City of Vancouver (Canada)

Update to credit analysis

Summary
The credit profile of the City of Vancouver (Aaa stable) reflects exceptional liquidity from high levels of cash and investments, low levels of debt and high debt affordability. The city's credit profile also reflects a strong local economy with access to a growing and broad tax base which has consistently translated into strong operating results. These strengths, coupled with very strong governance and management, allow the city to face fiscal and economic pressures from the coronavirus pandemic without material long-term adverse credit implications. The city is challenged by rising infrastructure needs from a growing population and housing affordability concerns which will keep expenses elevated over the next few years.

Credit strengths
» Exceptional liquidity coupled with high debt affordability
» Strong and diverse economy underpins long-term strength
» Stable revenue sources and operational flexibility cushion operating pressures
» Strong governance and fiscal management, and supportive institutional framework

Credit challenges
» Housing affordability challenges despite pandemic-related easing and government action
» Infrastructure needs require large-scale capital spending

Exhibit 1
Debt levels remain low with high debt affordability

Credit strengths
» Exceptional liquidity coupled with high debt affordability
» Strong and diverse economy underpins long-term strength
» Stable revenue sources and operational flexibility cushion operating pressures
» Strong governance and fiscal management, and supportive institutional framework

Credit challenges
» Housing affordability challenges despite pandemic-related easing and government action
» Infrastructure needs require large-scale capital spending
Rating outlook
The outlook is stable and reflects continued strong debt affordability, exceptional liquidity levels and prudent fiscal management which will allow the city to maintain stable operating results.

Factors that could lead to a downgrade
A sustained period of fiscal losses, a significant increase in the city’s debt burden beyond projected levels or a permanent reduction in the city’s liquidity sources would result in downward pressure on the rating.

Key indicators

<table>
<thead>
<tr>
<th>City of Vancouver</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Direct Debt/Operating Revenue (%)</td>
<td>54.5</td>
<td>51.9</td>
<td>48.6</td>
<td>45.2</td>
<td>40.0</td>
<td>38.6</td>
</tr>
<tr>
<td>Gross Operating Balance/Operating Revenue (%)</td>
<td>15.1</td>
<td>15.4</td>
<td>14.5</td>
<td>14.6</td>
<td>18.9</td>
<td>18.9</td>
</tr>
<tr>
<td>Cash Financing Surplus (Requirement)/Total Revenue (%)</td>
<td>10.4</td>
<td>12.3</td>
<td>4.1</td>
<td>5.8</td>
<td>10.8</td>
<td>14.0</td>
</tr>
<tr>
<td>Interest Payments/Operating Revenue (%)</td>
<td>2.9</td>
<td>2.7</td>
<td>2.8</td>
<td>2.8</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Debt Service/Total Revenue (%)</td>
<td>4.0</td>
<td>3.3</td>
<td>2.4</td>
<td>9.2</td>
<td>2.3</td>
<td>8.7</td>
</tr>
<tr>
<td>Capital Spending/Total Expenditures (%)</td>
<td>17.2</td>
<td>16.6</td>
<td>26.1</td>
<td>20.2</td>
<td>14.8</td>
<td>18.1</td>
</tr>
<tr>
<td>Self-Financing Ratio</td>
<td>1.7</td>
<td>1.9</td>
<td>1.2</td>
<td>1.4</td>
<td>1.9</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service, City of Vancouver

Detailed credit considerations
The credit profile of Vancouver, as expressed in its Aaa stable rating, reflects a baseline credit assessment (BCA) of aaa for the city and the likelihood of extraordinary support coming from the Province of British Columbia (Aaa stable) in the event that the city faced acute liquidity stress.

Baseline credit assessment
Exceptional liquidity coupled with high debt affordability
Vancouver maintains exceptional levels of liquidity with continued improvement over the last decade. Cash and investments (net of sinking funds) of CAD2.2 billion covered approximately 3.5x total outstanding debt and 1.7x operating expense in 2019, levels which are well in excess of the majority of its peers. The city’s robust liquidity profile provides it with a significant net cash position and a significant cushion against liquidity pressures, including those related to the coronavirus pandemic and capital spending.

