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Peel (Regional Municipality of)

Primary Credit Analyst:
Adam Gillespie, Toronto (1) 416-507-2565; adam_gillespie@standardandpoors.com

Secondary Contact:
Yousaf Siddique, CFA, Toronto (1) 416-507-2559; yousaf_siddique@standardandpoors.com

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Major Rating Factors

Issuer Credit Rating
AAA/Stable/--

Strengths:

- Well-diversified and robust economy with some concentration in manufacturing
- Strong-but-declining cash and reserve balances totaling about 79% of 2010 operating expenditures
- Low-but-rising debt levels

Weaknesses:

- Expected significant rise in direct debt to about 70% of operating revenue by 2012
- Decline in operating balances and significant after-capital deficits averaging 16% of total revenues over the past two years

Rationale

The ratings on the Regional Municipality of Peel, in the Province of Ontario (AA-/Stable/A-1+), reflect Standard & Poor's Ratings Services' opinion of the region's well-diversified and robust economy and strong cash and reserve balances, although we expect that these balances are likely to decline in the near term. The ratings also reflect currently low debt levels that we expect to rise substantially in the near-to-medium term and operating performance that has weakened in recent fiscal years.

Peel, containing the lower tier municipalities of the City of Brampton (AAA/Stable/--), the Town of Caledon (not rated), and the City of Mississauga (AAA/Stable/--), is located on the western edge of the Greater Toronto Area (GTA) and has a population approaching 1.3 million. The region benefits from extensive transportation links, including Canada's largest airport, two national rail lines, and a network of Canada's largest highways that fully integrate it with the large employment base of the GTA and allow its highly export-oriented economy to access further markets.

Despite this, Peel was not immune to the recent recession. Peel's economy was hampered throughout 2008 and 2009, similar to other municipalities, particularly those with large manufacturing bases. The unemployment rate in those years was 6.7% and 10.8%, respectively, the former of which was higher than the provincial average. Signs of recovery were evident in 2010 with the unemployment rate falling slightly to 9.9%. The total value of building permits rose almost 53% in 2010, with significant growth in residential permits, and continued to grow through the first quarter of 2011. 2010 was subsequently the first year since 2002 that saw an increase in housing starts, which rose 14%. This in turn has led to a modest increase in construction employment although this has yet to return to pre-recession levels.

The region's fortunes remain closely tied to the manufacturing sector, which employs about 16% of the labor force. This is down from almost 24% in 2004, reflecting a number of challenges that continue to affect the Canadian manufacturing sector, particularly the automotive industry, as well as the gradual diversification of the region's economy toward more services-based businesses. Peel's largest manufacturer and employer remains Chrysler Group

LLC (B+/Stable/--), which has about 2,900 employees currently working two shifts at its plant in Brampton. Chrysler has invested more than C$1 billion in the plant since 2008 and we expect that it will remain critical to Chrysler's growth strategy. Income support caseloads continued to rise in 2010 by about 14%, which is a more moderate increase than the almost 29% experienced in 2009.

Peel has maintained excellent liquidity levels although these have declined over the past two years. At Dec. 31, 2010, total free cash and liquid assets (Standard & Poor's adjusted) totaled 79% of operating expenditures during the year, down from 115% in 2008. Although this ratio compares favorably against that of many of Peel's similarly rated international and domestic peers, it has fallen consistently since 2003. The region expects that development charge (DC) reserve balances will continue to decrease in the near term to fund the front-loaded, growth capital plan but that they will recover in the medium term as development continues to ramp back up.

Peel's low debt levels have historically significantly enhanced its credit profile although debt increased substantially in 2010 when the region issued C$310 million in debt. This increased Peel's direct debt as a proportion of operating revenues to 42% in 2010 from 24% in 2009. Peel has also issued an additional C$267 million so far in 2011 and about C$457 million of these combined debentures were issued to fund the capital program whereas prior to 2010, all of the region's debt was associated with social housing and had been declining since 2001. Interest costs were 1.7% of operating revenues in 2010 and we expect that they will remain manageable at about 3.0%-4.0% of operating revenues over the next two years.

