have weakened slightly in recent years. High capital expenditures, particularly in 2010 and 2011, have resulted in persistent, although modest, after-capital deficits. This has hampered the city's budgetary performance. Although we expect that modest after-capital deficits, not materially exceeding 5%, will continue throughout the outlook horizon, Guelph does have substantial cash reserves which it can use to internally finance them.

Outlook

The positive outlook reflects Standard & Poor's expectation that throughout the two-year outlook horizon, Guelph will maintain robust liquidity levels, tax-supported debt will not materially exceed current levels (and should in fact decline slightly within several years), and after-capital deficits will not materially exceed 5% of total revenues. We could revise the outlook to stable if operating performance were to falter or capital spending were higher than expected resulting in operating balances of less than 5% of operating revenue or consistent after-capital deficits greater than 5% of total revenue. A meaningful decline in liquidity levels would also place downward pressure on the ratings. We could raise the ratings if the city's financial performance were to meet our expectations and there were no material weakening of the local economy.

Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

Guelph (City of)

Outlook Revised To Positive

	To	From
Issuer credit rating	AA/Positive/--	AA/Stable/--

Rating Affirmed

Senior unsecured debt	AA
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