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Research Update:

City of Greater Sudbury Assigned 'AA' Issuer Credit Rating; Outlook Is Stable

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Research Update:

City of Greater Sudbury Assigned 'AA' Issuer Credit Rating; Outlook Is Stable

Overview

- We are assigning our 'AA' long-term issuer credit rating to the City of Greater Sudbury.
- The rating reflects in part our view that the city's debt burden will remain very manageable and its liquidity levels very robust, despite a fast-growing capital plan that will require significant debt issuance.
- The stable outlook reflects our expectation that, in the next two years, Sudbury will maintain modest after-capital deficits and low levels of tax-supported debt.

Rating Action

On June 18, 2018, S&P Global Ratings assigned its 'AA' long-term issuer credit rating to the City of Greater Sudbury, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, in the next two years, after-capital deficits will remain less than 5% of total revenues, on average, and the tax-supported debt burden will remain modest. Moreover, we expect that economy will continue to gradually improve and financial management practices will remain strong.

Downside scenario

Although unlikely, we could take a negative rating action in the next two years if the city were to experience a significant deterioration of financial management practices following the 2018 elections, and we came to believe that sustained after-capital deficits will exceed 10% of total revenues on a consistent basis. In addition, economic deterioration from increasing volatility in the mining sector could put pressure on the ratings.

Upside scenario

We could raise the ratings if the city manages to complete its extensive capital plan and return to steady after-capital surpluses and a debt burden consistently below 30% of operating revenues. Alternatively, improving economic growth prospects could result in a positive rating action.

Rationale

The rating on Sudbury reflects, in part, our view that the city's debt burden will remain very manageable and its liquidity levels very robust, despite a fast-growing capital plan that will require unprecedented debt issuance. Sudbury has managed so far to fund its capital plan through a combination of reserves, transfers, and limited debt issuance. However, in 2017 and 2018, its approved capital budget rose significantly, reflecting the city's strong commitment to reduce the infrastructure gap and complete several one-time projects. As a result, we estimate that this will temporarily push after-capital balances into deficit. We expect that the city's political and managerial strength will remain intact following the 2018 elections, enabling Sudbury to continue its effective operating revenue and cost management. As well, the rating reflects our view that, despite the city being exposed to the mining sector and to the volatility in nickel prices, development of other sectors that bring some diversity and stability to the local economy will support fairly steady growth in the near term.

The public-sector presence partly mitigates exposure to volatile industries while strong financial management supports the rating.

Sudbury is centrally located in northeastern Ontario at the convergence of three major highways. It is the largest municipality in Ontario by area, formed in 2001 through the amalgamation of the towns and cities that constituted the former Regional Municipality of Sudbury, as well as several unincorporated townships. We believe the city would generate nominal GDP per capita close to that of Ontario of about US\$44,000, based on its income levels. The Census metropolitan area had median total income per household of C\$71,687 in 2015, compared with the provincial median of C\$74,287. According to the 2016 Census, Sudbury's population was 161,531 in 2016, up 0.8% since 2011.

Historically a world leader in nickel mining, Sudbury has diversified its economy in the past 30 years and expanded from its resource-based economy to emerge as the major retail, economic, health and educational center for Northeastern Ontario. The public sector (health care, school boards, higher education, and municipal and provincial administration, which has become an important contributor to the local economy, is a stabilizing force, in our view. Nevertheless, nickel mining remains a major industry that currently accounts for about 15% of local employment. In addition, several mining companies, including the two largest actors in the region (Vale Ltd. and Glencore), have announced investments totaling about C\$4 billion. While these will add a significant number of jobs to the local economy, we believe they will maintain the city's relatively high reliance on the mining sector, and in particular its exposure to the volatility of the nickel prices. In our opinion, this could affect revenue growth and expenditure needs in the future and partly constrains the economic profile.

We view Sudbury's financial management practices as strong, largely in line with those of similarly rated peers. The city provides transparent, easy-to-access disclosure to pertinent information and prepares robust operating and capital budgets. Its annual operating budget and five-year capital plan, which we view as realistic, reflect the broad goals outlined in the 10-year financial plan. Like other Canadian municipalities, Sudbury can issue debt only to finance capital expenditures, and we believe it has prudent and conservative policies as well as a stable and well-qualified management team to govern its debt and liquidity management. The management team has a good relationship with council. We believe that the city exhibited broad political consensus on fiscal policies since the past election, specifically those aimed at implementing an asset management policy and addressing its large infrastructure deficit. The council consists of the mayor and 12 councilors (each of whom represents a ward, or geographic area, of the community), and serves a four-year term; the next election will be held in October 2018.

We believe Sudbury, 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. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Despite high capital spending and significant debt issuance expected in next two years, the debt burden remains largely manageable.

Sudbury has proven its ability to increase taxes to match operating spending needs, and effectively control spending. This has allowed the city to preserve its operating balances, which have been relatively stable and in a strong surplus position in recent years. We expect operating surpluses will remain close to historical levels over our 2016-2020 forecast horizon, at more than 13% of operating revenues on average. Robust operating surpluses, aided by a dedicated capital levy, have enabled the city to internally finance its capital plan and limit the requirement for debt-financing. However, Sudbury plans to increase its capital spending in the next several years, primarily to help address its infrastructure deficit and build a new arena. Although the city expects to partly fund these with provincial and federal grants, we expect that after-capital deficits will occur, averaging almost 3.8% of total expenditures in 2016-2020.