In addition to exceptional levels of liquidity, the city also maintains low levels of debt. Net direct and indirect debt stood at 39% of operating revenue in 2019, a low level that has consistently improved since 2009 and which compares favourably to Moody’s-rated Canadian municipalities. Ongoing debt maturities will be financed from sinking fund reserves, which represented 43% of total direct debt in 2019. The city also includes safeguards against excessive debt, including setting an internal limit on its annual tax-supported debt servicing payments to 10% of operating expenses (the city expects this ratio to be below the limit over the next five years). The Moody’s-adjusted net debt balance includes the city’s debentures net of sinking funds (CAD620 million in 2019), and excludes the debt of Metro Vancouver (CAD2.2 billion in 2019). The city, which is a member of but does not borrow through Metro Vancouver, has contingent liability through a joint and several guarantee for the debt of Metro Vancouver which borrows through the Municipal Finance Authority of British Columbia (Aaa stable) on behalf of its member area municipalities (except Vancouver).

Debt affordability is also supported by a protracted period of low interest rates. Interest payments relative to operating revenue remained low at 2.4% in 2019, and we anticipate similar or slightly lower levels over the next two years.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Strong and diverse economy underpins long-term strength
Vancouver’s economic metrics are among the strongest within Canadian municipalities. Population growth has been consistent in recent years, rising to around 686,000 (2.7 million for the metropolitan area) at year-end 2019. The city expects annual population growth between 1.1% and 1.5% over the next three years, driven largely by immigration.

The city serves as a major trade, transportation and service centre and is home to Canada's largest and busiest port, the Port Metro Vancouver. The economy is diversified and benefits from its position as a gateway to the Pacific and access to Asian markets. The economy has expanded at a solid pace in recent years, supported by strong performances in the resource, services, technology and construction sectors. Strong growth has been fuelled by both commercial and residential real estate construction in support of increasing housing demand, which over the last few years exceeded housing supply. Despite measures to curb speculative demand and some softening in the housing market, the construction sector remains strong, although the coronavirus pandemic has at least temporarily restrained the pace of construction activity.

Rising population and strong primary sectors resulted in robust historical economic growth, with real GDP growth rates of 2.6% in 2018 and 2.9% in 2019. With the pandemic impacting much of 2020, the economy is contracting significantly with a real GDP decline estimated at 6% (Conference Board of Canada) before a recovery in 2021. The pace of the economic recovery will depend on a number of factors outside the control of the city’s administration, including the availability of a vaccine and additional waves of outbreaks. The city’s unemployment rate has fluctuated between 4% and 5% in recent years, below the national average. Although it has risen significantly during the pandemic to exceed 10%, we expect a gradual decline during 2021 as economic recovery takes hold.

Stable revenue sources and operational flexibility cushion operating pressures
Vancouver’s operating structure benefits from stable property taxes and utility fees which tend not to fluctuate with economic changes. Combined, property taxes and utility fees account for around three-quarters of operating revenue and will drive most of the future revenue growth.

The city’s revenue structure, along with its exceptional liquidity, allows it to face manageable operating pressures. Barring significant new coronavirus-related restrictions in 2021, we expect that the fiscal impact of the pandemic will be primarily contained to 2020 and part of 2021 but will not have material long-term credit implications for the city. The city currently expects the combined operating impact of the coronavirus at CAD34 million in 2020 (around 2% of budget revenues) resulting from lower license and parking fees and costs incurred for service delivery in response to the pandemic, but partly mitigated by expense reduction efforts by the city, including temporary staff layoffs and facility closures. In November 2020 the city received CAD16 million coronavirus-related restart funding from the federal and provincial governments which will alleviate part of the operating shortfall, and expects to cover the remaining shortfall from its CAD130 million fiscal stabilization reserve.

