Research Update:

City of Edmonton Rating Affirmed At 'AA'; Outlook Stable

July 19, 2022

Overview

- The City of Edmonton's stronger-than-expected financial results during the COVID-19 pandemic, in large part due to support from senior levels of governments, set the stage for continued healthy operating balances and modest after-capital deficits in the next two years.
- Capital funding needs remain considerable and the debt burden is high and increasing, while the city's liquidity position remains a strength.
- Accordingly, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on Edmonton.
- The stable outlook reflects our view that moderate expected economic growth will support strong financial results, such that operating balances remain healthy and after-capital deficits are modest. We also expect the city's execution of the capital plan will not result in a significantly higher reliance on debt or internal resources relative to our current expectations.

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Rating Action

On July 19, 2022, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings and its 'A-1+' short-term rating and 'A-1(High)' Canada scale commercial paper rating on the City of Edmonton, in the Province of Alberta. The outlook is stable.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that, in the next two years, Edmonton will maintain sound financial results overall and secure the pay-as-you-go funding required under its large capital spending plan. This will allow the city to mitigate additional borrowing beyond current expectations or excessive drawdowns of reserves. We also expect that the economy will grow moderately during the outlook horizon.

Downside scenario

Weaker-than-expected economic activity could reduce Edmonton's user-fee revenues and affect property tax tolerance. If this, or an unexpected major spending decision, were to happen while the city is undertaking its substantial capital spending plan, Edmonton's budgetary performance and flexibility could weaken, such that after-capital deficits increase to more than 10% of total adjusted revenues. We could lower the rating as a result.

Upside scenario

We could raise the rating in the next two years if robust economic growth continued to support strong revenue generation, allowing the city to hold modest after-capital deficits of less than 5% of total adjusted revenues on a sustained basis. We would also expect Edmonton to execute on its capital plan without significantly increasing its reliance on debt beyond our current expectations.

Rationale

Edmonton's strong financial performance through the pandemic, in large part due to support from senior levels of government, and positive projected economic growth bode well for the city's ability to maintain very strong operating results and generate smaller-than-previously expected after-capital deficits. Nevertheless, projections show elevated reliance on debt funding and the tax-supported debt burden is rising. While we expect the city's management team will remain prudent in its decision-making heading into a new four-year budget cycle, some uncertainty remains given a high proportion of new council members, competing priorities, and diverse views on funding strategies.

The city heads into a new four-year budget cycle with a largely new council; economic fundamentals remain strong

Although economic activity has rebounded since the notable contraction in 2020 as a result of the pandemic, current labor and supply availability issues are straining goods-producing industries such as construction and agriculture. We view these as temporary and believe Edmonton continues to demonstrate the characteristics of a strong economy, despite headwinds. We estimate the city's GDP per capita at more than US$55,000 and above the national average. The Edmonton region is the design-and-fabrication center for most of the equipment used in the oil sands and other oilfield equipment. This results in high income levels and represents substantial economic concentration. As the city is the provincial capital, its economy has historically been anchored by a large public sector, which partially insulates the labor force from economic cycles.

In our opinion, the management team is experienced and qualified to effectively enact appropriate fiscal policies, as well as respond to external risks, most recently the pandemic. The 2021 municipal election resulted in eight new council members, of 12, and a new mayor. The city has a robust set of financial policies and a well-documented financial plan. In addition, it provides transparent disclosure of pertinent information. Management prepares detailed four-year operating and capital budgets, as well as a 10-year capital investment plan. Management of debt and liquidity is prudent, and the business plan details formal risk-management strategies and policies. We expect these practices will continue in the next two years.

As do other Canadian municipalities, Edmonton benefits from an extremely predictable and supportive local and regional government framework that has demonstrated high institutional stability and evidence of systemic extraordinary support in times of financial distress. Most recently through the pandemic, senior levels of government provided operating and transit-related grants to municipalities, in addition to direct support to individuals and businesses. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and 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. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations) through reserve contributions. Municipalities have demonstrated a track record of strong budget results and, thus, debt burdens, on average, are low relative to those of global peers and growth over time has been modest.

Substantial capital needs keep after-capital results in a deficit and add to the rising debt burden

Proactive management action around cost control, coupled with extraordinary support from senior levels of government, has strengthened budgetary results in the past two years compared with pre-pandemic levels. As pandemic-related support wanes, we expect operating balances will moderate but remain very healthy in the next two years, at more than 18% of adjusted operating revenues. We expect the city will approach upcoming budget discussions with tax affordability and fiscal sustainability in mind, as it manages growth in an inflationary environment.

