S&P Global
Ratings

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Research Update:

City of Laval Ratings Affirmed At 'AA'; Outlook Remains Stable

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Overview

- We expect the City of Laval will continue to benefit from a strong, dynamic, and diversified economy.
- While the city aims to maintain a level of spending that will keep up with its growing needs, we believe its funding strategy will allow it to preserve its budgetary performance, as well as its debt and liquidity profile.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the city, and maintaining our stable outlook.

Rating Action

On Nov. 21, 2019, 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 is stable.

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 additional 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.

Downside scenario

We could lower the ratings in the next two years if the city's strategy to keep up with economic growth pushed it into higher-than-expected spending, which resulted in after-capital deficits consistently higher than 10% of total revenues and in higher-than-expected borrowing that pushed tax-supported debt to operating revenues over 120%.

Upside scenario

All else being equal, we could take a positive rating action in the next two years if Laval was able to adjust its fiscal policy and respond to rising spending levels so that operating margins remained well above 5% of operating revenues and after-capital balances returned to sustainable surpluses, while maintaining a manageable debt burden and strong liquidity.

Rationale

We expect Laval to pursue its significant capital plan in the next two years in order to support rapid economic growth. Despite the city's better-than-expected financial performance in 2018 and 2019, we believe 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 be able to maintain a manageable, albeit gradually rising, debt burden and comfortably high liquidity levels to meet its annual debt service requirements.

Strong economic growth 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 the presence of a campus 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 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 close to national levels. In our opinion, Laval has a 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 benefit from significant public and private investments (estimated at C$1.3 billion in 2018), an attractive nonresidential tax base, and available space for development. The local economy improved in 2018, 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 2019 and grew more than 1% annually in the past five years, a level higher than that of the province.

In our view, Laval demonstrates 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. 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. We expect recent changes to the city's administration, including the appointment of a new general director and the new service reorganization, will allow Laval to provide the adequate framework to support economic growth. 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.

Laval to contain debt burden and preserve liquidity despite high capital spending program.

We expect Laval's operating margins to gradually decrease in the next two years and average 12.1% of operating revenues in 2017-2021. At the same time, we expect after-capital balances to remain in negative territory in the near term and average close to 6% in 2017-2021. We believe that these metrics are largely in line with those of '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 capital spending (including that for its transit operator, Societe de Transport de Laval; STL) significantly boosted, representing over 70%, on average, of its total capital budget in the past three years. 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 capital spending, which although partly financed with higher cash payments (C$35 million in additional annual contributions), transfers, and government and third-party grants, puts pressure on its financial performance. In addition, STL's rising funding needs in the next five years could further weigh on budgetary results beyond our outlook horizon.

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 has increased significantly over the past few years and is expected to exceed C$200 million per year, on average, from 2019-2021 (including amounts borrowed on behalf of STL). As a result, we expect tax-supported debt (composed of Laval's direct debt, STL's debt guaranteed by Laval, and capital leases) will continue to increase, reaching C$1 billion by 2021, or about 95% of operating revenues. We believe, however, that its interest burden will remain manageable, averaging about 3% of operating revenues from 2018-2020.

In our view, Laval benefits 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. We estimate the city's free cash will total about C$690 million in the next 12 months and cover more than 2.5x estimated debt service for the period. 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$	**2016**	**2017**	**2018**	**2019bc**	**2020bc**	**2021bc**
Operating revenues	877	896	1,005	1,042	1,071	1,103
Operating expenditures	728	784	861	889	975	992
Operating balance	149	112	144	153	96	111
Operating balance (% of operating revenues)	17.0	12.5	14.4	14.7	8.9	10.0
Capital revenues	91	72	89	70	96	101
Capital expenditures	247	251	291	234	292	307
Balance after capital accounts	(6)	(67)	(58)	(10)	(100)	(95)
Balance after capital accounts (% of total revenues)	(0.7)	(6.9)	(5.3)	(0.9)	(8.6)	(7.9)
Debt repaid	143	141	140	169	161	180
Gross borrowings	149	208	172	174	214	295
Balance after borrowings	(1)	0	(26)	(5)	(47)	20
Direct debt (outstanding at year-end)	772	839	871	878	931	1,046
Direct debt (% of operating revenues)	88.0	93.6	86.7	84.3	86.9	94.8
Tax-supported debt (outstanding at year-end)	772	839	871	878	931	1,046
Tax-supported debt (% of consolidated operating revenues)	88.0	93.6	86.7	84.3	86.9	94.8
Interest (% of operating revenues)	4.9	3.7	2.9	2.9	3.0	2.7
National GDP per capita (single units)	56,169	58,607	59,879	61,413	63,082	65,120

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 Laval -- Ratings Score Snapshot

Key rating factors	Assessment
Institutional framework	2
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
Debt burden	3

Table 2

City of Laval -- Ratings Score Snapshot (cont.)

Key rating factors	Assessment
Stand-alone credit profile	aa
Issuer credit rating	AA

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, Oct. 10, 2019. Interactive version available at http://www.spratings.com/sri

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Public Finance System Overview: Canadian Municipalities, 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	
Laval (City of)	
Issuer Credit Rating	AA/Stable/--
Senior Unsecured	AA