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Research Update:

City of St. John's 'A+' Ratings Affirmed; Outlook Remains Stable

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Overview

- The City of St. John's is facing subdued economic growth and likely falling assessment values; however, we believe that GDP per capita will remain high and that operating balances will remain strong supporting the city's capital plan and meeting its debt service requirements.
- As a result, we are affirming our 'A+' long-term issuer credit and senior unsecured debt ratings on the city.
- The stable outlook reflects our expectation that, in the next two years, St. John's will maintain its high GDP per capita and strong operating balances, which should support its capital plans and keep debt in line with forecast.

Rating Action

On May 23, 2018, S&P Global Ratings affirmed its 'A+' long-term issuer credit and senior unsecured debt ratings on the City of St. John's, in the Province of Newfoundland and Labrador. The outlook is stable.

Outlook

The stable outlook reflects our expectation that, within the two-year outlook horizon, St. John's will maintain strong budgetary performance with operating balances of more than 10% and small after capital deficits on average. We also expect the next 12 months' debt service coverage to remain above 40%.

Downside scenario

Although unlikely, we could take a negative rating action if the city drew down its cash levels, to meet operating or capital spending needs causing liquidity balances to fall below 40% of next year's debt service in the next two years.

Upside scenario

We could take a positive rating action in the next two years if St. John's were to improve its sustained after-capital balances through moderate operating spending and improved revenue growth without deferring critical capital projects, or sustain liquidity balances exceeding 100% of next year's debt service.

Rationale

Our affirmation of the ratings on St. John's reflects the city's high GDP per capita and strong budgetary balances even in the face of subdued economic growth and likely falling assessment values. Furthermore, the ratings reflect our belief that St. John's debt burden is high and will remain so as the city continues to address capital maintenance. The ratings also reflect that, despite an improvement this year, St. John's liquidity position remains weaker than that of domestic peers. We have updated our base-case scenario for the city and extended our forecasting horizon through 2020.

St. John's is a wealthy economy with a concentration in the oil industry; subdued growth will likely have minimal effect on GDP per capita.

St. John's is the capital of Newfoundland, Canada's easternmost province. Based on the city's role as provincial capital and the business center for the oil industry, we believe St. John's has a strong economy, with GDP per capita in line with the provincial average and exceeding US$38,000. While the city estimates that GDP growth was slightly negative in 2017, we believe GDP per capita will remain strong on average. The oil and gas industry is St. John's main growth factor; however, lower oil prices have slowed growth in recent years. We believe the sector also makes the local economy very sensitive to the swings in oil prices, which constrains the city's economic profile. Oil is the primary driver of St. John's Census metropolitan area GDP, which the city estimates was negative 0.9% in 2017 including oil and gas and negative 2.7% without. We expect GDP growth to remain muted in the next two years.

We view St. John's financial management practices to be in line with those of domestic peers, but several factors constrain our assessment. Management demonstrates political and managerial strength through generally good political consensus in passing budgets and a sufficient degree of transparency and disclosure in its financial statements. We expect council will take the necessary measures to raise rates and fees to generate sufficient revenues, even if unpopular. The city has moved to a three-year planning cycle for its operating budget, which has improved transparency at the beginning of the cycle, but is more ambiguous at the end of the cycle. Furthermore, St. John's 10-year capital plan does not break down expenditures by year, and cash spending can be difficult to forecast even from year to year. The city issues debt only for capital purposes, and sinking funds back the majority of its debt, which should mitigate redemption risk somewhat. St. John's historical practices of keeping low levels of unencumbered cash requires careful liquidity management

Like other Canadian municipalities, the city 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. Canadian municipalities generally are able to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities through reserve contributions.

Budgetary balances is expected to remain strong despite a subdued economy.

The city reports that property assessment values likely fell in the most recent assessment cycle, which could put pressure on revenues. However, St. John's has historically had high levels of modifiable, or own-source, revenues and we expect this will allow the city to raise rates and fees as necessary to meet its revenue goals. Furthermore, the city's recent expenditure review should translate into lower operating expenses, and we expect the net result will be high ongoing operating balances. Capital spending in 2017 was lower than expected, but St. John's 2018 planned capital spending is higher. The net effect of this is an expected small average after-capital deficit in 2016-2020. With small average after-capital deficits and strong operating balances, we believe the city has strong budgetary performance. Furthermore, we believe St. John's has strong budgetary flexibility, with more than 95% of revenues generated from its own sources and capital expenditures exceeding 15% of total expenditures on average for 2016-2020. However, in line with those of many domestic peers, the city's collective bargaining agreements, and large infrastructure needs limit its leeway to cut spending.