Edmonton's considerable capital plan will keep pressure on after-capital balances, which we forecast will remain in a deficit and average 2.3% of adjusted total revenues in 2020-2024. Notably, the trajectory in after-capital results has improved since our last review due to stronger-than-expected operating performance in 2021 and healthier revenue. The city plans to spend more than C$4.8 billion on capital projects through 2024. The three light-rail transit (LRT) projects make up about half of the capital plan in the next two years, with the Valley Line Southeast LRT (stage one) set to open later this summer.

Although Edmonton shares the cost of the LRT projects with senior levels of government, its portion includes a large debt-funding component and will continue to spur borrowings. The city plans to issue about C$2.3 billion in 2022-2024, which includes C$490 million related to the promissory note program, leading to an increase in the tax-supported debt burden to C$5.03 billion. This represents about 151% of forecast operating revenues in 2024. Correspondingly, we expect interest costs will modestly increase during the outlook horizon but remain manageable, averaging 4.2% of operating revenues in 2021-2023. Our measure of tax-supported debt includes C$523 million in debt issued by Edmonton for EPCOR Utilities Inc. The city's contingent liabilities are low. We do not consider the debt EPCOR issues in its own name as a contingent liability, because we believe the likelihood of the city providing the utility with extraordinary support in a stress scenario is low.

Edmonton benefits from exceptional internal liquidity support and strong 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. Edmonton can also draw up to C$100 million in promissory notes and C$250 million on its line of credit, and can access the province for term debt financing. We estimate that the city's cash and investments will total about C$2.3 billion in the next 12 months, sufficient to cover about 4.0x estimated debt service for the period.

Key Statistics

Table 1

City of Edmonton--Selected Indicators

	--Fiscal year-end Dec. 31--					
(Mil. C$)	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenues	3,060	3,066	3,142	3,218	3,272	3,328
Operating expenditures	2,545	2,407	2,462	2,615	2,659	2,705
Operating balance	514	659	680	603	613	623
Operating balance (% of operating revenues)	16.8	21.5	21.7	18.7	18.7	18.7
Capital revenues	603	599	432	764	999	929
Capital expenditures	1,259	1,379	1,136	1,593	1,663	1,590
Balance after capital accounts	(142)	(121)	(25)	(226)	(51)	(37)
Balance after capital accounts (% of total revenues)	(3.9)	(3.3)	(0.7)	(5.7)	(1.2)	(0.9)
Debt repaid	335	474	240	434	429	414
Gross borrowings	452	659	379	823	785	694
Balance after borrowings	(25)	63	115	162	305	243
Direct debt (outstanding at year-end)	3,810	3,963	4,070	4,457	4,782	5,029
Direct debt (% of operating revenues)	124.5	129.3	129.5	138.5	146.1	151.1
Tax-supported debt (outstanding at year-end)	3,810	3,963	4,070	4,457	4,782	5,029
Tax-supported debt (% of consolidated operating revenues)	124.5	129.3	129.5	138.5	146.1	151.1
Interest (% of operating revenues)	4.6	4.7	3.7	4.2	4.9	5.2
Local GDP per capita (single units)	N/A	N/A	N/A	N/A	N/A	N/A
National GDP per capita (single units)	61,469	58,016	65,186	69,471	70,786	71,954

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

City of Edmonton--Ratings Score Snapshot

Table 2

Key rating factors	Scores
Institutional framework	1
Economy	2
Financial management	1
Budgetary perfomance	2

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

Liquidity	1
Debt burden	4
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, April 11, 2022. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Canada Q3 2022: Near-Term Growth To Slow Amid Faster Rate Hikes And Surging Inflation, June 27, 2022
- Canada Real-Time Data: Reopening Helps Offset Inflation Pain, For Now, June 3, 2022
- Institutional Framework Assessment: Canadian Municipalities, June 1, 2022
- Sector And Industry Variables | Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Feb. 23, 2022
- S&P Global Ratings Definitions, Nov 10,, 2021
- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019

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	
Edmonton (City of)	
Issuer Credit Rating	AA/Stable/A-1+
Edmonton (City of)	
Commercial Paper	A-1(HIGH)
Commercial Paper	A-1+