

Research Update:

City of Guelph 'AAA' Issuer Credit Rating Affirmed; Outlook Remains Stable

August 21, 2024

Overview

- The City of Guelph's after-capital performance will come under pressure in 2024-2026 due to a large capital plan, which will also increase the city's reliance on debt in the medium term. Nevertheless, we expect the city's capital expenditures will be more manageable after 2026.
- A strong economy and liquidity position and an extremely predictable and supportive institutional framework remain credit strengths.
- S&P Global Ratings affirmed its 'AAA' long-term issuer credit and senior unsecured debt ratings on Guelph.
- The stable outlook reflects our expectation that the city will post after-capital deficits of more than 5% of total revenues but that debt will remain less than 30% of operating revenues in the next two years.

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Rating Action

On Aug. 21, 2024, S&P Global Ratings affirmed its 'AAA' long-term issuer credit and senior unsecured debt ratings on the City of Guelph, in the Province of Ontario. The outlook remains stable.

Outlook

The stable outlook reflects our expectation that Guelph will significantly increase its capital expenditures in the next two years, which will result in after-capital deficits of more than 5% of total revenues. We expect capital expenditures will remain relatively elevated but will decrease after 2026 as the city makes progress on major projects. In the medium term, the large capital plan will also increase the city's reliance on debt, which we estimate will rise to 26% of operating revenues by 2026. Nevertheless, we believe the city's strong management and strengthened financial planning will support Guelph's long-term creditworthiness.

Downside scenario

We could lower the ratings in the next two years if we expected Guelph to maintain significantly high capital expenditures in the long term that resulted in persistent after-capital deficits of more than 5% of total revenues and tax-supported debt of more than 30% of operating revenues.

Rationale

High capital expenditures associated with three major projects will weaken Guelph's after-capital balance and will require additional borrowing in 2024-2026. Nevertheless, we expect the city's capital expenditures will be more manageable after 2026 as Guelph makes progress on the projects. The city benefits from a strong and diverse economic base, rising population, and proximity to the Greater Toronto Area. Guelph's robust liquidity and the extremely supportive and predictable institutional framework of Canadian municipalities remain key credit strengths.

A solid economic base, grounded by a large public sector, and an extremely predictable and supportive institutional framework bolster the ratings.

Guelph benefits from a strong local economy, in part due to a broad manufacturing sector and a large public sector, including schools, hospitals, the University of Guelph, and municipal administration. We expect that economic growth will continue in 2024. Although GDP per capita data is not available at the local level, we believe that Guelph's is in line with the national level, which we estimate will be about US\$54,300 in 2024. The local unemployment rate is projected at 4.2%. We expect the city's robust population growth will continue after estimated growth of about 2.2% per year since 2021. We believe the city's growing population could have an impact on services and could result in increasing operating and capital needs.

Guelph's credit profile also benefits from strong management, as evidenced by generally good political consensus in passing budgets and effective revenue and expenditure planning practices. The city adopted its first four-year multiyear operating budget covering 2024-2027 in November 2023. It also prepares a 10-year capital forecast and updated its asset management plan in June 2024. In addition, we believe the city has well-defined financial policies to govern debt and liquidity management.

As do other Canadian municipalities, Guelph benefits from an extremely predictable and supportive local and regional government framework that has demonstrated high institutional stability and evidence of systemic extraordinary support in times of financial distress. Most recently through the pandemic, senior levels of government provided operating and transit-related grants to municipalities, in addition to direct support to individuals and businesses. 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. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations) through reserve contributions. Municipalities have demonstrated a track record of strong budget results and, therefore, debt burdens, on average, are low relative to those of global peers and growth over time has been modest.

After-capital performance will come under pressure due to a large capital plan, which will also increase the city's reliance on debt.

We estimate operating balances will remain relatively stable and average 12.2% of operating revenues in 2022-2026. These surpluses should help to fund part of Guelph's capital spending. Nevertheless, the city began construction on three major projects recently: the Baker District redevelopment, the South End Community Centre, and the F.M. Woods Pumping Station upgrades. The high capital expenditures for the projects will result in after-capital deficits of 4.9% of total revenues, on average, in 2022-2026. We expect after-capital deficits will deteriorate beyond 5% of total revenues in 2024-2026. After 2026, we expect capital expenditures will remain relatively elevated, as the city strives to reduce its capital backlog. Nevertheless, we estimate the city will post after-capital deficits of less than 5% of total revenues as it makes progress on the major projects. In addition, we believe Guelph will delay the execution of some projects if there is insufficient funding, which could prevent further deterioration in its fiscal performance.

The large capital plan will result in increased reliance on debt in the medium term. We estimate Guelph will issue C\$74 million in 2025-2026. As a result, we forecast tax-supported debt will rise to C\$160 million or 26% of operating revenues by 2026. We estimate interest costs will increase as the city issues more debt but that they will remain very manageable at less than 1% of operating revenues in 2024-2026.

We expect Guelph will draw on its reserves to fund part of its capital plan but that its liquidity position will remain very strong. We estimate total free cash in the next 12 months will be enough to cover more than 30x the estimated debt service for the period. We expect this ratio will remain well above 100% during the outlook horizon.

Key Statistics

Table 1

City of Guelph--Selected indicators

Mil. C\$	--Fiscal year end Dec. 31--					
	2021	2022	2023	2024bc	2025bc	2026bc
Operating revenues	479	514	544	575	594	614
Operating expenditures	406	450	479	502	521	543
Operating balance	73	63	65	73	73	71
Operating balance (% of operating revenues)	15.2	12.4	11.9	12.7	12.2	11.5
Capital revenues	28	30	38	81	95	85
Capital expenditures	61	83	106	202	236	212
Balance after capital accounts	41	10	(4)	(48)	(69)	(56)
Balance after capital accounts (% of total revenues)	8.0	1.8	(0.7)	(7.3)	(10.1)	(8.0)
Debt repaid	13	14	10	10	10	10
Gross borrowings	49	0	0	0	50	24
Balance after borrowings	77	(5)	(14)	(58)	(29)	(43)
Direct debt (outstanding at year-end)	140	126	116	107	147	160

Table 1

City of Guelph--Selected indicators (cont.)

Mil. C\$	--Fiscal year end Dec. 31--					
	2021	2022	2023	2024bc	2025bc	2026bc
Direct debt (% of operating revenues)	29.3	24.5	21.3	18.5	24.7	26.1
Tax-supported debt (outstanding at year-end)	140	126	116	107	147	160
Tax-supported debt (% of consolidated operating revenues)	29.3	24.5	21.3	18.5	24.7	26.1
Interest (% of operating revenues)	0.7	0.6	0.5	0.5	0.4	0.8
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	65,825	72,249	72,127	73,304	75,035	77,376

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

City of Guelph--Ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	1
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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 8, 2024

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Research: Economic Outlook Canada Q3 2024: Turning The Corner, June 24, 2024
- Institutional Framework Assessment: Canadian Municipalities Employ Flexibilities Within Fiscal Framework To Temper Cost Pressures, April 2, 2024
- Sector And Industry Variables | Criteria | Governments | Sovereigns: Sovereign Rating Methodology, March 26, 2024
- S&P Global Ratings Definitions, June 9, 2023

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 AAA/Stable/--

Guelph (City of)

Senior Unsecured AAA

Research Update: City of Guelph 'AAA' Issuer Credit Rating Affirmed; Outlook Remains Stable

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