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Ratings

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Summary:

City of Vancouver

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Summary:

City of Vancouver

Issuer Credit Rating	AAA/Stable/A-1+

Key Rating Factors

Credit context and assumptions	Base-case expectations
Continuity of sound management under new government and steady, but milder, economic growth will support creditworthiness. • We expect the City of Vancouver's management, led by a new mayor and council, will continue to execute fiscal discipline. • Vancouver's relationship with the Province of British Colombia (B.C.) will be supportive around core policy issues. • Despite local housing market imbalances, we believe that the city's economy will experience stable, though lower, growth.	Higher spending will be mitigated by a sustainable mix of revenue and funding sources. • Vancouver's growing size, mandate, and infrastructure needs will lead to capital spending that averages 22% of total spending over the next three years. • Nevertheless, a supportive revenue base will sustain the city's after-capital surpluses. • Budget surpluses will reduce the city's reliance on new borrowing and sustain its large liquidity cushion.

Outlook

The stable outlook reflects our assumption that a solid economy and comprehensive fiscal planning will facilitate operating and after-capital fiscal surpluses over the next two years. These will fund debt repayment and support Vancouver's cash position.

Downside scenario

We could lower our ratings on the city if a housing correction from an economic downturn, or other external shock, negatively affected revenues. This, combined with a sluggish or inadequate response by management, could lead to sustained after-capital deficits, causing the debt burden to rise to more than 60% of revenues.

Rationale

We have updated our base-case scenario for Vancouver, extending our forecast horizon through 2021. We expect that the city's new government will remain focused on fiscal sustainability, reflected by after-capital surpluses through 2021, despite higher spending. This will reduce Vancouver's need for significant new borrowings, and sustain its low debt burden. At the same time, high per capita income will continue to provide Vancouver with a supportive economic foundation to implement evolving policy objectives.

A stable economy and prudent institutions will allow the new government to implement its agenda in a fiscally sustainable way.

We believe that Vancouver's detailed long-term financial planning, as well as its experienced financial management team, will provide a solid fiscal policy anchor as the city's new government looks to implement its policy agenda. Vancouver's government, led by independent mayor Kennedy Stewart, took office in late 2018. Mr. Stewart is the city's first independent mayor in nearly 30 years. Unlike in most Canadian municipalities, local politicians in Vancouver are generally associated with local political parties. While no political party holds a majority in the city's new council, we expect broad political consensus on fiscal discipline across party lines. At the same time, the city's administration, which implements the government's policies and monitors key external risks, will continue to facilitate fiscal policy continuity. We expect this structure to further the sustainable implementation of the new government's priorities, including the provision of affordable housing.

In our view, a supportive institutional framework will continue to bolster the city's management. The government framework under which Vancouver, like other Canadian municipalities, operates is very predictable and well balanced. The provincial government imposes fiscal restraint through legislative requirements to pass balanced operating budgets. At the same time, provincial-municipal relationships have proven to be more dynamic than the federal-provincial one, largely because municipal governments are established through provincial statute and not the constitution. In that regard, we expect Vancouver's relationship with B.C. will continue to be supportive under the new local government, and will strengthen on core policy issues that affect Vancouver. The two levels of government will likely continue to collaborate on issues related to the availability and affordability of housing in Vancouver, particularly given the low vacancy rate in the city, which was about 1% in Vancouver's rental market in 2018. The province and city worked together to implement a vacancy tax on empty homes in 2018, which may contribute to a rise in homes that are made available for rentals. The city estimates that it collected about C$30 million, or about 2% of operating revenues, from this tax in its first year of implementation in 2018, which it will use for affordable housing initiatives. Availability of affordable housing is a core policy issue at both the municipal and provincial level.

We expect federal, provincial, and city government measures that have been put in place to cool Vancouver's overheated housing market will lead to slower growth in the city's housing sector over the next two years. We believe that these measures will contribute to lower, but still positive, economic growth in the city over the forecast horizon, relative to historical real GDP growth rates estimated to average over 4% annually from 2015-2017 by the Conference Board of Canada. Nevertheless, these policy-induced changes do not represent underlying economic weaknesses, in our view. We believe that Vancouver's position as B.C.'s economic engine will continue over the next two years. This will provide a solid anchor for fiscal stability. Although GDP data from Statistics Canada are not available at the municipal level, we estimate that the city has per capita GDP equal to or higher than the three-year B.C. provincial average of around US$43,000. The city is consistently ranked as one of the most liveable in the world. In addition to real estate, the Census metropolitan area economy includes major forestry, mining, finance, and tourism. Vancouver is also one of the country's chief head office locations and attracts businesses in the advanced technology, biomedical research, and film industries. At the same time, the city is home to many of the province's preeminent public institutions, with two universities, several schools and colleges, several specialized hospitals, the Port of Vancouver, and Vancouver International Airport.

Fiscal surpluses, a large liquidity cushion, and low debt will remain rating strengths.

Vancouver's extremely low dependence on transfers from upper levels of government and tax competitiveness--both regionally and globally--provide the city with a high degree of revenue flexibility that will support its growing spending mandate over the next two years. We expect the city's proportion of modifiable (own source) revenues to average nearly 99% of operating revenues over the next three years. Most senior government grants go to the regional district, Metro Vancouver, which is responsible for most capital-intensive infrastructure (arterial roads and potable water and wastewater treatment plants). The city's own revenues mostly come from property taxes and fees (predominantly water and sewer). While property tax increases in Vancouver have historically been lower than those of other cities in the Metro Vancouver region, we expect that increasing investment needs related to public amenities and infrastructure to support population growth, as well as infrastructure renewal, will lead the city to raise property tax rates above inflation levels over the next several years. In turn, we expect capital spending to increase, averaging nearly 22% of total spending over the next three years. Under the city's new four-year capital plan, investment in new assets will represent nearly 46% of capital spending, while 54% will go to maintenance of existing assets. Investment in new assets will reflect the administration's mandate, with over one-third going to affordable housing projects. Although this high level of capital expenditure provides the city with a solid amount of spending flexibility, we believe that Vancouver is more limited in its ability to adjust operating spending in the near term, mainly due to multiyear labor contracts.

