

Research Update:

City of Guelph Ratings Affirmed At 'AAA'; Outlook Stable

September 14, 2022

Overview

- A recovery is underway in the City of Guelph, supported by its relatively diverse economy that is underpinned by a robust manufacturing sector and large public sector.
- Guelph will increase capital spending starting this year as it boosts resources for its capital projects team and we expect that the after-capital surpluses the city has produced historically will shrink over the next few years.
- 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 Guelph will continue to generate strong operating surpluses and small after-capital surpluses, mitigating the need for additional borrowing over the next one-two years.

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Rating Action

On Sept. 14, 2022, 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 is stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, Guelph's liquidity will remain very strong and although increasing capital expenditures will pressure after-capital balances, the city's robust operating surpluses will help to keep the increase in the tax-supported debt burden below 30% of operating revenues until 2024.

Downside scenario

Although unlikely, we could lower the ratings or revise the outlook to negative in the next two years if the city's operating revenue growth was lower than expected, leading to persistently weaker

operating balances below 15%, sustained after-capital deficits, and the debt burden surpassing 60% of revenues.

Rationale

Guelph's booming population and diverse employment base should support the city's economic and budgetary resilience through economic cycles. We expect Guelph will remain a destination for economic development, supported by strong links and proximity to the Greater Toronto Area. In addition, we expect that prudent financial management and cost-containment efforts will help Guelph to continue generating strong operating surpluses in the next several years. However, as the city pursues its capital asset management strategies, we expect capital spending will increase. We do not anticipate additional debt issuance over the next few years, but expect this could change as the city's capital plans evolve. The city benefits from a very low interest burden that should persist over the next few years. We expect the city to maintain reserves supporting its exceptional liquidity.

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

Our very strong economic assessment reflects our belief that Guelph's economy supports GDP per capita in line with the national average at about \$52,900 and growth in line with that of Canada. We believe the city has a strong local economy, owing in part to a broad manufacturing sector and a large public sector, consisting of a university, schools, hospitals, and municipal administration. Local economic growth resumed in 2022. The most recent census reveals a growing population with 9% more residents than in 2016. Building activity and assessment growth are strong and support municipal finances.

In our view, Guelph's credit profile benefits from generally good political consensus in passing budgets without material delays and the city demonstrates effective revenue and expenditure planning practices. The city has begun preparing multiyear budgets and approved its first two-year operating budget in December 2021 covering 2022 and 2023. In addition, Guelph plans to introduce a four-year operating budget in 2024 covering 2024-2027. Guelph has also begun to reinforce its capital projects team, resulting in increased capital spending this year and lower expected deferrals in the future. It is also undertaking a capital reprioritization project to better inform its future capital plans. The city issues debt to finance capital expenditures, and we believe it 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 COVID-19 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, as such, debt burdens, on average, are low relative to global peers and growth over time has been modest.

Healthy operating balances will continue, despite near-term pressures, mitigating somewhat higher capital spending.

Guelph maintained strong operating balances and after-capital surpluses in 2021, supported by senior government funding for pandemic-related expenses. Despite some lingering effects of pandemic-related measures, transit ridership is recovering, while tax arrears remain low, supporting healthy operating balances, averaging almost 15.5% of operating revenue for 2020-2024. As the city implements its asset management strategies, capital spending will begin to rise in 2022. Nevertheless, based on current plans, we expect after-capital surpluses will remain positive, averaging 4.65% for 2020-2024. However, we expect after-capital surpluses will erode beyond our outlook horizon, as the city strives to reduce its capital backlog through the implementation of its capital program resource strategy.

Annual operating surpluses and healthy reserves will help to fund Guelph's capital plan, although the city will continue to issue debt to finance certain projects. Guelph issued almost C\$50 million in 2021; however, we do not expect further issuances for the next several years. Its tax-supported debt as a proportion of operating revenues was 29.3% in 2021, and we believe it will fall to 20.1% in 2024, which is lower than previously expected. We expect more details on borrowing plans will be available as the city's capital asset management plans evolve. Guelph's direct debt is expected to represent less than five years of operating surpluses, which indicates strong capacity to support higher debt levels and supports our assessment of the city's debt burden. We believe that interest payments will remain very modest, at less than 1% of operating revenues for 2022–2024.

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\$306 million of free cash available in the next 12 months, which will be sufficient to cover more than 2.15x 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\$) | --Fiscal year end Dec. 31-- | | | | | |
|--|-----------------------------|------|------|--------|--------|--------|
| | 2019 | 2020 | 2021 | 2022bc | 2023bc | 2024bc |
| Operating revenues | 454 | 453 | 479 | 495 | 513 | 532 |
| Operating expenditures | 380 | 381 | 406 | 420 | 434 | 449 |
| Operating balance | 75 | 72 | 73 | 75 | 79 | 83 |
| Operating balance (% of operating revenues) | 16.4 | 16.0 | 15.2 | 15.2 | 15.3 | 15.6 |
| Capital revenues | 40 | 22 | 28 | 47 | 43 | 43 |
| Capital expenditures | 89 | 59 | 61 | 115 | 105 | 105 |
| Balance after capital accounts | 25 | 35 | 41 | 7 | 17 | 21 |
| Balance after capital accounts (% of total revenues) | 5.2 | 7.3 | 8.0 | 1.3 | 3.0 | 3.6 |
| Debt repaid | 14 | 14 | 13 | 12 | 12 | 10 |
| Gross borrowings | 34 | 0 | 49 | 0 | 0 | 0 |
| Balance after borrowings | 46 | 21 | 77 | (5) | 5 | 11 |

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Table 1

City of Guelph--Selected Indicators (cont.)

| (Mil. C\$) | --Fiscal year end Dec. 31-- | | | | | |
|---|-----------------------------|--------|--------|--------|--------|--------|
| | 2019 | 2020 | 2021 | 2022bc | 2023bc | 2024bc |
| Direct debt (outstanding at year-end) | 117 | 104 | 140 | 129 | 116 | 107 |
| Direct debt (% of operating revenues) | 25.7 | 23.0 | 29.3 | 26.0 | 22.7 | 20.1 |
| Tax-supported debt (outstanding at year-end) | 117 | 104 | 140 | 129 | 116 | 107 |
| Tax-supported debt (% of consolidated operating revenues) | 25.7 | 23.0 | 29.3 | 26.0 | 22.7 | 20.1 |
| Interest (% of operating revenues) | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 |
| Local GDP per capita (single units) | N/A | N/A | N/A | N/A | N/A | N/A |
| National GDP per capita (single units) | 61,469 | 58,016 | 65,186 | 69,471 | 70,786 | 71,954 |

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 | 2 |
| 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 11, 2022

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 Outlook Canada Q3 2022: Near-Term Growth To Slow Amid Faster Rate Hikes And Surging Inflation, June 27, 2022
- Institutional Framework Assessments For International Local And Regional Governments, June 15, 2022
- Institutional Framework Assessment: Canadian Municipalities, June 1, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021
- 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 AAA/Stable/--

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Ratings Affirmed

Guelph (City of)

Senior Unsecured AAA

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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