

Research Update:

City of Guelph Ratings Affirmed At 'AA+'; Outlook Remains Stable

August 20, 2020

Overview

- We believe that the global COVID-19 pandemic will negatively affect many economic sectors and employment in the City of Guelph, and pressure its finances in 2020, but that a large public sector presence helps foster longer-term stability in the local economy.
- The city plans to partially debt-finance its large capital program, which will result in its debt burden increasing to about 45% of operating revenues by 2022.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on Guelph.
- The stable outlook reflects our expectation that Guelph will continue to generate robust operating surpluses, helping to mitigate the increase in the tax-supported debt burden to more than 40% of operating revenues beyond 2021.

Rating Action

On Aug. 20, 2020, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the City of Guelph, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, Guelph's liquidity will remain very healthy and although increasing capital expenditures will pressure after-capital balances, the city's robust operating surpluses will help to mitigate the increase in the tax-supported debt burden to more than 40% of operating revenues beyond 2021.

Downside scenario

We could lower the ratings in the next two years if the city's operating revenue growth was lower than expected such that Guelph generated persistently weaker operating balances and large

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after-capital deficits.

Upside scenario

We could raise the ratings in the next two years if, all else equal, Guelph's financial management practices strengthened in line with those of higher-rated peers, including the adoption of multiyear operating budgets. Alternatively, if the city were to consistently generate after-capital surpluses due to better-than-expected revenue growth or lower capital expenditures, this would also put upward pressure on the ratings.

Rationale

The slowdown in economic activity brought about by the COVID-19 pandemic and its associated restrictions will create a challenging operating environment for Guelph in the next two years. However, we believe that over the longer term the city's economy will remain broadly healthy, underpinned by sizable manufacturing and public sectors. In addition, we expect that Guelph's prudent financial management and cost-containment efforts will help it generate robust operating surpluses in the next several years, although elevated capital spending--partially debt-financed--will pressure after-capital balances.

A solid economic base, grounded by a large public sector, and strong financial management practices bolster the ratings.

We believe Guelph's economy will contract in 2020 and begin to recover over the next two years as social distancing measures ease. Despite what we view as a temporary shock, we believe Guelph continues to demonstrate characteristics of a strong economy, including a broad manufacturing sector and a large public sector, consisting of a university; schools; hospitals; and municipal, county, and provincial government offices. We estimate that Guelph's GDP per capita is approximately in line with that of the national economy at about US\$42,000.

In our view, Guelph's credit profile benefits from generally good political consensus in passing budgets without material delays, and demonstrates effective revenue and expenditure planning practices. The city annually approves detailed one-year operating and capital budgets (with a 10-year outlook) and is developing a multiyear operating budget. It issues debt to finance capital expenditures, and we believe it has well-defined financial policies to govern its debt and liquidity management.

We believe Guelph, like other Canadian municipalities, benefits from a very predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

High operating balances will continue, despite near-term pressures, mitigating increased capital spending and borrowing.

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Guelph has estimated that the COVID-19 pandemic has resulted in about C\$20 million of forgone revenue and almost C\$4 million in unplanned operating expenses through July. The revenue loss stems from lower collection of transit fees, fines, and penalties; additional expenditures have been largely for public health measures. Although the city recently announced that it will receive C\$12 million in emergency operating funds (including for transit) through the federal Safe Restart agreement, we believe that its operating balance is likely to be weaker in 2020 before beginning to recover in 2021. In our base-case scenario for 2018-2022, we expect that Guelph will maintain healthy operating balances overall, averaging close to 13% of operating revenue. Although Guelph has deferred some capital expenditures in order to ease near-term pressures, its capital plan indicates increasing spending in the next several years, which will likely result in modest after-capital deficits after 2020.

Annual surpluses and healthy reserve levels help fund Guelph's capital plan, although the plan does identify a need to finance certain projects with C\$133 million of gross additional debt, which we expect will be issued in 2022. This will push the city's tax-supported debt as a proportion of consolidated operating revenues to 45% in 2022, from 26% in 2019. However, debt is expected to represent less than five years of operating surpluses, indicating significant capacity to support the higher debt load. We believe that interest payments will remain very modest, at less than 1% of operating revenues in the outlook horizon.

Guelph's credit profile is bolstered by what we view as an exceptional liquidity position. We estimate that the city will have more than C\$167 million of free cash available in the next 12 months, which will be sufficient to cover more than 10x the debt service requirements. Similar to that of its domestic peers, the city's access to external liquidity is satisfactory, in our view.

Key Statistics

Table 1

City of Guelph -- Selected Indicators

(Mil. C\$)	--Year ended Dec. 31--				
	2018	2019	2020bc	2021bc	2022bc
Operating revenues	427	454	439	460	474
Operating expenditures	369	380	392	404	417
Operating balance	58	75	47	56	57
Operating balance (% of operating revenues)	13.6	16.4	10.8	12.2	12.1
Capital revenues	34	40	30	31	32
Capital expenditures	91	89	75	95	100
Balance after capital accounts	1	25	3	(8)	(10)
Balance after capital accounts (% of total revenues)	0.3	5.2	0.5	(1.7)	(2.0)
Debt repaid	15	14	13	13	8
Gross borrowings	0	34	0	0	133
Balance after borrowings	(14)	46	(10)	(21)	114
Direct debt (outstanding at year-end)	96	117	103	90	215
Direct debt (% of operating revenues)	22.6	25.7	23.3	19.6	45.3
Tax-supported debt (outstanding at year-end)	96	117	103	90	215

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Table 1

City of Guelph -- Selected Indicators (cont.)

(Mil. C\$)	--Year ended Dec. 31--				
	2018	2019	2020bc	2021bc	2022bc
Tax-supported debt (% of consolidated operating revenues)	22.6	25.7	23.3	19.6	45.3
Interest (% of operating revenues)	0.8	0.7	0.7	0.8	1.1
National GDP per capita (single units)	60,011	61,291	57,181	60,677	63,026

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

City of Guelph -- Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa+
Issuer credit rating	AA+

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 14, 2020. Interactive version available at <http://www.spratings.com/sri>.

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

Related Research

- S&P Global Ratings Definitions, Aug. 7, 2020
- Public Finance System: Canadian Municipalities, May 12, 2020
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Guelph (City of)

Issuer Credit Rating	AA+/Stable/--
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Senior Unsecured	AA+
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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