

Research Update:

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

August 13, 2019

Overview

- We expect the City of Guelph to continue generating robust operating margins, although we believe that elevated capital spending will pressure its budgetary performance in the next two years.
- We expect that the city will finance its capital plan without material borrowing in the next two years, and that robust cash generation will allow it to maintain an extremely strong liquidity position.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on Guelph and maintaining our stable outlook.

Rating Action

On Aug. 13, 2019, 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 after-capital balances will erode but remain in surplus on average. We also expect the city will maintain tax-supported debt well below 30% of operating revenues through 2021 while preserving a very healthy liquidity position.

Downside scenario

Although it is unlikely, we could lower the ratings in the next two years if the city were to pursue an aggressive capital plan absent operating revenue growth sufficient to prevent a material erosion of operating balances, large after-capital deficits, and a tax-supported debt burden greater than 30% of operating revenues.

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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 multi-year operating budgets, and we believed that the city would consistently generate after-capital surpluses.

Rationale

Guelph continues to benefit from an economy that is wealthy and stable, underpinned by sizable manufacturing and public sectors, although it is somewhat less diverse than that of higher-rated peers. We believe that the city will continue to generate robust operating surpluses in the next several years, with no additional debt issuance, but that elevated capital spending will pressure after-capital balances.

A stable economy, grounded by a large public sector, and strong financial management practices bolster the ratings.

Guelph benefits from its advantageous location close to the Greater Toronto Area and along the Highway 401 corridor. Although municipal GDP data are unavailable, we estimate that the city would generate GDP per capita in line with the national level of more than US\$45,000. Guelph has experienced stable population growth in the past several years, increasing 3.5% since 2016 to reach about 136,400 in 2018. The city has a large public sector, consisting of a university; schools; hospitals; and municipal, county, and provincial government offices, all of which helps stabilize employment.

In our view, Guelph's credit profile benefits from generally good political consensus in passing budgets without material delays and demonstrates prudent revenue and expenditure planning practices. The city annually approves one-year operating and capital budgets (with a 10-year outlook), which we view as detailed and realistic. Well-defined financial policies also guide debt and liquidity management. In addition, the civil service is experienced and qualified to effectively enact fiscal policies.

We believe Guelph, like other Canadian municipalities, benefits from a very predictable and well-balanced institutional 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. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Debt will remain very low but capital spending will increase pressure on budgetary performance.

We believe that Guelph will continue to generate strong operating balances, averaging close to 14% in our base-case scenario for 2017-2021. However, based on the city's capital plan, we estimate that capital spending will be higher than we had previously expected, which will pressure after-capital balances and could result in modest after-capital deficits in the next several years.

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Guelph borrowed C\$33 million in July 2019 and we do not expect any additional material borrowing in the next two years. We believe that steady debt principal repayments over that period will bring total tax-supported debt down to about C\$90 million by the end of 2021, from C\$115 million in 2019. This is equal to 19% of estimated operating revenues, which we consider very low; and is also less than five years of operating balances, which in our view indicates significant capacity to support its debt burden. At the same time, we expect interest costs to remain very modest, at less than 1% of operating revenues in the outlook horizon. Effective Jan. 1, 2019, the city's wholly-owned electricity distribution company was acquired by Alectra Inc. The city now owns 4.6% of Alectra, through a holding company, and has no exposure to Alectra's debt. Guelph's contingent liabilities are very modest, in our opinion, and are not likely to affect the city's financial standing.

In addition to a modest debt burden, Guelph has exceptional liquidity. We estimate that the city will have free cash and liquid assets, totaling more than C\$260 million, sufficient to cover about 16x the estimated debt service requirements over the next 12 months. 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--				
	2017	2018	2019bc	2020bc	2021bc
Operating revenues	411	427	436	450	464
Operating expenditures	343	369	380	393	405
Operating balance	67	58	56	57	59
Operating balance (% of operating revenues)	16.4	13.6	12.9	12.7	12.8
Capital revenues	34	34	36	34	36
Capital expenditures	88	91	95	90	95
Balance after capital accounts	14	1	(3)	1	(0)
Balance after capital accounts (% of total revenues)	3.0	0.3	(0.6)	0.2	(0.0)
Debt repaid	25	15	14	12	13
Gross borrowings	0	0	33	0	0
Balance after borrowings	(11)	(14)	16	(12)	(13)
Direct debt (outstanding at year-end)	112	96	115	103	90
Direct debt (% of operating revenues)	27.2	22.6	26.4	22.9	19.4
Tax-supported debt (outstanding at year-end)	112	96	115	103	90
Tax-supported debt (% of consolidated operating revenues)	27.2	22.6	26.4	22.9	19.4
Interest (% of operating revenues)	1.0	0.8	0.6	0.8	0.7

Table 1

City of Guelph -- Selected Indicators (cont.)

(Mil. C\$)	--Year ended Dec. 31--				
	2017	2018	2019bc	2020bc	2021bc
National GDP per capita (single units)	58,607	59,879	60,943	62,586	64,363

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. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade.

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 11, 2019. An interactive version is available at <http://www.spratratings.com/sri>

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Credit Conditions North America: Trade Tensions Cloud The Outlook, June 27, 2019
- Public Finance System Overview: Canadian Municipalities, July 18, 2018

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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