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Region of Peel
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REPORT
Meeting Date: November 14, 2013
Regional Council

For Information

DATE: October 15, 2013

REPORT TITLE: **UPDATE ON CREDIT RATINGS FOR REGION OF PEEL - 2013**

FROM: Norma Trim, Chief Financial Officer and Commissioner of Corporate Services

OBJECTIVE

This report is to advise that the Region of Peel's Triple A credit rating has been reconfirmed and to highlight the Region's strengths and future challenges as outlined in the credit rating reports.

REPORT HIGHLIGHTS

- The Region of Peel's Triple A credit rating with a stable outlook has been reconfirmed this year by both S&P and Moody's.
- High credit rating remains the goal of the Council's adopted Long Term Financial Planning Strategy and also provides access to lower long-term borrowing costs for the Region and the area municipalities.
- On balance the noted strengths of high liquidity, well diversified Peel economy and effective financial management are challenged by a decline in budgetary performance and increasing debt burden due to significantly higher capital spending.
- Council has demonstrated leadership in strengthening the Region's finances including but not limited to: enhancing prior decision to raise the annual 3 per cent utility rate increase to 6 per cent over 2012-2015 for state of good repair needs, in addition to a 1 per cent annual increase to tax rate supported reserves approved previously; and, adopting the Long Term Financial Planning Strategy.
- Council's continued commitment to these adopted financial management strategies is required to stabilize future financial performance of the Region of Peel.
- A credit rating downgrade could potentially nullify the important benefit of lower borrowing costs and result in increased borrowing costs for both the Region and the area municipalities.

DISCUSSION

1. **Background**

Credit rating agencies perform a credit risk evaluation of a municipality to advise potential investors' of the quality of the municipality's credit worthiness and their ability to service future planned debt issuances. In effect, the assigned credit rating represents a declaration of the municipality's financial health based on the rating agency's criteria. The Region of Peel is currently rated by both Standard and Poor's Ratings Services (S&P) and Moody's Investors Services which are the two largest rating agencies. The Region has received the highest possible rating (Triple A with positive outlook) available to municipalities by both agencies; Standard and Poor's (since 2001) and Moody's Investors Services (since 2011). Both agencies' detailed reports about Peel (2013) are posted on the Region's website: peelregion.ca/finance/investors.htm. The Dominion Bond Rating Services (DBRS) also awarded Peel a Triple A rating (1995-2008), but coverage was discontinued as a cost mitigation measure.

a) **High Credit Rating – Benefits**

The benefits of a high credit rating for the Region of Peel are several including:

- ensures the Region's ability to access the capital markets at very competitive borrowing rates for its long-term debt and it provides the ability to reach the widest possible pool of investors;
- ensures the benefit of competitive financing would also extend to the area municipalities on whose behalf the Region would be borrowing as the Region's credit rating serves as the basis for issuing their debt; and
- confirms that the Region has a significant objective 'vote of confidence' that bolsters trust and confidence in its ability to manage its financial performance and demonstrate financial sustainability.

2. Findings

The credit rating agencies apply a rigorous evaluation framework to support their analysis of a municipality's credit rating. The agencies' assessment to the Region's credit notes several key findings which must be considered in the management of its financial performance.

a) Highlights of Credit reviews

i) Strengths

The Region is rated at the highest possible end of Canadian municipalities and benefits from a highly regulated institutional framework governing municipalities in Ontario which is similar to other jurisdictions in Canada. More specifically related to Peel, the credit rating agencies have acknowledged the Region's high level of cash and secure investments (liquidity), the well diversified Peel economy, and its effective financial management including prudent fiscal planning and policies as major attributes.

ii) Challenges

Both agencies have identified the recent decline in the Region's operating balances (operating expenses have risen faster than revenues) as well as a rising debt burden attributed to the significant capital program required to support growth related infrastructure as factors that mitigate the above noted strengths.