St. John's has a 10-year, C$1.3 billion capital plan primarily for maintenance, with core infrastructure and water and sewer works as the main projects. The city plans to continue financing its capital program partially with debt. Its debt burden is already high at 108% of revenues and we expect this to reach almost 116% in 2020 (when net debt is forecast to be C$373 million). St. John's plans to issue C$120 million in 2019. At the same time, it expects to increase contributions to the sinking fund, which will help reduce its overall debt burden. We expect interest costs will account for about 7.7% of revenues on average. In addition to high and rising debt, the city's large unfunded pension liabilities constrain its debt profile further. The liabilities consist of accrued pension benefits and postretirement health and life benefits, accounting for 64% of adjusted operating revenues. While St. John's has taken credit positive measures, including closing its defined benefit pension plan to new members, we believe their effects are well outside the rating horizon. Meanwhile, exposure to contingent liabilities is very low, in our opinion, consisting largely of sick leave and severance pay, as well as landfill closure and postclosure costs.

St. John's liquidity position improved this year, owing to higher forecast cash balances. We expect the city's free cash and liquid assets will average C$38.6 million and cover about 105% of estimated debt service in the next 12 months (up from 41% at our most recent review). While improved, this level of coverage remains weaker than that of domestic peers. Given St. John's past practices of holding low cash balances and fluctuating cash flows within the year, we expect volatility in this ratio to persist over the next few years, which weakens our view of the city's liquidity. In line with that of its peers, the city's access to external liquidity is satisfactory, in our view.

Key Statistics

Table 1

City of St. John's--Selected Indicators

	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	270	296	297	311	316	322
Operating expenditures	260	256	255	272	279	286
Operating balance	9	39	42	38	37	36
Operating balance (% of operating revenues)	3.5	13.3	14.1	12.3	11.7	11.1
Capital revenues	26	23	12	43	31	18
Capital expenditures	88	65	36	123	65	35
Balance after capital accounts	(53)	(2)	17	(41)	2	18
Balance after capital accounts (% of total revenues)	(17.8)	(0.8)	5.6	(11.7)	0.7	5.4
Debt repaid	10	73	11	11	11	18
Gross borrowings	70	120	0	0	120	0
Balance after borrowings	7	44	6	(53)	111	0
Modifiable revenues (% of operating revenues)	96.4	95.8	95.2	95.5	95.5	95.6
Capital expenditures (% of total expenditures)	25.3	20.2	12.5	31.1	18.9	10.9
Direct debt (outstanding at year-end)	291	323	306	288	386	361
Direct debt (% of operating revenues)	107.8	109.2	103.0	92.8	122.1	111.9
Tax-supported debt (outstanding at year-end)	309	340	321	302	400	373
Tax-supported debt (% of consolidated operating revenues)	114.7	115.1	108.0	97.4	126.4	115.9
Interest (% of operating revenues)	6.8	7.0	7.9	7.6	7.4	7.3
National GDP per capita (C$)	55,673	56,129	58,418	59,938	61,829	63,688

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. 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. N/A--Not applicable.

Ratings Score Snapshot

Table 2

City of St. John's--Ratings Score Snapshot

Key rating factor	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Strong
Financial Management	Satisfactory

Table 2

City of St. John's--Ratings Score Snapshot (cont.)

Key rating factor	Assessment
Budgetary Flexibility	Strong
Budgetary Performance	Strong
Liquidity	Adequate
Debt Burden	Very high
Contingent Liabilities	Very low

Note: S&P Global Ratings bases its ratings on local and regional governments on the 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 rating.

Key Sovereign Statistics

Sovereign Risk Indicators, April 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

- 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

Ratings Affirmed

St. John's (City of)	
Issuer credit rating	A+/Stable/--
Senior unsecured	A+

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.