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## Research Update:

# City of Laval 'AA' Ratings Affirmed; Outlook Remains Positive

### Primary Credit Analyst:

Nineta Zetea, Toronto (416) 507-2508; nineta.zetea@spglobal.com

### Secondary Contact:

Stephen Ogilvie, Toronto (1) 416-507-2524; stephen.ogilvie@spglobal.com

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## Overview

- While the City of Laval continues to demonstrate an increased focus on political stability and completion of capital spending close to budget levels, higher spending requirements could add pressure to its budgetary performance and debt burden in the near term.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the City of Laval.
- The positive outlook reflects our opinion that, in the next 12 months, Laval will continue to demonstrate its ability to deliver on its long-term capital planning, while preserving its robust budgetary flexibility and performance, and relatively manageable debt burden.

## Rating Action

On Dec. 14, 2017, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the City of Laval, in the Province of Quebec. The outlook remains positive.

## Outlook

The positive outlook reflects that, all else equal, there is at least a one-in-three chance we could upgrade Laval one notch in the next 12 months if the city continues to demonstrate its ability to deliver on its long-term capital planning, while preserving its robust budgetary flexibility and performance, and relatively manageable debt burden. The outlook also reflects our expectation that Laval will maintain exceptional liquidity balances, and that its financial management practices and economy will remain strong.

## Downside scenario

We could revise the outlook to stable in the next 12 months should the city find difficulties in managing its rising spending requirements, resulting in significantly lower operating margins and consistently high after-capital deficits; or if larger-than-expected borrowing pushed tax-supported debt to operating revenues over 120%.

## **Rationale**

Laval has stabilized its political and managerial strength in the past several years, and, with the election in November 2017, will have the opportunity to demonstrate continuity in its recently introduced initiatives. While we believe Laval's strategy to support rapid economic growth brought the city in line with peers in terms of the difference between budgeted and actual cash capital spending, we believe an upgrade in the next 12 months will be linked to the city's capacity to build a track record on its long-term capital planning realization, while preserving its robust budgetary flexibility and performance, and relatively manageable debt burden.

### **Improving long-term capital planning and above-average growth economic prospects support the ratings.**

In our view, Laval continues to demonstrate strong financial management practices, with an increased focus on improving its year-to-year visibility of capital spending and reducing its capital spending deferral rate. The city has prudent financial policies that ensure a good degree of transparency and fiscal discipline. We believe management demonstrates relevant expertise through prudent debt and liquidity management. The city prepares an operating budget annually and a rolling three-year capital plan, which presents detailed information regarding the funding sources. The municipal council consists of 22 members: the mayor and 21 councilors; the next election will take place in 2021.

Laval is north of Montreal and is the third-largest municipality in Quebec by population, after Montreal and Quebec City. It is part of the greater Montreal area (GMA), the province's financial and socioeconomic center. The GMA dominates the Quebec economy, representing close to half of the province's population, employment, and output. The city benefits from a branch of the University of Montreal, as well as the extension of Montreal's subway into Laval. This had a significant impact on the city's economy, contributing to the growth in employment and GDP. Based on Laval's median income (which we use as a proxy for GDP and is higher than the provincial one), we estimate the city's GDP per capita to be above the 2014-2016 provincial average of US\$37,495. Based on the 2016 Census, the population was 5.3% higher in 2016 than in 2011 and above the provincial growth rate of 3.3%. In our opinion, Laval has a very strong, dynamic, and diversified economy, which limits volatility. The service sector (including retail, health and social assistance, and financial services) dominates employment, representing more than 80% of jobs, followed by manufacturing and public administration. In our view, Laval continues to have above-average growth prospects, supported by a significant level of investments in the city (close to C\$1 billion in 2016), a more attractive nonresidential tax base, and available space for development. The local economy improved slightly in 2016, with higher employment and property assessment values, which were partly offset by a slowdown in construction activity, as reflected in weaker building permits and housing starts.

We believe Canadian municipalities benefit 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 impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive.

**Laval's capital expenditures to continue to grow as the city spends more to support economic growth and maintain state of good repair.**

As result of its new, project-based capital budget approach, Laval saw its 2016 consolidated cash capital spending (including Societe de Transport de Laval; STL) significantly boosted, representing 77% of its 2016 consolidated capital budget. This is a notable increase from the previous years' realization rate, which averaged a relatively low level of about 45% per year. About 60% of Laval's C\$1.1 billion budgeted capital plan for 2018-2020 (excluding STL) is growth related, oriented mainly toward infrastructure, with the remainder dedicated to maintenance. In the near term, the city expects to maintain a high realization rate for its cash capital spending, which, although partly financed with higher cash payments (totaling C\$141.5 million for 2018), transfers, government and third-party subsidies, could pressure its after-capital balances. We estimate that its after-capital balance will remain in small surplus (0.9%) on average from 2015-2019, but will slip into consistent deficits thereafter. We expect Laval will continue to generate strong adjusted operating surpluses, allowing it to maintain its annual contributions to cash capital payment reserves. Nevertheless, as the city has to manage its economic growth and deal with rising operating pressures, we expect its operating balance to gradually decrease from the historically exceptional performances to an average 17% in 2015-2019.

Laval relies very little on transfers from senior levels of governments and has significant revenue-raising tools such as property taxes and user fees. We believe modifiable revenues will account for about 92% of operating revenues in 2015-2019. Nevertheless, like that of most Canadian municipalities, Laval's budgetary flexibility is somewhat constrained on the expenditure side, given provincially mandated service levels, labor contracts, and inflation. Following the implementation of its new capital budgeting approach, the city's actual capital spending rate increased significantly in 2016, to 25% of total expenditures from close to 20% in the previous years, primarily because of more efficient capital planning. We expect the city will continue addressing its capital needs at a faster pace in the near future, and will maintain its capital expenditures to total expenditures ratio consistently above 20%, on average, from 2015-2019.

