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## Research Update:

# City of Saskatoon 'AAA' Ratings Affirmed On Very Strong Economy And Exceptional Liquidity

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## Research Update:

# City of Saskatoon 'AAA' Ratings Affirmed On Very Strong Economy And Exceptional Liquidity

## Overview

- We are affirming our 'AAA' long-term issuer credit and senior unsecured debt ratings on the City of Saskatoon.
- The ratings reflect our opinion of the city's very strong economy and budgetary flexibility, exceptional liquidity levels, and very low debt.
- The stable outlook reflects our expectations that, throughout the two-year outlook horizon, Saskatoon will continue benefiting from a very strong economy, and maintain exceptional liquidity and very strong budgetary flexibility.

## Rating Action

On Jan. 21, 2016, Standard & Poor's Ratings Services affirmed its 'AAA' long-term issuer credit and senior unsecured debt ratings on the City of Saskatoon, in the Province of Saskatchewan. The outlook is stable.

## Rationale

The ratings on Saskatoon reflect Standard & Poor's opinion of the city's very strong economy, budgetary flexibility and budgetary performance, and exceptional liquidity levels. The ratings also reflect our assessment of the very predictable and well-balanced institutional framework for Canadian municipalities, strong financial management, and very low contingent liabilities. In our opinion, offsetting these strengths are a very low, but increasing, debt burden owing to the city's very large capital program.

Saskatoon's economic fundamentals are very strong, in our view. Saskatchewan's GDP per capita averaged US\$69,568 in 2012-2014, and we estimate that the city's GDP per capita would be in line with the province's given its stature as Saskatchewan's largest Census metropolitan area and the subsequent greater economic diversity than other areas of the province. Agriculture, the public sector, and in particular the resource sector (mining and potash) are all important employers for Saskatoon, although the city does not have significant concentration in any one sector. While we expect that a downturn in the resource sector would somewhat negatively affect the city's economy through higher unemployment, lower population growth, we believe that the city's revenue structure would be able to mitigate this impact.

We believe Saskatoon's financial management is strong. In our view, the city's management team is experienced and qualified to effectively enact fiscal

policies, as well as effectively respond to external risks. Saskatoon demonstrates what we view as good political and managerial strength as evidenced by its very lengthy track record of passing budgets and meeting goals. We also believe that management accountability is strong and that its financial policies are prudent. Disclosure and transparency are what we believe to be good, annual financial statements are audited and unqualified, and the city prepares robust annual operating and capital budget documents. It also prepares long-term capital and borrowing plans.

We believe Canadian municipalities benefit 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.

We believe Saskatoon also has very strong budgetary flexibility, which is consistent with that of its peers. In our 2013-2017 base-case forecast, we expect the city's budgetary flexibility will remain in line with historical results, with average capital expenditures that represent greater than 15% of adjusted total expenditures and modifiable revenues of greater than 70% of adjusted operating revenues, on average.

The city's budgetary performance has historically been stable and very strong, in our view. In our 2013-2017 base-case scenario, we expect the region will continue to generate very healthy operating surpluses relative to those of its peers, averaging about 28% of adjusted operating revenue. Saskatoon typically generates near-balanced results or modest deficits of less than 5% after taking into account capital revenues and expenditures, helping to maximize pay-as-you-go financing for capital projects and mitigating the need to issue additional debt. In our base-case forecast, we expect the city will generate a modest after-capital surplus, on average, from 2013-2017. Of note, the city derives some of its revenues from its land development operations. However, this introduces risks to total revenues due to the exposure to potential fluctuations in demand and the high cost of servicing land.

Offsetting these strengths somewhat is our assessment of Saskatoon's very low, but increasing debt burden which its large capital program fuels. The city's tax-supported debt burden was about 29.7% of consolidated operating revenues in 2014 and we forecast it will remain above 30% on average through 2017. However, in our view, mitigating this increased debt burden are the large operating margins Saskatoon generates, which totaled C\$729 million in 2012-2014, and 2.2x the estimated debt outstanding at the end of 2017. Interest expenses are what we view as low, and we expect that they will continue to represent about 1% of operating revenues, on average.

