Research Update:

City of Brampton 'AAA' Issuer Credit Rating Affirmed; Outlook Is Stable

October 20, 2023

PRIMARY CREDIT ANALYST

Elisa Lopez cortes
Toronto
+1 416 507 2574
elisa.lopez.cortes
@spglobal.com

SECONDARY CONTACT

Dina Shillis, CFA
Toronto
+ 1 (416) 507 3214
dina.shillis
@spglobal.com

RESEARCH CONTRIBUTOR

Ritesh Bagmar
CRISIL Global Analytical Center, an
S&P affiliate, Pune

Overview

- Strength in the local economy and prudent financial management support the City of Brampton's creditworthiness despite uncertainty about the dissolution of the Regional Municipality of Peel and recent legislative changes to municipal collection of development charges in Ontario.
- Although the impact of both could pressure Brampton's debt burden and available funding for capital, we believe the city has robust liquidity and dedicated reserves to accommodate the needs of its expanding economy.
- Accordingly, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on Brampton.
- The stable outlook reflects our view that the growing local economy and prudent management will support the city's solid financial results. We also expect the city's liquidity position to remain a key credit strength.

Rating Action

On Oct. 20, 2023, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on the City of Brampton in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that despite operating and capital pressures, Brampton's record of very strong and prudent financial management will continue. We expect the debt burden will remain relatively stable and represent about 21% of operating revenues at year-end 2025. However, it could increase further if the dissolution of Peel Region results in Brampton assuming a significant share of Peel's debt servicing cost without a commensurate increase in revenue.

Downside scenario

We could lower the rating if Brampton's revenue growth does not support the city's expanding needs, leading to deterioration in after-capital balances such that they remain in a deficit on a sustained basis. This could lead to higher-than-expected reliance on debt, with tax-supported debt approaching 60% of operating revenues in the next two years. This could happen if tax and fee increases needed to cover lost revenue and expanded service responsibilities were met with effective resistance.

Rationale

We believe that Brampton's stable economy and prudent financial management will help the city keep posting strong results despite uncertainty around the Peel Region dissolution and its financial impacts. We estimate on average from 2021 to 2025 modest surplus after capital accounts in an environment of escalating costs and an increasing capital plan for maintenance and accommodation of the city's growth needs.

We also expect the city will keep its tax-supported debt at about 21% of operating revenues by 2025, as it has been able to establish reserves in advance for specific capital projects. We have incorporated volatility from the risk of Brampton assuming a significant share of Peel's debt once the dissolution occurs.

Strong management and advance planning for growth support financial results despite potential budget impact of regional dissolution.

We expect Brampton will remain one of the fastest-growing municipalities in the province. Compared with its peers, the city has strong socioeconomic and demographic characteristics, a younger-than-national-average population, sounder population growth, and a diversified economy that benefits from its advantageous location near major highways and central markets. Brampton continues to meet the high demand for industrial land by building out infrastructure. It continues to attract new businesses and many existing ones are expanding. We estimate that the city's GDP per capita would be in line with the national average of more than US$54,400, based on Brampton's relatively high median household income and prosperous economy.

The dissolution's ultimate impact on the structure and size of the city's operating and capital budget remains unclear; however, we expect the city's prudent financial management practices will persist and support fiscal sustainability in the future. We think the dissolution will increase the city's budget and alter its capital structure since the three lower-tier municipalities--Brampton, Caledon, and Mississauga--assume a share of service responsibilities from the region. They also assume a share of revenue, assets, and liabilities, including debt service obligations.

The potential impact on both revenue and spending could, in our view, influence Brampton's budgetary flexibility. In 2019, two third parties conducted analyses of the potential tax impact of the dissolution. We did not examine the detailed assumptions used in these analyses, but in our view, estimates of significant tax benefits to Brampton based on these studies could be overstated. This is particularly evident given the additional impact of Ontario's Bill 23, the More Homes Built Faster Act, on the ability to collect development charges (DCs) at both the regional and local levels.

We consider that the timeframe for municipalities to adjust future budgets and find alternative sources of funding to offset potential lost DC revenue is likely sufficient. Still, the city might have to raise tax rates to make up a key source of funding for growth capital, defer or scale back some projects, or debt-finance a more significant portion of its capital plan. Key to this would be a thoughtful management response to navigating changes that could strain tax affordability and revenue diversity. The province intends to make cities whole for their ability to fund growth and is undertaking an audit of certain cities' DC reserves. However, many questions remain about the impact of legislation on the city's revenue-raising capacity.