The Region commenced its development charges (DC) related borrowing plan in 2010 and to date has issued $1.273 billion ($1.219 billion after application of sinking funds and principal repayment). Approximately half of the capital spending over the next 10-year period (2013-2022) will be for growth related infrastructure, especially for water, wastewater and roads projects, that are funded from development charges. An additional $85 million has been issued for non-growth purposes (e.g. primarily for 7120 Hurontario Road and selected Region Social Housing properties to repay internal loans).

Prior to 2010, the Region of Peel's debt consisted of mortgages related to Peel Living properties (amounting to $268.9 million as of August 31, 2013) in part transferred to the Region as part of the transferred ownership and responsibility for the administration of social housing from the Province through the *Social Housing Reform Act, 2000.*

b) Risks to Rating – Outlook

Based on the credit ratings review, the outlook for the Region of Peel's credit worthiness remains stable. However, there are some noted concerns that will need to be closely monitored going forward and that could weigh against the Region's financial performance and place downward pressure on the rating. Measures relating to both the performance of the Region's operating balance and capital balance along with measures that monitor both the amount of debt as well as interest costs compared to operating revenues have been identified as key measures that will be influential in determining the rating in the near future.

The credit rating agencies have acknowledged the extraordinary growth pressures that some municipalities, particularly in the GTA, are facing. Unlike the creation and expansion of the South Peel system in the 1940's to 1970's which the Province designed, built and debt financed (and cost recovered over time from Peel utility ratepayers), all of these responsibilities in relation to the current investment in the expansion of the systems now fully rest with the Region.

The amount of planned borrowing is closely tied to the balance between capital spending for growth related infrastructure and the level of DC revenues. It is noted that capital spending will remain elevated over the next five years and DC revenues are expected to recover over that same period. While expected debt levels and the amount of debt service costs relative to operating revenues are currently seen as manageable, higher than expected increases could lead to a ratings downgrade or a revision of the ratings outlook to negative which would in turn result in increased borrowing costs for both the Region of Peel and the area municipalities.

Recently the Region of York's credit rating was affirmed by S&P as Triple A although its outlook was changed from positive to negative primarily as a result of higher than expected levels of debt. Both Halton and Durham Regions like Peel have Triple A ratings with stable outlooks.

c) Managing Challenges

The Region has instituted actions to address the challenges identified by the credit rating agencies. As noted above the Region's effective financial management has been cited as having a positive impact on credit quality. The Region has demonstrated strong financial management through long-term financial planning and prudent use of reserves. More recently Council adopted the Long Term Financial Planning Strategy to ensure the long term financial sustainability of Peel's services and to maintain a high credit rating. Specifically the strategy incorporates a high level credit rating as the indicator for the overall financial condition of the Region and requires monitoring this measure closely. Maintaining a high credit rating also constitutes one of the key objectives of the Regional Debt Management Policy. The Long Term Financial Planning Strategy will play a very important role in addressing concerns regarding the observed decline in the Region's operating balance. The strategy has been acknowledged as a positive development in the credit rating reports.

To further strengthen the financial planning tools that comprise the Long Term Financial Planning Strategy staff will be bringing forth key policy updates to guide both reserve management and cash management. A companion report addressing these policies is on the Council agenda. Further, to ensure that development charges are adequately funding the growth capital program, staff will continue to undertake an annual review of development charges and advise Council of the results of the review as part of the capital budget process. These actions will help the Region manage the concerns relating to growing debt.

Council has demonstrated leadership through concerted actions over the years to maintain the financial strength of the Region of Peel. These actions need to continue in order for the Region to stay on course and achieve the intended benefits. In particular, during the 2008 Budget process Council adopted a strategy to annually increase both the tax rate supported reserves by the equivalent of a one per cent tax supported net budget increase; and the utility rate supported reserves by three per cent in order to finance the expanding state of good repair budget. During the 2012 budget process Council enhanced the three per cent annual increase to the utility rate supported reserves to six per cent for the 2012-2015 period to further address state of good repair, service enhancements and non-DC growth needs.

