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Research Update:

City of Laval Outlook Revised To Stable From Positive; 'AA' Ratings Affirmed

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Table Of Contents

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Overview

- Although improvement in the City of Laval's capital budgeting approach led to the city catching up significantly on its capital backlog without weakening its debt and liquidity profile, we believe that, on a consolidated basis, its financial performance will be strained more than we anticipated.
- As a result, we are revising our outlook on Laval to stable from positive.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the city.
- The stable outlook reflects our expectation that, in the next two years, Laval will maintain a level of spending that will keep up with its growing needs and that will not additionally pressure its budgetary performance or substantially weaken its liquidity; its debt burden will remain manageable; and local economic growth will continue.

Rating Action

On Nov. 30, 2018, S&P Global Ratings revised its outlook on the City of Laval, in the Province of Quebec, to stable from positive. At the same time, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on Laval.

Outlook

The stable outlook reflects our expectations that, in the next two years, the city will demonstrate its ability to deliver on its long-term capital planning without putting further pressure on its budgetary performance or 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.

All else equal, we could take a positive rating action in the next two years if Laval proved its ability to adjust its fiscal policy and response to rising spending levels in such a way that operating margins remain well above 5% of operating revenues and after-capital balances returned to sustainable surpluses.

Conversely, we could lower the ratings in the next two years if the city proved unable or lacked political willingness to address fiscal imbalances caused by its mounting spending requirements, resulting in operating margins below 5% of operating revenues and after-capital deficits consistently higher than 10% of total revenues or in higher-than-expected borrowing that pushed tax-supported debt to operating revenues over 120%.

Rationale

The outlook revision reflects our view that Laval's strategy to support rapid economic growth, although proactive, resulted in a lower-than-anticipated budgetary performance. We expect the city's growth in expenditures will continue to exceed the increase in revenues in the near term, leading to somewhat tighter operating surpluses and consistent after-capital deficits. Nevertheless, we believe that the city will maintain a manageable, albeit gradually rising, debt burden; and comfortably large liquidity levels to meet its annual debt service requirements.

Laval's significant funding needs put pressure on budgetary performance while the city manages to contain its debt burden and preserve its liquidity.

We expect Laval's operating margins to gradually decrease in the next two years and average 12.3% of operating revenues in 2016-2020. At the same time, we expect after-capital balances, which slipped into deficit for the first time in 2017, will remain in negative territory in the near term and average 5.5% in 2016-2020. We believe that these metrics are largely in line with those of other 'AA' rated peers. In our view, the city's financial performance reflects the tightening budgetary environment in which Laval operates, as it tries to keep up with rising funding needs required to support strong economic growth. Because of its project-based capital budget approach, Laval saw its cash capital spending (including that for its transit operator, Societe de Transport de Laval [STL]) significantly boosted, representing on average about 73% of its 2016 and 2017 total capital budget. This is a notable improvement from the previous years' actual spending, which averaged a relatively low level of about 45% per year. Laval's three-year capital plan (excluding STL) typically includes over 60% of growth-related projects, oriented mainly toward infrastructure renewal, with the remainder dedicated to maintenance. In the near term, the city expects to maintain a relatively high realization rate for its cash capital spending, which although partly financed with cash payments (C$138 million in annual contributions, on average from 2019-2021), transfers, and government and third-party subsidies, puts pressure on its financial performance. In addition, STL's rising funding needs in the next five years could weigh on budgetary results beyond our outlook horizon.

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 93% of operating revenues in 2016-2020. Nevertheless, like 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 increased significantly in 2016 and 2017, to almost 25% of total expenditures from close to 20% in the previous 10 years primarily because of more efficient capital planning. We expect the city to continue addressing its capital needs at a similarly fast pace in the near future, and to maintain its capital expenditures (which include spending realized by STL) to total expenditures ratio of 23.7%, on average, from 2016-2020.