Higher-than-historical property tax rate increases will somewhat mitigate the impact of Vancouver's evolving policy mandate over the forecast horizon. We expect the city will, increasingly, deliver services that the provincial government has traditionally provided, including emergency response, social housing, mental health and addictions, and childcare. This healthy level of growth on both the operating revenue and expenditure sides will permit the government to maintain robust operating surpluses of 11%, on average, from 2017-2021. Our forecasts for 2019 and beyond do not incorporate new revenues from Vancouver's empty homes tax, implemented in 2018, because of the uncertainty of how homeowner behavior, and revenues from this tax, will evolve beyond its successful implementation in 2018. At the very least, these measures will likely have a neutral impact on the operating balance, given that any new net revenues will be spent on affordable housing projects. Together, along with capital revenues stemming mostly from developer's contributions, the city's operating surpluses will, we expect, more than cover high levels of capital spending. We expect the after-capital surplus to average 3% from 2017-2021.

Budget surpluses over the forecast horizon will reduce the city's dependence on new net borrowing. Although we expect Vancouver to issue C$125 million annually over the next several years for long-term capital purposes, principal repayments for about that amount, on average, will lead to a relatively stable debt burden. We forecast that the city's tax-supported debt (net of sinking funds and including debt obligations it guarantees) will reach about 41% of projected operating revenues by 2021, from an estimated 42% this year. Most of Vancouver's debt (about 90% of tax-supported debt net of C$395 million in sinking funds as of year-end 2017) consists of long-term bonds. The remainder consists of mortgages and loan guarantees. We also expect that the city's interest payments will remain stable, and below 3% of operating revenues on average, through 2021.

Vancouver's budgetary performance will also limit the need to draw down on the city's robust liquidity reserves. In our forecast, we estimate that the city will maintain free cash and liquid assets (S&P Global Ratings-adjusted) sufficient to cover over 10x our estimated debt service requirements for 2019. Further bolstering liquidity is Vancouver's satisfactory external liquidity, given the city's continued access to a strong and diversified pool of Canadian banks.

We do not expect Vancouver's contingent liabilities to present significant risks to the city's creditworthiness. As a member of Metro Vancouver, which provides regional services to member municipalities, Vancouver is contingently liable for the debt of the regional authorities, which we view as a modest risk to the city. At fiscal year-end 2017, Metro Vancouver's debt represented about 131% of the city's operating revenue. We believe these entities are unlikely to need Vancouver's support in the event of financial stress because they take in revenues to sustain their operations through property taxes and user fees collected by member municipalities. Other contingent liabilities, which include standard employee benefits and landfill postclosure liabilities, represented about 11% of operating revenues at year-end 2017 and do not have a significant impact on Vancouver's credit profile.

Key Statistics

Table 1

Vancouver (City of) -- Selected Indicators

	--Year ended Dec. 31--						
(Mil. C$)	**2015**	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**	**2021bc**
Operating revenues	1,381	1,459	1,518	1,567	1,631	1,693	1,759
Operating expenditures	1,194	1,267	1,343	1,403	1,461	1,505	1,555
Operating balance	186	192	175	164	170	189	204
Operating balance (% of operating revenues)	13.5	13.2	11.5	10.5	10.4	11.1	11.6
Capital revenues	137	173	298	208	259	259	259
Capital expenditures	226	376	310	335	418	418	418
Balance after capital accounts	97	(11)	163	37	11	30	45
Balance after capital accounts (% of total revenues)	6.4	(0.7)	9.0	2.1	0.6	1.5	2.2
Debt repaid	17	5	134	6	132	132	141
Gross borrowings	90	90	85	85	125	125	125
Balance after borrowings	170	74	114	116	4	23	29
Modifiable revenues (% of operating revenues)	98.3	98.4	98.6	98.6	98.7	98.7	98.8
Capital expenditures (% of total expenditures)	15.9	22.9	18.7	19.3	22.3	21.8	21.2
Direct debt (outstanding at year-end)	650	644	621	623	641	660	686
Direct debt (% of operating revenues)	47.1	44.1	40.9	39.7	39.3	39.0	39.0
Tax-supported debt (outstanding at year-end)	704	696	668	663	681	699	726
Tax-supported debt (% of consolidated operating revenues)	51.0	47.7	44.0	42.3	41.7	41.3	41.2
Interest (% of operating revenues)	2.8	2.7	2.7	2.9	3.0	2.5	2.5

Table 1

Vancouver (City of) -- Selected Indicators (cont.)							
	--Year ended Dec. 31--						
(Mil. C$)	2015	2016	2017	2018bc	2019bc	2020bc	2021bc
National GDP per capita (single units)	55,673	56,129	58,440	60,163	61,966	63,704	65,542

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.

Ratings Score Snapshot

Table 2

City of Vancouver -- Ratings Score Snapshot	
Key Rating Factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Very strong
Budgetary Flexibility	Strong
Budgetary Performance	Very strong
Liquidity	Exceptional
Debt Burden	Low
Contingent Liabilities	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, Dec. 13, 2018. An interactive version is also available at http://www.spratings.com/sri

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Americas Economic Snapshots: January 2019, Jan. 25, 2019
- Public Finance System Overview: Canadian Municipalities, July 18, 2018
- Default, Transition, And Recovery: 2017 Annual International Public Finance Default Study and Rating Transitions, June 11, 2018

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