Approximately 80% of Sudbury's operating revenues are internally modifiable (primarily from taxes, fees, and user charges), granting it a high degree of budgetary flexibility, which we expect to be largely stable within our two-year outlook horizon. However, Sudbury faces some practical constraints

typical of Canadian municipalities, namely provincially mandated municipal programs and personnel costs, many of which are subject to collective agreements, and which limit the city's ability to cut spending. In addition, given Sudbury's greater focus on large infrastructure projects, such as roads, we believe that the city has little ability to defer such a capital program over the next few years. We estimate that the city's capital expenditures will account for nearly 22% of total expenditures, on average from 2016-2020.

Large capital spending will require Sudbury to borrow up to C\$130 million in the next two years. The city estimates that its tax-supported debt will grow to about C\$179 million in 2020, from C\$69 million at the end of 2017. As a result, we estimate that Sudbury's tax-supported debt to operating revenues will reach about 32% at the end of 2020, up from 14% in fiscal 2017. Nevertheless, the city's debt burden represents less than three years of operating surpluses, which mitigates our assessment of the debt burden. In addition, despite the higher debt, we expect that the average interest expense will remain very manageable, at 0.6% of operating revenues, in 2017-2019.

Sudbury benefits from exceptional internal liquidity support. Although the city's debt includes only loans and debentures issued through Infrastructure Ontario, we believe it would have satisfactory access to external liquidity for financing needs, similar to its local peers. We also believe that the city demonstrates very robust internal cash flow generation capability, with operating balances expected to remain largely above 2x its debt service, despite the additional debt issuance. We estimate that Sudbury's adjusted average cash and liquid assets total about C\$270 million in fiscal 2019, which are sufficient to cover close to 33x the estimated debt service for the year.

We believe Sudbury's exposure to contingent liabilities is limited. They include debt of the two entities owned by the city, which totaled about 11% of the city's 2017 adjusted operating revenues. Sudbury Airport Community Development Corp. promotes the Greater Sudbury Airport as the preeminent aviation hub and the key engine for the region's economic growth. Greater Sudbury Utilities Inc. is an investment holding company that provides distribution of electricity, broadband telecommunications services and rental and customer support services. We believe that in the unlikely event of financial stress at the utility, which we view as self-supporting, the city's support would be limited to less than 10% of its operating revenues. Other contingent liabilities include standard employee benefits and landfill closure costs, which equaled about 10% of consolidated operating revenues at fiscal year-end 2017, and do not have a significant impact on the city's credit profile.

Key Statistics

Table 1

City of Greater Sudbury -- Selected Indicators						
-- Fiscal year ended Dec. 31 --						
Mil. C\$	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	480	493	516	530	544	558
Operating expenditures	412	431	448	459	469	482
Operating balance	69	61	69	71	75	76
Operating balance (% of operating revenues)	14.3	12.5	13.3	13.4	13.8	13.6
Capital revenues	27	11	42	55	48	31
Capital expenditures	77	64	119	133	168	169
Balance after capital accounts	19	9	(8)	(7)	(45)	(62)
Balance after capital accounts (% of total revenues)	3.7	1.8	(1.5)	(1.2)	(7.6)	(10.6)
Debt repaid	3	4	4	4	5	7
Gross borrowings	61	0	0	0	68	58
Balance after borrowings	77	5	(12)	(11)	18	(11)
Modifiable revenues (% of operating revenues)	78.8	79.3	78.9	79.5	80.0	80.5
Capital expenditures (% of total expenditures)	15.8	12.8	21.1	22.5	26.4	26.0
Direct debt (outstanding at year-end)	77	73	69	65	128	179
Direct debt (% of operating revenues)	16.0	14.9	13.4	12.3	23.5	32.2
Tax-supported debt (outstanding at year-end)	77	73	69	65	128	179
Tax-supported debt (% of consolidated operating revenues)	16.0	14.9	13.4	12.3	23.5	32.2
Interest (% of operating revenues)	0.5	0.7	0.6	0.5	0.7	1.1
National GDP per capita (single units)	55,673	56,129	58,418	59,938	61,829	63,688

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. 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 Greater Sudbury -- Ratings Score Snapshot	
Key rating factors	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Strong
Financial Management	Strong
Budgetary Flexibility	Strong
Budgetary Performance	Strong
Liquidity	Exceptional
Debt Burden	Very low

Table 2

City of Greater Sudbury -- Ratings Score Snapshot (cont.)

Key rating factors	Assessment
Contingent Liabilities	Low

Note: S&P Global Ratings' credit ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, Apr. 10, 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

Related Research

- Americas Economic Snapshots--May 2018, May 26, 2018
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local and Regional Government Default Study and Rating Transitions, May 8, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Public Finance System Overview: Canadian Municipalities, Dec. 1, 2016

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

New Rating

Greater Sudbury (City of)

Issuer Credit Rating

AA/Stable/--

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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