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## Research Update:

# City of Winnipeg 'AA' Ratings Affirmed; Outlook Remains Stable

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## Research Update:

# City of Winnipeg 'AA' Ratings Affirmed; Outlook Remains Stable

## Overview

- The City of Winnipeg continues to benefit from a strong and stable economy, in our opinion. However, the city plans to address part of its sizable infrastructure deficit with debt financing leading to a rising debt burden over the next two years.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on Winnipeg.
- The stable outlook reflects our expectation that, in the next two years, the city's operating balances will remain strong and its debt burden will not surpass 120% of revenues.

## Rating Action

On Nov. 20, 2018, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the City of Winnipeg, in the Province of Manitoba. The outlook is stable.

## Outlook

The stable outlook reflects our expectation that Winnipeg's economy will continue to perform well in the next two years. Furthermore, we expect Winnipeg will post average after-capital deficits approaching 5% of total revenues over the next few years and tax-supported debt will increase to about 100% of operating revenues pursuant to the city's borrowing plans. Nevertheless, we estimate liquidity will remain robust, with debt service coverage ratios well above 100%.

## Downside scenario

Although we view this as unlikely, we could take a negative rating action if erosion of financial management practices and higher capital requirements lead to a material decline in liquidity and a rise in the interest burden above 5% of revenues, or a debt burden above 120% of revenues.

## Upside scenario

We could take a positive rating action if the city's capital spending were to remain less than 5% of total revenues on a sustained basis in conjunction with a lower and declining debt burden.

## **Rationale**

Winnipeg remains committed to maintaining and improving city assets, especially roads as requested by residents. To that end, the city has developed a variety of capital tools and asset management reports to track, manage, and plan capital projects. Furthermore, after many years of 0% tax increases, the city has introduced dedicated tax increases to fund roads and transit. However, we believe additional tax increases above the dedicated 2.33% are unlikely in the short term, and city management expects to issue debt to meet its capital plans. Consequently, despite Winnipeg's healthy operating balances, after-capital deficits and planned borrowing are causing the city's forecast debt burden to climb, although we expect it will remain below 120% of revenues during our two-year rating horizon. We believe the city's dynamic and diversified economy and forecast high operating balances should support the planned debt issuance while the city's strong liquidity balances will provide bondholders with additional security.

### **Economy is very strong and diversified while institutions remain broadly supportive.**

Winnipeg is a growing midsize city that benefits from its role as provincial capital as well as its diverse local economy. Financial services, manufacturing, and retail trade are the foundations of the Winnipeg census metropolitan area's economy. Because the city is the province's capital and main population center, the public sector makes an important contribution to the local economy. The city is home to almost all of the preeminent provincial institutions, such as Manitoba Hydro-Electric Board, provincial ministries, specialized hospitals, universities, and colleges. Winnipeg's population has grown steadily since 1999, and the city expects it will experience 1.5% annual growth over the next five years. We estimate that in 2015-2017, Winnipeg's average GDP per capita was in line with that of the province, at US\$39,700. We also believe the city's well-diversified economy, compared with that of peers, offers a relatively high degree of protection from external economic shocks.

In our view, Winnipeg exhibits strong financial management, which supports the ratings. The management team is what we consider experienced and qualified to effectively enact fiscal policies, as well as effectively respond to external risks. City management has been especially proactive in developing capital asset tools and metrics. The city prepares six-year capital forecasts that include annual approved budgets, which are very detailed, as well as periodic state-of-infrastructure reports. Winnipeg's budgets reflect goals defined in the city's long-term financial plan, which is informed by resident surveys, and are based on realistic assumptions. In our view, management's debt and liquidity management policies are prudent. Cash and debt management functions are integrated and the city has detailed annual planning of cash flows.

As do other Canadian municipalities, Winnipeg 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. Operating surpluses typically fund capital expenditures and future liabilities through reserve contributions.

**The city is expecting significant debt issuance in 2019 to fund capital projects; after-capital deficits are expected to persist over the next two years.**

In our opinion, significant infrastructure renewal requirements constrain the city's budgetary flexibility. Winnipeg faces an infrastructure deficit of about C\$7 billion in the next 10 years, mainly related to aging roads, transit, facilities, buildings, and parks. We believe that Winnipeg's high capital needs as well as operating requirements including provincially mandated level of services and multiyear labor contracts limit the city's ability to adjust operating expenditures meaningfully in the near term, similar to other Canadian municipalities.