As part of the 2013 budget, Council made several decisions to ensure that services were delivered more effectively and to deliver value for money for taxpayers:

- Child Care Service Delivery - $6 million re-invested to reduce waitlist serving 370 additional children and 205 children with special needs;
- Laboratory Service Delivery – improved efficiency resulting in annual cost savings of $2.1 million; and
- Bi-Weekly Garbage Collection - increased diversion/resource recovery by four to six per cent and reducing collection costs by an estimated $5 million.

The ongoing implementation of the Long Term Financial Planning Strategy along with continued commitment to the tax and utility rate increases, review of services to promote efficiency such as the measures introduced in the 2013 budget, and other measures such as updating the DC By-law when needed will provide key contributions to securing the long-term financial sustainability of the Region. Moving away from this financial discipline could lead to further erosion of financial performance and could potentially trigger a revision of the outlook or the rating itself.

d) Credit Rating Frameworks

Both S&P and Moody's apply rigorous evaluation frameworks based on quantitative and qualitative criteria in their ratings models. Although some criteria (i.e. institutional framework and debt levels) may be weighted more than others when assigning credit ratings both agencies stress that the scorecard derived from the criteria is not intended to be a substitute for their rating committee judgments regarding individual credit assessments. The following table outlines the criteria used by both agencies.

Standard & Poor's Ratings Model Criteria	Moody's Investor Services Ratings Model Criteria
1. Institutional Framework	1. The Operating Environment
2. Economy	2. The Institutional Framework
3. Financial Management	3. Financial Position and Performance
4. Budgetary Flexibility	4. The Debt Profile
5. Budgetary Performance	5. Governance & Management Practices
6. Liquidity	6. Economic Fundamentals
7. Debt Burden	---
8. Contingent Liabilities	---

In addition to directly monitoring the Region's current and planned debt levels, the credit rating agencies also indirectly consider the overall debt issued by the Region on behalf of area municipalities as part of the "Peel debt story". Debt issued by the Region, regardless of its source, is viewed by the investment community as Region of Peel debt. The debt is joint and several in its obligation between the Region and its area municipalities.

3. Proposed Direction

The Region has established the retention of a high credit rating as the key goal of its Long Term Financial Planning Strategy. Staff will monitor the criteria comprising the credit rating agencies, especially operating and capital balances and debt levels, to manage the challenges identified in the 2013 credit rating reports for the Region. The applied criteria will be further reviewed as part of the consideration of the 2014 budget and capital plan.

Continued commitment to the Council-adopted strategy to dedicate tax and utility rate increases in the coming years to the state of good repair and replacement of assets and continued policy and service review such as the work of the Aging Population Term of Council Steering Committee provide a strong indication of the fiscal discipline demonstrated by Council to stabilize its financial performance. These actions will play a valuable role in helping further promote financial sustainability and should weigh positively on the Region's future ratings.

FINANCIAL IMPLICATIONS

A high credit rating directly benefits the Region of Peel and its area municipalities through lower borrowing costs. The interrelationship between the level of capital spending and DC revenue collection (part of capital balance measure) is critical to determining whether more or less amounts of debt need to be issued and will have a direct bearing on the Region's future credit rating. In addition, the balance between operating revenues and expenses (i.e. operating balance) will influence the ratings. The operating balance is addressed through the budget process and ongoing financial management policies and actions.

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CONCLUSION

The high credit ratings from both Standard and Poor's and Moody's Investors Services confirm the strengths of Region of Peel as well as the financial challenges that it faces. Regional staff will work with Council to continue with the implementation of the Long Term Financial Planning Strategy and bring forward supporting financial strategies and actions to manage these challenges to achieve financial sustainability and to continue securing a high credit rating.

Norma Trim
Chief Financial Officer
and Commissioner of Corporate Services

Approved for Submission:

D. Szwarc, Chief Administrative Officer

For further information regarding this report, please contact Dave Bingham at extension 4292 or via email at dave.bingham@peelregion.ca

Authored By: Ed Zamparo

c. Legislative Services