In our view, Brampton has strong financial management practices. It has infrastructure and transit levies and dedicated contributions to several reserves and reserve funds built into the operating budget, such as a debt service reserve, dedicated transit fund, and stormwater funds, to ensure long-term capital needs. We will continue to monitor the council's commitment to fiscal sustainability against the expanding city's funding requirements and the evolution of dedicated funding sources relative to the state of infrastructure assets over time. Brampton provides clear, transparent disclosure information and annually prepares detailed operating and capital budgets, including funding sources.

As do other Canadian municipalities, Brampton 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, therefore, debt burdens, on average, are low relative to those of global peers and growth over time has been modest.

The city will increase reliance on accumulated reserves to fund higher capital spending, while future adoption of regional debt will drive up debt.

A stable economy, booming population, and growing property tax base bolstered the city's revenues but also have contributed to Brampton's rising operating and capital pressures. As wage and cost pressure catches up with several years of elevated inflation and an expansive capital plan, we expect operating margins will weaken but remain healthy while after-capital results slip into a modest deficit in the next two years. Despite projected deterioration in financial results to support infrastructure requirements, we believe the city administration has planned for these outlays over time by building up dedicated reserves, including by means of special levies.

We expect Brampton to spend about C$230 million annually on capital improvements in the next two years, focusing primarily on roads, bridges, and transit projects. DCs and grants from senior levels of government are important funding sources for capital, constituting 36% and 19% of the total capital budget, respectively.

In the next two years, Brampton plans to issue C$75 million in new debt, bringing total tax-supported debt to about C$180 million by 2025 or 21% of forecast operating revenues. We believe this is manageable and is lower than the debt burden of Canadian peers in the same rating category. Interest costs, at about 1% of operating revenues, are very low, and exposure to contingent liabilities is limited. A large portion of upcoming issuance is for the Centre for Innovation, a new multi-story institutional, academic, and library building. Total debt also includes the capital lease obligations related to the Southwest Quadrant Renewal Plan and the guaranteed loan for the CAA Centre.

Current projections don't include borrowing under the city's C$400 million credit agreement with the Canada Infrastructure Bank to fund the purchase of up to 450 electric buses by 2027. Council approved the agreement in early 2022. The city deferred borrowing requirements related to this deal and it is uncertain when this will be formalized.

We believe the city's debt burden will rise substantially following dissolution and debt to revenue could weaken if total revenue does not increase accordingly. In our analysis, we have incorporated the potential for future volatility in the debt burden. However, our forecast through 2025 does not incorporate the impact of dissolution on debt, revenue, or expenditures, given uncertainty regarding how regional services, assets, and liabilities will be apportioned. Our analysis of Brampton's post-dissolution debt profile will consider the stock of regional debt for which the city pays debt service from its own revenue, in addition to debt issued on its behalf by the region and independently as a city.

We expect liquidity will remain very strong and estimate in the next 12 months, Brampton's adjusted free cash and liquid assets will average about C$841 million, representing more than 67x debt service in that period. Similar to that of domestic peers, the city's access to external liquidity is satisfactory, in our view.

Key Statistics

Table 1

City of Brampton -- selected indicators

	--Fiscal year-end Dec. 31--					
(Mil. C$)	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenues	705	743	766	808	839	868
Operating expenditures	590	599	669	725	749	776
Operating balance	115	144	97	83	89	92
Operating balance (% of operating revenues)	16.3	19.4	12.6	10.3	10.7	10.6
Capital revenues	101	87	137	158	130	123
Capital expenditures	230	186	236	219	230	230
Balance after capital accounts	(13)	46	(2)	21	(11)	(16)
Balance after capital accounts (% of total revenues)	(1.7)	5.5	(0.2)	2.2	(1.1)	(1.6)
Debt repaid	3	3	4	4	5	6
Gross borrowings	0	18	0	0	25	50
Balance after borrowings	(16)	62	(6)	17	10	29
Direct debt (outstanding at year-end)	108	123	120	116	136	180
Direct debt (% of operating revenues)	15.3	16.6	15.6	14.3	16.2	20.8
Tax-supported debt (outstanding at year-end)	115	130	126	122	142	186

Table 1

City of Brampton -- selected indicators (cont.)

	--Fiscal year-end Dec. 31--					
(Mil. C$)	2020	2021	2022	2023bc	2024bc	2025bc
Tax-supported debt (% of consolidated operating revenues)	16.3	17.5	16.5	15.1	17.0	21.4
Interest (% of operating revenues)	1.0	1.0	1.0	0.9	1.0	1.2
National GDP per capita (single units)	58,139	65,651	71,478	72,372	73,609	75,112

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.

Ratings Score Snapshot

Table 2

Brampton -- ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary perfomance	1
Liquidity	1
Debt burden	2
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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

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: Principles Of Credit Ratings, Feb. 16, 2011

Per our relevant policies and procedures, the Rating Committee was composed of analysts 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	
Brampton (City of)	
Issuer Credit Rating	AAA/Stable/--