In our base-case scenario, we expect modifiable revenues to remain stable at 88% of operating revenues on average in 2016-2020. Given somewhat high growth experienced in salaries and benefits, which the city is addressing, we estimate operating balances will slightly increase from our forecast last year to 12.8% of operating revenues on average in 2016-2020, driven by unexpectedly strong results in 2017. We estimate capital expenditures will average 26% of total expenditures, leading to an average after-capital deficit of almost 4% of total revenues in 2016-2020.

To fund part of its capital projects, in the next three years, the city plans to increase net debt by C\$560.5 million, related to rapid transit and road work. As a result, we expect tax-supported debt to increase to about 100% of operating revenues at year-end 2020, up from 66% at year-end 2017. Interest costs accounted for 3.3% of operating revenues in 2017 and we expect them to remain slightly below 5.0% during the two-year outlook horizon.

Winnipeg has robust liquidity in our opinion. We estimate its adjusted free cash and liquid assets will total C\$346 million on average in 2019 and will be enough to cover more than 3x the estimated debt service for the year. We expect this ratio to remain well above 100% during the outlook horizon. The city also generates robust internal cash flow, as measured by its operating balance (before interest), which exceeds twice its annual debt service requirements. In our view, Winnipeg has strong 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.

Winnipeg has what we view as low contingent liabilities and they relate largely to standard future retirement allowance, accrued vacation time, and landfill postclosure costs. These liabilities represented about 17% of 2017 operating revenues, which we do not consider significant, and the city has

reserves to cover a portion of them.

## Key Statistics

**Table 1**

City of Winnipeg -- Selected Indicators						
	--Fiscal year-end Dec. 31--					
(Mil. C\$)	2015	2016	2017	2018bc	2019bc	2020bc
Operating revenues	1,422	1,497	1,578	1,629	1,681	1,736
Operating expenditures	1,265	1,337	1,346	1,400	1,463	1,535
Operating balance	158	159	232	228	219	201
Operating balance (% of operating revenues)	11.1	10.6	14.7	14.0	13.0	11.6
Capital revenues	333	238	265	200	200	200
Capital expenditures	558	476	476	516	516	516
Balance after capital accounts	(68)	(78)	21	(87)	(97)	(115)
Balance after capital accounts (% of total revenues)	(3.9)	(4.5)	1.1	(4.8)	(5.2)	(5.9)
Debt repaid	93	5	35	45	50	114
Gross borrowings	76	80	0	194	490	235
Balance after borrowings	(85)	(3)	(14)	62	342	7
Modifiable revenues (% of operating revenues)	87.9	87.8	87.6	88.0	88.4	88.8
Capital expenditures (% of total expenditures)	30.6	26.2	26.1	26.9	26.1	25.2
Direct debt (outstanding at year-end)	996	1,048	1,043	1,192	1,631	1,752
Direct debt (% of operating revenues)	70.0	70.0	66.1	73.2	97.0	100.9
Tax-supported debt (outstanding at year-end)	996	1,048	1,043	1,192	1,631	1,752
Tax-supported debt (% of consolidated operating revenues)	70.0	70.0	66.1	73.2	97.0	100.9
Interest (% of operating revenues)	3.9	3.5	3.3	3.5	4.0	4.9
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	55,673	56,129	58,440	60,109	61,755	63,347

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. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. dc--Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. uc--Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. N/A--Not applicable.

## Ratings Score Snapshot

**Table 2**

City of Winnipeg	
Key Rating Factors	Assessment
Institutional Framework	Very predictable and well balanced
Economy	Very strong
Financial Management	Strong

**Table 2**

<b>City of Winnipeg (cont.)</b>	
<b>Key Rating Factors</b>	<b>Assessment</b>
Budgetary Flexibility	Strong
Budgetary Performance	Strong
Liquidity	Exceptional
Debt Burden	Moderate
Contingent Liabilities	Very low

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 foreign currency rating on the government.

## Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 11, 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

- Public Finance System Overview: Canadian Provinces, July 18, 2018

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

Winnipeg (City of)

Issuer Credit Rating

AA/Stable/--

Senior Unsecured

AA

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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