Exhibit 3
Property taxes and utility fees remain stable sources of revenue

Source: Moody’s Investors Service, City of Vancouver
Vancouver’s budgetary flexibility is somewhat constrained by its need to manage property tax increases in conjunction with other taxing authorities including the Province of British Columbia (for school taxes), TransLink (the region’s public transit authority), as well as regional authorities of Metro Vancouver. The city could face fiscal pressures if expenditures outpaced revenue growth, however Vancouver’s ability to maintain strong fiscal results is supported by prudent fiscal management and its ability to generate strong cash flows. For 2020, city council approved a property tax increase of 7%, a level that is higher than the tax increases of most Canadian municipalities, to cover cost escalation and significant capital maintenance and new initiatives. For 2021, the city has laid out three scenarios for property tax increases, ranging from 3% to 5% depending on the magnitude of service level adjustments and deferral of capital projects and amount of reserves used.

**Strong governance and fiscal management, and supportive institutional framework**

Vancouver’s operating results are supported by strong governance and prudent financial management practices including comprehensive, transparent and timely financial reporting. The city uses a long-term financial planning framework, including a 10-year Capital Strategic Outlook, a 4-year Capital Plan, and a 5-year Financial Plan which help identify anticipated pressures upfront. The strength of the city's governance is also evidenced by its strategic planning during the coronavirus pandemic, including incorporating scenario analysis into its fiscal planning and an ability to quickly adjust expenditures in response to revenue shortfalls.

With the exception of utility projects (water, sewer and neighbourhood energy), authority to borrow for capital projects requires electorate approval and is sought via plebiscite held concurrently with civic elections. In addition to multi-year financial planning, management has historically adhered to conservative debt and investment management policies, limiting the city’s exposure to market related risks and helping to ensure relatively smooth debt servicing costs.

Vancouver’s credit profile also benefits from the stability inherent in the provincial institutional framework. The division of roles and responsibilities between the province and municipalities is clearly articulated. Provincial legislation dictates a high degree of oversight, including limits on debt burdens, while policy flexibility, on both the revenue and expenditure sides, helps Vancouver manage pressures as they arise.

**Housing affordability challenges despite pandemic-related easing and government action**

Vancouver’s limited land base and growing population have resulted in the city becoming one of the most densely populated major cities in Canada. Housing prices in Vancouver have seen rapid historical increases due to a strong regional economy and job growth, consistent demand from a rising population, and limited supply of housing stock, leading to housing affordability pressures. The cost of living remains high, limiting employers’ ability to attract workers. A softening housing market could negatively impact the city’s revenues, including lower license and development fee revenues.

At the same time, the city faces expenditure pressures since it needs to allocate significant capital resources to increase affordable housing supply and improve vacancy rates. The coronavirus pandemic dampened property prices and demand in the first half of 2020, easing some of the housing pressures. Nevertheless prices and sales volumes began to rebound significantly in recent months and therefore we expect that affordability will remain a challenge over the next few years.

The federal and provincial governments instituted a number of policy actions in recent years to temper the persistent rise in housing prices. These measures included tighter federal mortgage eligibility rules, a property transfer tax on purchases by foreign residents, a tax on vacant and secondary homes, and a luxury home surtax. The city implemented its own measures with the empty homes tax and new short-term rental regulations. In response to its housing affordability challenges, city council also authorized the creation of the Vancouver Affordable Housing Endowment Fund in 2018 by transferring non-market housing assets from its capital and property endowment funds to better manage its stock of affordable housing assets under the new consolidated fund.

**Infrastructure needs require large-scale capital spending**

Rising population and job growth will continue to require the city to expand its capital infrastructure including transportation networks, housing and utility projects. The city also needs to maintain its existing transportation and utilities infrastructure. The combination of maintaining existing infrastructure and expanding its networks will continue to necessitate both property tax and utility rate increases. In April 2019, Council also approved a 1% tax shift from non-residential to residential properties for 2019, with an additional 1% to be phased in 2020 and 2021.
The city's capital plan totals CAD2.9 billion over the four-year period 2019-2022. The capital plan is funded through a combination of pay-as-you-go financing from development contributions, property tax and utility fees, capital reserves and debt financing. Around two-thirds of the plan supports renewing and maintaining the city's ageing infrastructure, which requires significant annual capital outlay. One-third supports new capital projects or upgrades to existing infrastructure. Nevertheless, the city maintains some flexibility in capital planning. For example, in response to the pandemic the city recalibrated and scaled back nearly CAD260 million in growth-related capital projects to help alleviate financial strain in 2020 and the 2021-2022 periods.

