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Ratings

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Research Update:

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

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Overview

- The City of Guelph's budgetary performance in 2017 was better than we had anticipated, with stronger operating margins and after-capital surpluses.
- A healthy liquidity cushion will allow the city to advance its capital needs while maintaining a minimal debt burden over 2018-2020.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on Guelph.
- The stable outlook reflects our expectation that, in the next two years, the city's robust budgetary performance results will help it maintain a healthy liquidity position and its tax-supported debt will be less than 30% of operating revenues.

Rating Action

On Aug. 15, 2018, 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 will post after-capital surpluses of about 5% of total revenues on average in 2018-2020. We also expect the city will maintain tax-supported debt well below 30% of operating revenues through 2020 while preserving a healthy liquidity position.

Downside scenario

Although unlikely, we could lower the ratings in the next two years if deteriorating financial management practices lead to aggressive capital spending that pushed Guelph's tax-supported debt to more than 30% of operating revenues, and combined with weaker operating performance result in sustained after-capital deficits of over 5% of total revenues.

Upside scenario

We could raise the ratings in the next two years if, all else equal, Guelph's economy diversified significantly in line with that of some of our higher-rated peers and the city's exposure to its government-related entities (GREs) debt falls considerably.

Rationale

In our updated base-case scenario for 2018-2020, we estimate Guelph will maintain stable operating balances and positive after-capital balances. We expect the city will issue about C$42 million of debt in 2018-2020, resulting in a debt burden of about 24% of operating revenues by 2020. We also expect that Guelph will continue to benefit from a supportive institutional framework, solid financial management, and healthy liquidity. Similar to many other Canadian municipalities, we believe that the city's constrained ability to cut expenditures materially mitigates these strengths somewhat.

Guelph continues to benefit from an economy that is wealthy and dynamic, although it is somewhat less diverse than that of higher-rated peers. Ongoing trade frictions with the U.S remain a risk to the city's significant manufacturing. Hence, Guelph is focusing on expanding its economy, particularly in the life science, agri-food, and biotechnology sectors.

A stable economy, grounded by a large public sector, and strong financial management practices bolster the ratings, while institutions remain broadly supportive.

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 for 2016-2018, the city generated GDP per capita above the threshold of US$38,000, as per our criteria. Guelph's population in 2018 is about 136,400, up 3.5% since 2016. 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 benefits from a track record of strong and stable management practices. The city prepares robust operating and capital budgets, which we view as detailed and realistic. Well-defined, prudent 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.

Exceptionally high operating balances will lead to a minimal debt burden.

In our base-case scenario for 2016-2020, we expect modifiable revenues and operating balances to average about 88% and 16% of operating revenues, respectively, which are in line with those of similarly rated peers. We also estimate that the city will post an after-capital surplus of just over 4% of total revenues, despite fairly high capital expenditures of about C$81 million, or 19% of total expenditures, on average in 2016-2020. While the significant capital spending suggests some ability to defer unessential capital projects, we believe the city's operating expenditure flexibility is limited, similar to that of many Canadian municipalities, primarily due to provincially mandated service levels and collective agreements with employees.

We expect Guelph's tax-supported debt burden to remain at about 24% of operating revenues by 2020. The city plans to issue debt to fund part of its capital projects, which include combating aging infrastructure. At the same time, we expect interest costs to remain very modest, at less than 1% of operating revenues in the outlook horizon.

In addition to the modest debt burden, Guelph has exceptional liquidity. By our calculations, the city's average free cash and liquid assets will total about C$259 million in the next 12 months and represent more than 13x the estimated debt service for the same period. Guelph also benefits from strong internal cash flow generation, which boosts our assessments of its liquidity profile. Similar to that of its domestic peers, the city's access to external liquidity is satisfactory, in our view.

Guelph's contingent liabilities are modest, in our opinion. The city owns two companies, Guelph Junction Railway Co. and Guelph Municipal Holding Inc. (GMHI). We view both as self-supporting and our assessment of the likelihood of extraordinary support from the city is low. GMHI is by far the largest entity, and its primary holding is a local electrical distribution company, Guelph Hydro Inc. (GHI). In December 2017, city council voted to merge Guelph Hydro Electric Systems Inc. (a 100%-owned subsidiary of GHI) and Alectra Inc. The merged company, once it receives all necessary approvals, could begin operating in January 2019. We estimate that the city's current exposure to its GREs' combined debt of about 24% of adjusted operating revenues will decrease considerably, if the merger goes through. Other contingent liabilities consist mainly of standard employee benefits and landfill postclosure liabilities. They represented just over 6% of operating revenues in 2017.

Key Statistics

Table 1

City of Guelph -- Selected Indicators						
	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2015**	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	375.94	389.18	410.63	418.59	430.93	443.81

Table 1

City of Guelph -- Selected Indicators (cont.)						
	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2015**	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Operating expenditures	325.45	335.62	343.41	352.66	362.45	373.82
Operating balance	50.48	53.56	67.22	65.93	68.48	70.00
Operating balance (% of operating revenues)	13.43	13.76	16.37	15.75	15.89	15.77
Capital revenues	36.19	37.09	34.41	38.21	35.96	33.71
Capital expenditures	58.78	78.84	88.12	85.00	80.00	75.00
Balance after capital accounts	27.89	11.81	13.51	19.14	24.44	28.71
Balance after capital accounts (% of total revenues)	6.77	2.77	3.04	4.19	5.23	6.01
Debt repaid	10.55	11.03	24.55	16.69	15.65	14.77
Gross borrowings	0.00	62.50	0.00	4.45	0.00	37.57
Balance after borrowings	17.33	63.28	(11.04)	6.89	8.79	51.51
Modifiable revenues (% of operating revenues)	88.11	87.86	87.88	88.11	88.45	88.78
Capital expenditures (% of total expenditures)	15.30	19.02	20.42	19.42	18.08	16.71
Direct debt (outstanding at year-end)	81.62	136.26	111.50	99.26	83.61	106.41
Direct debt (% of operating revenues)	21.71	35.01	27.15	23.71	19.40	23.98
Tax-supported debt (outstanding at year-end)	81.62	136.26	111.50	99.26	83.61	106.41
Tax-supported debt (% of consolidated operating revenues)	21.71	35.01	27.15	23.71	19.40	23.98
Interest (% of operating revenues)	0.93	1.07	0.96	0.79	0.66	0.81
National GDP per capita (single units)	55,673	56,129	58,440	59,985	61,845	63,611

Note: 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. Base case reflects S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. bc--Base case.

Ratings Score Snapshot

Table 2

City of Guelph -- Ratings Score Snapshot	
Key Rating Factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Strong
Budgetary Flexibility	Strong
Budgetary Performance	Very strong
Liquidity	Exceptional
Debt Burden	Very low
Contingent Liabilities	Low

Note: S&P Global Ratings bases its ratings on local and regional governments on eight main rating factors listed in the table. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, July 5, 2018. Interactive version available at http://www.spratings.com/sri

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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/--
Senior unsecured	AA+

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.