In our opinion, the city has very low contingent liabilities. We believe Saskatoon will remain contingently liable for the financing costs through the construction phase of the two public-private partnership projects (P3s) in the capital plan. The Civic Operations Centre project will enter its operating phase in 2017. As a result, the costs related to this project are incorporated into our analysis of tax-supported debt. In addition, we deem the proposed contracts' fixed-price nature and risk transference sufficiently robust such that the impact on the city's credit profile is not material. Liabilities stemming from standard future employee benefits and landfill postclosure liabilities equaled about 5% of consolidated operating revenues in 2014.

## Liquidity

Saskatoon's exceptional liquidity bolsters its credit profile, in our opinion. In our base-case scenario, we estimate free cash and liquid assets to average about C\$380 million in 2016 and to cover more than 15x the projected debt service for 2016. In our view, Saskatoon has satisfactory access to external liquidity, given its proven ability to issue into public debt markets and the presence of a secondary market for Canadian municipal debt instruments. We believe that the city will maintain exceptional liquidity levels to meet debt service requirements.

## Outlook

The stable outlook reflects our base-case expectations that, in the next two years, Saskatoon will continue to benefit from a very strong economy and maintain exceptional liquidity. We further expect the city's debt burden to increase moderately to about 40% of consolidated operating revenue and for high operating margins to continue mitigating them. Although we view it as unlikely in the medium term, we could lower the ratings if the city's capital program were to increase significantly and remain high, putting pressure on budgetary performance, debt, and liquidity.

## Key Statistics

Table 1

City of Saskatoon -- Economic Statistics						
	--Fiscal year ended Dec. 31--					
(%)	2010	2011	2012	2013	2014	2015bc
Population (total)	224,300	234,200	239,000	248,700	257,300	262,900
Population growth	2.5	4.4	2.0	4.1	3.5	2.2
Unemployment rate	8.3	8.6	5.6	4.1	5.8	5.6

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include Statistics Canada.

**Table 2**

City of Saskatoon -- Financial Statistics						
(Mil. C\$)	--Fiscal year ended Dec. 31--					
	2012	2013	2014	2015bc	2016bc	2017bc
Operating revenues	760	765	803	837	870	903
Operating expenditures	495	545	558	598	626	660
Operating balance	264	220	245	238	244	243
Operating balance (% of operating revenues)	34.8	28.7	30.5	28.5	28.1	26.9
Capital revenues	135	102	67	96	62	75
Capital expenditures	380	380	307	373	240	293
Balance after capital accounts	20	(58)	5	(39)	66	25
Balance after capital accounts (% of total revenues)	2.2	(6.7)	0.6	(4.2)	7.1	2.6
Debt repaid	20	23	21	24	24	25
Balance after debt repayment and onlending	(1)	(81)	(16)	(63)	42	(0)
Balance after debt repayment and onlending (% of total revenues)	(0.1)	(9.3)	(1.9)	(6.8)	4.5	(0.0)
Gross borrowings	90	60	25	14	7	144
Balance after borrowings	89	(21)	9	(49)	49	144
Operating revenue growth (%)	14.8	0.7	4.9	4.3	4.0	3.8
Operating expenditure growth (%)	3.1	10.1	2.3	7.3	4.6	5.4
Modifiable revenues (% of operating revenues)	69.7	74.4	76.7	77.6	78.5	79.3
Capital expenditures (% of total expenditures)	43.4	41.0	35.5	38.4	27.7	30.8
Direct debt (outstanding at year-end)	197	235	238	228	211	226
Direct debt (% of operating revenues)	25.9	30.7	29.7	27.3	24.2	25.0
Tax-supported debt (% of consolidated operating revenues)	25.9	30.7	29.7	27.3	24.2	36.6
Interest (% of operating revenues)	0.8	0.8	0.9	0.8	0.7	1.1
Debt service (% of operating revenues)	3.5	3.7	3.6	3.7	3.5	3.9

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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 Standard & Poor's expectations of the most likely scenario. bc--Base case.

## Ratings Score Snapshot

**Table 3**

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

**Table 3**

**City of Saskatoon -- Ratings Score Snapshot (cont.)**

Contingent Liabilities

Very low

Note: Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "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, Dec. 14, 2015. Interactive version available at <http://www.spratings.com/sri>

## Related Criteria And Research

### Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009

### Related Research

- Canada Economic Outlook: Low Oil Prices Ignite Recessionary Forces, Sept. 3, 2015
- 2014 Annual International Public Finance Default Study And Rating Transitions, June 8, 2015

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

Saskatoon (City of)

Issuer credit rating	AAA/Stable/--
Senior unsecured debt	AAA

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