In our view, an expected continuing and significant rise in debt partially mitigates these strengths. To prefinance costs of servicing land for growth that the region expects will occur out to 2031, Peel is likely to issue close to C$900 million of additional debt by 2015. This, in conjunction with the expected decline in DC reserve balances, could eliminate the region's current net creditor position in the near term.

Peel's operating performance has moderated over the past two years with its operating surplus falling to 9.9% and 9.5% of operating revenues (Standard & Poor's adjusted) in 2010 and 2009, respectively, from the prior five-year average of almost 17%. This is partially due to the adoption of full-accrual accounting for fiscal 2009, which altered how some items were accounted for, but it also reflects the negative impact of the recession on total revenues, particularly DCs, and the increase in social support costs. Despite the continuing provincial upload of certain social support costs, we expect that rising nondiscretionary operating expenditures and the additional interest costs from the expected debt will continue to pressure operating performance. However, we believe that development activity will increase, thereby increasing the assessment base, which could lead to a modest improvement in operating balances in the next couple of years.

After capital spending, the balance was in a large deficit position of 17% and 16% in 2010 and 2009, respectively. This is due to the weaker operating surplus and capital expenditures, which increased significantly over that period. Peel's after-capital balance is weak compared with its peers' and as the capital plan calls for elevated levels of spending through 2014, we do not expect that the balance will return to a surplus position before that time unless the region were to defer some significant capital projects, despite the expected increase in DC revenue.

Capital expenditure program, liquidity, and debt

Peel's capital expenditure in 2010 was C$742 million, or about 36% of total expenditures. This is a meaningful increase from the C$561 million spent in 2009. The majority of spending in 2010, about 53%, went toward water and wastewater, up from 46% the previous year. Roads and transportation made up 14%. Capital spending is expected to peak in 2011 at about C$900 million of approved spending with about 65% being directed toward water and wastewater, while roads and transportation will again account for about 14%. According to the C$5.2 billion long-range capital plan for 2011-2020, Peel's annual expenditures will gradually decline over the next several years to about C$450 million in 2015. About half of the total spending over the next 10 years will be for growth-related water and sewer projects. Some of these expenditures, expected to be less than 10%, should be recovered from neighboring Regional Municipality of York (AAA/Stable/--), which Peel has partnered with for several of these projects.

Due to the recession, DC revenues declined sharply, and were substantially below budget in 2008-2010. Management also attributes this to DC rates that do not reflect rapid price increases in construction and construction materials, which could be addressed as the region plans to update its DC background study in the near term. Until 2010, Peel chose to internally borrow from its reserves to fill this gap, resulting in the DC reserve being in a C$229 million deficit position at Dec. 31, 2010. Previous forecasts indicated that using the same strategy could result in the deficit growing to about C$1.5 billion by 2014, assuming that the region spent according to its approved capital plan. This would result in significant erosion of Peel's liquidity and we believe that prolonged internal borrowing is unsustainable. Recognizing this and the fact that much of the growth-related construction (mostly for water and sewer) is large-scale and must accommodate current and forecast population growth, Peel began to borrow for these projects in 2010 and plans to service the debt with future DC revenues associated with the projects. We believe that prudent borrowing and the likelihood of DC rate increases could lead to the DC deficit being erased by 2015, although there exist some moderate medium-to-long-term economic risks related to DC revenues recovering from their current lower levels and from construction price indexes being revised lower, which would lower the DC rate. Our projections indicate that as early as 2012, Peel's debt, including social housing mortgages, could exceed its cash and liquid investment balances (excluding deferred revenues such as DCs).

Prior to 2010, all of Peel's existing debt consisted of mortgages for social housing. The Social Housing Reform Act, 2000, transferred the ownership and responsibility for the administration of provincial public housing to Peel. In addition to these mortgages, we expect that Peel will have issued about C$775 million in additional debt by the end of 2011, most of it to support the growing capital plan. We believe that the region's direct debt as a proportion of operating revenues could rise from 42% in 2010 to about 70% in 2012 and likely will remain at elevated levels of 65%-75% in the next two years. These debt ratios are very high compared to other 'AAA' peers and could exert significant downward pressure on the ratings, particularly if operating performance were to fall below current expectations.