Laval's strategy to use cash payments to partly fund its extensive capital plan is intended to limit debt borrowing in the next two years. Nevertheless, the city estimates its consolidated debt borrowing will exceed C\$200 million per year from 2017-2019, which is the highest borrowing level it has

experienced so far. As a result, we expect tax-supported debt (composed of Laval's direct debt, STL's debt guaranteed by Laval, and capital leases) to reach C\$954 million by 2019, or 102.2% adjusted operating revenues. We believe, however, that its interest burden will remain fairly manageable, averaging 5.1% from 2016-2018. Laval has an unfunded liability for pensions and OPEBs. At the end of 2016, the unfunded liabilities for pension and OPEBs were C\$144 million and C\$111 million, respectively. Together, they represented 29% of 2016 operating revenues. The city does not have any significant off-balance-sheet or contingent liabilities.

In our view, Laval continues to benefit from exceptional internal liquidity support and satisfactory access to external liquidity for refinancing needs, given its proven ability to issue into various markets, including that for public debt, and the presence of a secondary market for Canadian municipal debt instruments. We estimate that, on an adjusted basis, Laval's next 12 months' cash and liquid assets total about C\$661 million, which are sufficient to cover 3.5x the next 12 months' debt service charges. Although the city expects to use more of its previously amassed reserves to finance some capital projects, and interest and principal payment increases, we believe that free cash and liquid assets will remain sufficient to cover all debt service requirements throughout our outlook horizon.

## Key Statistics

Table 1

| City of Laval -- Selected Indicators                 |      |      |      |        |        |        |
|--|------|------|------|--------|--------|--------|
| -- Fiscal year ended Dec. 31 --                      |      |      |      |        |        |        |
| Mil. C\$   | 2014 | 2015 | 2016 | 2017bc | 2018bc | 2019bc |
| Operating revenues                                   | 841  | 852  | 885  | 906    | 918    | 934    |
| Operating expenditures                               | 643  | 678  | 728  | 754    | 777    | 787    |
| Operating balance                                    | 198  | 174  | 157  | 152    | 141    | 147    |
| Operating balance (% of operating revenues)          | 23.6 | 20.4 | 17.7 | 16.8   | 15.3   | 15.7   |
| Capital revenues                                     | 55   | 49   | 91   | 105    | 113    | 112    |
| Capital expenditures                                 | 165  | 133  | 247  | 264    | 282    | 279    |
| Balance after capital accounts                       | 88   | 90   | 1    | (6)    | (29)   | (21)   |
| Balance after capital accounts (% of total revenues) | 9.8  | 9.9  | 0.1  | (0.6)  | (2.8)  | (2.0)  |
| Debt repaid  | 148  | 137  | 143  | 139    | 135    | 166    |
| Gross borrowings                                     | 149  | 137  | 149  | 208    | 200    | 229    |
| Balance after borrowings                             | 89   | 89   | 7    | 64     | 36     | 42     |
| Modifiable revenues (% of operating revenues)        | 90.7 | 92.8 | 92.6 | 92.2   | 92.4   | 92.8   |
| Capital expenditures (% of total expenditures)       | 20.4 | 16.4 | 25.3 | 25.9   | 26.7   | 26.2   |
| Direct debt (outstanding at year-end)                | 767  | 766  | 772  | 839    | 898    | 954    |
| Direct debt (% of operating revenues)                | 91.1 | 90.0 | 87.2 | 92.7   | 97.8   | 102.2  |
| Tax-supported debt (outstanding at year-end)         | 767  | 766  | 772  | 839    | 898    | 954    |

**Table 1**

| City of Laval -- Selected Indicators (cont.)              |                                 |        |        |        |        |        |
|---|---------------------------------|--------|--------|--------|--------|--------|
|   | -- Fiscal year ended Dec. 31 -- |        |        |        |        |        |
| Mil. C\$  | 2014                            | 2015   | 2016   | 2017bc | 2018bc | 2019bc |
| Tax-supported debt (% of consolidated operating revenues) | 91.1                            | 90.0   | 87.2   | 92.7   | 97.8   | 102.2  |
| Interest (% of operating revenues)                        | 6.1                             | 5.7    | 4.8    | 4.7    | 5.8    | 5.2    |
| National GDP per capita (single units)                    | 55,807                          | 55,430 | 55,910 | 58,448 | 60,211 | 61,903 |

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. 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.

## Ratings Score Snapshot

**Table 2**

| City of Laval -- Ratings Score Snapshot |                                    |
|---|------------------------------------|
| Key rating factors                      | Assessment                         |
| Institutional Framework                 | Very predictable and well-balanced |
| Economy                                 | Very strong                        |
| Financial Management                    | Strong                             |
| Budgetary Flexibility                   | Strong                             |
| Budgetary Performance                   | Strong                             |
| Liquidity                               | Exceptional                        |
| Debt Burden                             | High                               |
| Contingent Liabilities                  | Very low                           |

Note: S&P Global Ratings' credit ratings on local and regional governments are based on 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. 14, 2017. Interactive version available at [www.spratings.com/SRI](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

- North America November 2017: As Favorable Conditions Persist, All Eyes Are On Washington, Dec. 1, 2017
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local and Regional Government Default Study and Rating Transitions, May 8, 2017

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 agreed that the assessments of budgetary performance deteriorated. Key rating factors are 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

Laval (City of)

|                      |                |
|----------------------|----------------|
| Issuer Credit Rating | AA/Positive/-- |
| Senior Unsecured     | AA             |

Certain terms used in this report, particularly certain adjectives used to

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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 the 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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