The city's capital budgeting includes new debt issuances estimated at CAD100 million in each of the next three years to maintain and renew critical infrastructure and public amenities in state of good repair. This puts manageable pressure on debt and liquidity metrics.

**Extraordinary support considerations**

Moody's assigns a high likelihood of extraordinary support from the Province of British Columbia, reflecting our assessment of risk to the province's reputation as a regulator of municipalities and incentive for the provincial government to minimize the risk of potential disruptions to capital markets if Vancouver or any other municipality were allowed to default.

**ESG considerations**

**How environmental, social and governance risks inform our credit analysis of Vancouver**

Moody's takes into account the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Vancouver, we assess the materiality of ESG to the credit profile as follows:

Environmental considerations are material but pose low risks to Vancouver’s credit profile. Vancouver is in an active seismic zone which elevates the risk of earthquakes, whose occurrence could have material credit implications given unexpected and high emergency and first responder costs, property damage to land and buildings, and potentially dampened economic activity. However, the city manages these risk well through important initiatives including its Climate Emergency Strategy, Earthquake Preparedness Strategy which involves the roll-out of disaster support hubs, facility upgrades and seismic retrofits, and various training and response exercises. The city also addresses other climate-related risks through its climate task force, with published and transparent metrics. The city is one of the most progressive Canadian cities for green initiatives, which is addressed through its multi-year Greenest City Action Plan and Renewable City Action Plan, targeting carbon and waste reductions, rain city strategy, renewable energy initiatives and green buildings and transportation.

Exposure to social risks is moderate. High housing and living costs could limit employers' ability to attract workers and dampen economic activity. This requires the city to allocate development contributions to increase affordable housing supply, although a large portion of costs relating to improving affordability are borne by the provincial and federal governments. The opioid pandemic also raises social costs for the city. Although we regard the coronavirus outbreak as a social risk given the implications for public health, the credit impact from the pandemic is low as the majority of related healthcare expenses are the responsibility of the province and not the region.

Governance considerations are material to the credit profile but risks are low. The city utilizes prudent financing planning which enables it to identify potential pressures early on and adjust plans on a timely basis to mitigate any credit implications. The city provides transparent, timely financial reports including forward-looking fiscal policies through its 10-year Capital Strategic Outlook, 4-year Capital Plan, and 5-year Financial Plan, and adheres to strict policies on debt and investment management.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing Environmental, Social and Governance Risks](#).
Rating methodology and scorecard factors
The assigned BCA of aaa is one notch above the scorecard-indicated outcome of aa1. The scorecard-indicated outcome of aa1 reflects (i) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (ii) a systemic risk score of Aaa, as reflected in the sovereign bond rating for the Government of Canada (Aaa stable).

For details about our rating approach, please refer to Rating Methodology: Regional and Local Governments, 16 January 2018.

Exhibit 4
City of Vancouver

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<tbody>
<tr>
<td>Score</td>
<td>Economic strength</td>
<td>Legislative background</td>
<td>Gross operating balance / operating revenues (%)</td>
<td>Risk controls and financial management</td>
<td>1.94(2)</td>
<td>Aaa</td>
<td>aa1</td>
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<tr>
<td>Value</td>
<td>Economic volatility</td>
<td>Financial flexibility</td>
<td>Interest payments / operating revenues (%)</td>
<td>Investment and debt management</td>
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<tr>
<td>Weighting</td>
<td>70%</td>
<td>50%</td>
<td>12.5%</td>
<td>30%</td>
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<tr>
<td>Total</td>
<td>3.8</td>
<td>1</td>
<td>2.25</td>
<td>0.68</td>
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Source: Moody’s Investors Service

Ratings

Exhibit 5

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<td>VANCOUVER, CITY OF</td>
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<td>Outlook</td>
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<td>Senior Unsecured -Dom Curr</td>
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Source: Moody’s Investors Service
City of Vancouver (Canada): Update to credit analysis