Not included in the debt ratios above are debentures that Peel has issued on behalf of the Town of Caledon, estimated to be about C$29 million at Dec. 31, 2010 (excluding a C$15 million debt retirement fund held by Peel). Debentures issued on behalf of any lower tier municipality are direct, joint, and several obligations of the region and area municipalities within. Starting as early as 2012, we expect that Mississauga will begin to debt-finance a small-but-increasing portion of its annual capital budget.

Peel has standard future employee benefits and obligations, and landfill postclosure costs that totaled about 6% of 2010 operating revenue. We do not consider this to be a significant amount and the region has reserves in place to cover about 30% of these liabilities. Peel also has an unfunded liability outstanding to GO Transit of about C$35 million that has been accruing since 2007. Other GTA municipalities have similar liabilities that have arisen from their decision to limit their funding of GO Transit to DC funded growth capital.

For fiscal 2009, all Ontario municipalities were required to adopt full accrual accounting and reporting of tangible capital assets. To improve comparability across local and regional governments globally, Standard & Poor's adjusts the published figures of all municipalities to reflect their budgetary balances on a cash basis. This includes adjusting for major accruals; restating capital spending to a cash basis by removing the influence of capital amortization and net income of certain government business enterprises; and adjusting for one-time revenues.

Outlook

The stable outlook reflects Standard & Poor's expectation that Peel's economy will continue to rebound from the recession such that DC revenues will rise in order to adequately support the increasing debt load. It also reflects the expectation that Peel will maintain strong cash and liquid investment balances, operating surpluses do not decline further, and that after-capital deficits do not increase further than currently forecasted. Downward pressure could be placed on the ratings if Peel issued more debt than expected or operating revenue growth is slower than forecast. A significant decline in liquidity levels could also result in a downgrade or a revision of the outlook to negative.

Peel (Municipality of) Financial And Economic Statistics

Financial Statistics (%)	**2010**	**2009**	**2008**	**2007**	**2006**
Operating balance/operating revenue	9.9	9.5	18.9	16.1	16.8
After capital expenditure balance/total revenue	(16.9)	(15.7)	1.9	(1.9)	(0.4)
Capital expenditure/total expenditure	35.8	30.8	28.5	29.1	30.1
Direct debt/operating revenue	42.2	24.3	26.4	30.7	33.5
Debt service/total revenue	3.2	2.4	2.5	1.6	1.9
Net direct debt*/operating revenue	(29.1)	(53.7)	(67.1)	(65.8)	(68.9)
Cash & committed facilities/operating expenditure	90.4	96.4	129.7	137.8	148.2
Economic Statistics					
Population summary	**% aged 14 years or younger¶**	**% aged 65 years or older¶**	**Median age¶**		
Population	21	9	35.6		
	2010	**2009**	**2008**	**2007**	**2006**
Total population§	1,317,900	1,303,984	1,263,000	1,240,000	1,204,469
Population (% change)	1.1	3.2	1.9	3.0	2.0
Unemployment rate (%)	9.9	10.8	6.6	6.9	6.4
Assessment base (% change)**	1.8	1.9	7.5	1.6	2.7

*Direct debt less cash and equivalents. ¶Based on 2006 Census data. §Population figures from the region. **Includes both unit growth and market value changes.

Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings Detail (As Of June 30, 2011)*	
Peel (Regional Municipality of)	
Issuer Credit Rating	AAA/Stable/--
Senior Unsecured (2 Issues)	AAA

Ratings Detail (As Of June 30, 2011)***(cont.)**

Issuer Credit Ratings History		
29-Jul-2002	*Foreign Currency*	AAA/Stable/--
29-Mar-2001		AA+/Stable/--
17-Jan-1997		NR/--/--
29-Mar-2001	*Local Currency*	AAA/Stable/--
17-Jan-1997		NR/--/--
27-May-1994		AAA/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.