Laval's strategy to use cash payments to partially fund its extensive capital plan is intended to limit excessive borrowing in the near term. Nevertheless, the city's total borrowing including refinancing reached the highest level so far at C$208.5 million in 2017 (of which C$185.3 million was for the city's needs and C$23.2 million was borrowed by STL). The city estimates its borrowing will remain elevated and average about C$203 million per year from 2018-2020. As a result, we expect tax-supported debt (composed of Laval's direct debt, STL's debt guaranteed by Laval, and capital leases) to continue to increase, reaching C$974.4 million by 2020, or 92.5% adjusted operating revenues. We believe, however, that its interest burden will remain fairly manageable, averaging 3.2% of operating revenues from 2017-2019.

Laval has an unfunded liability for pensions and other postemployment benefits (OPEB). At the end of 2017, the unfunded liabilities for pension and OPEB were C$77.6 million and C$107.6 million, respectively. Together, they represented about 21% of 2017 operating revenues. Laval's pension deficit decreased significantly as result of the application of the recent pension reform to its renegotiated collective agreements, which also significantly decreased pension costs. 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$649 million, which is sufficient to cover 3.3x 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.

Above-average growth economic prospects and a well-balanced institutional framework support the ratings.

Laval is north of Montreal and is the third-largest city in Quebec, 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 2015-2017 provincial average of about US$37,000. 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$1.2 billion in 2017), a more attractive nonresidential tax base, and available space for development. The local economy improved in 2017, with higher employment and property assessment values, in addition to strong construction activity, as reflected in higher building permits and housing starts. Population was more than 437,000 in 2017 and grew more than 1% annually in the past five years, a level superior to that recorded by the province.

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 deferral spending rate. It has prudent financial policies that ensure a good degree of transparency and fiscal discipline. Financial statements are independently audited, and the notes provide detailed information. 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.

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.

Key Statistics

Table 1

City of Laval -- Selected Indicators

	-- Fiscal year ended Dec. 31 --					
Mil. C$	**2015**	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	852	885	898	986	1,022	1,053
Operating expenditures	678	728	784	885	913	947
Operating balance	174	157	114	101	109	105
Operating balance (% of operating revenues)	20.4	17.7	12.7	10.3	10.7	10.0

Table 1

City of Laval -- Selected Indicators (cont.)						
	-- Fiscal year ended Dec. 31 --					
Mil. C$	**2015**	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Capital revenues	49	91	72	92	82	96
Capital expenditures	133	247	251	280	248	290
Balance after capital accounts	90	1	(65)	(86)	(57)	(89)
Balance after capital accounts (% of total revenues)	9.9	0.1	(6.7)	(8.0)	(5.2)	(7.7)
Debt repaid	137	143	141	139	169	165
Gross borrowings	137	149	208	172	203	233
Balance after borrowings	89	7	2	(54)	(22)	(21)
Modifiable revenues (% of operating revenues)	92.8	92.6	92.9	93.3	93.3	93.3
Capital expenditures (% of total expenditures)	16.4	25.3	24.3	24.0	21.3	23.4
Direct debt (outstanding at year-end)	766	772	839	872	907	974
Direct debt (% of operating revenues)	90.0	87.2	93.5	88.5	88.7	92.5
Tax-supported debt (outstanding at year-end)	766	772	839	872	907	974
Tax-supported debt (% of consolidated operating revenues)	90.0	87.2	93.5	88.5	88.7	92.5
Interest (% of operating revenues)	5.7	4.8	3.7	3.0	2.9	3.0
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. 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.

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	Average
Liquidity	Exceptional
Debt Burden	Moderate
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, 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

- Americas Economic Snapshots--November 2018, Nov. 26, 2018
- Global Trade At A Crossroads: USMCA, NAFTA's Successor--It Could Have Been Worse, Oct. 8, 2018
- Public Finance System Overview: Canadian Municipalities, July 18, 2018
- 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'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; CreditWatch/Outlook Action

	To	From
Laval (City of)		
Issuer Credit Rating	AA/Stable/--	AA/Positive/--

Ratings Affirmed

Laval (City of)	
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 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.