

Global Credit Research - 23 Oct 2015

Vancouver, British Columbia, Canada

## Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	Aa2
Senior Unsecured -Dom Curr	Aa2

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## Key Indicators

South Coast British Columbia Transport. Auth (Calendar Year)	2010	2011	2012	2013	2014
Net Debt (C\$000)	3,458,742	3,544,341	3,589,025	3,577,233	3,580,066
Net Debt per Revenue Passenger (C\$) [1]	15.8	15.2	15.0	15.3	15.3
Growth in Revenue Passengers (%) [1]	15.7	6.6	2.4	(2.1)	0.3
Net Debt as a % of Revenues [2]	278.6	282.3	264.6	259.5	258.8
Interest Payment as % of Revenues	10.0	12.2	12.0	12.0	12.4
Farebox Recovery Ratio (%) [3]	48.0	47.6	47.4	51.0	49.0

[1] TransLink's methodology for estimating revenue passengers was changed in 2011 resulting in a restatement of 2010 results. [2] Revenues are net of capital contributions. [3] Farebox receipts as a percentage of operating expenses net of amortization.

## Opinion

### SUMMARY RATING RATIONALE

The Aa2 rating assigned to the South Coast British Columbia Transportation Authority ("TransLink") reflects (1) the authority's strong market position as the main provider of transportation services in the Greater Vancouver region with a robust ridership, (2) access to a diverse set of revenue sources, including its status as a taxing authority, and (3) solid governance and management practices requiring balanced operating budgets, 10-year fully funded investment plans and a 30-year long-term strategy.

TransLink has one of the highest debt (259% of revenue net of capital contributions) and interest burdens (12.4% as a of revenue net of capital contributions) among similar rated global peers, but benefits from more diverse revenue sources, as well as favorable network characteristics, solid operating margins and liquidity. TransLink's wider responsibilities and status as a taxing authority allow it to sustain a higher debt burden than other public mass transit enterprises at the same rating level.

We expect that future expansionary capital investments will likely lead to a further modest increase in debt over

the next few years. However, we expected debt to remain below 300% of revenue.

### **Credit Strengths**

- Access to a wide variety of revenue sources stemming from its status as a taxing authority
- Governance policies support solid governance and management practices
- Track record of finding cost efficiencies

### **Credit Challenges**

- Limited prospects for deleveraging due to high expansionary capital requirements
- Constructive working relationship with Mayor's Council and provincial government is critical for gaining support and funding for future capital projects

### **Rating Outlook**

The rating outlook is stable.

### **What Could Change the Rating - Up**

The rating could be upgraded in case of new sustainable revenue sources for capital projects which would also support a decrease in TransLink's debt burden.

### **What Could Change the Rating - Down**

The rating could be downgraded in case of (1) evidence that TransLink cannot capitalize on its status as a taxing authority anymore; (2) an increase in debt to revenue above 300%, (3) a deterioration in TransLink's liquidity profile or (4) material changes to TransLink's governing legislation, removing requirements to achieve balanced financial plans, or changes to TransLink's governance model, leading to greater uncertainty in medium-term operating and capital planning.

### **Issuer Profile**

The South Coast British Columbia Transportation Authority was created by the Province of British Columbia and assumed responsibility for the Greater Vancouver regional transportation system in 1999. Despite the provincial government's role in creating the authority, TransLink operates fairly independently from the provincial government. TransLink is responsible for (1) planning, constructing, funding, operating and maintaining a regional transport system, (2) the construction and maintenance of a "major road network" that crosses the boundaries of several area municipalities, as well as (3) managing transportation demand-management strategies and programs.

### **DETAILED RATING CONSIDERATIONS**

The Aa2 rating assigned to TransLink reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for government related issuers (GRIs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) of a1 for TransLink and then considers the likelihood of support coming from the Province of British Columbia (Aaa, stable) in the event that the entity faces acute liquidity stress.

### **Baseline Credit Assessment**

#### **ACCESS TO A VARIETY OF REVENUE SOURCES STEMMING FROM ITS STATUS AS A TAXING AUTHORITY**

TransLink's institutional characteristics correspond to those defining municipal governments (legislated balanced budget requirements, taxing authority) and transit authorities (fare box revenues) in Canada, making it unique among mass transit providers. The company does not rely on operating grants from local government or the province. Fares, fuel taxes, property tax receipts, toll fees, and parking rights taxes account for about 90% of its revenues, while operating grants from governments contribute just 1%.

TransLink's assets are essential to the functioning of the Metro Vancouver economy. While overall demand for its services is sensitive to changes in fares and service levels, overall ridership tends to be robust. TransLink has the ability to raise revenues and/or cut expenses as required to meet its legislated balanced budget requirement.

Moreover, TransLink's founding legislation allows it to access, by law, any tax or revenue source not included in its strategic plan if its board considers it necessary to do so in order to meet debt obligations.

We expect that TransLink can continue to exploit its status as a taxing authority despite a rejected sales tax referendum which leaves the authority with more limited funds to finance infrastructure and service expansion over the next 10 years.

#### GOVERNANCE POLICIES SUPPORT SOLID GOVERNANCE AND MANAGEMENT PRACTICES

TransLink continues to benefit from sound governance and management practices. The authority has a long-term focus, and has made progress in benchmarking its own performance against peers. TransLink's governance and management practices are subject to the oversight of the Mayors' Council. The authority is also required to present a balanced budget, a 10-year fully-funded investment plan, and is subject to restrictions that limit its debt burden to a maximum of CAD3.5 billion (CAD2.7 billion in 2014 according to the applicable definition). The Mayors' Council also approves annual fare increases beyond the 2% legislated limit and annual property tax revenue increases beyond a 3% legislated limit.

Turnover in TransLink's leadership team and controversy about executive remuneration have temporarily created corporate governance uncertainties in 2015. However, we note positively that the Mayors' Council has now passed a revised executive remuneration plan and TransLink has resumed its search for a new CEO. Until a new CEO has been found, the current CFO will serve as acting CEO.

Strong management leadership and a constructive working relationship with the Mayors' Council will be critical for restoring public confidence in TransLink, which took a hit during the rejected sales tax referendum in 2015, and for maintaining support for larger capital projects as well as fare and property tax revenue increases.

The Mayors' Council, made up of all the mayors from the 21 municipalities in Metro Vancouver and the Chief of the Tsawwassen First Nation, has substantial oversight responsibilities, and appoints 7 of TransLink's 11 directors. The Chair and Vice Chair of the Mayors' Council also sit on the board. The Province of British Columbia has the right to appoint another 2 board members.

#### TRACK RECORD OF FINDING COST EFFICIENCIES

We expect that TransLink will be able to record a small consolidated surplus or at least balanced results in 2015.

Funds for expansionary capital projects are limited and TransLink has a high fixed cost burden in terms of depreciation (11.7% of revenue in 2014) and interest expense (12.4% of revenue in 2014). However, TransLink benefits from solid operating margins before interest and depreciation which have supported small positive consolidated surpluses for the last two years. In addition, the group has achieved CAD240 million of claimed cost savings since 2012 (17% of total expenses) and has maintained capital expenditures under control.

2015 and 2016 are critical years for TransLink's operations. The authority is currently in the roll-out phase of an electronic payment system, the Compass Card, which will be a phased roll-out. The project has been delayed by over two years and is around CAD23 million over the original budget of CAD171 million. Once successfully rolled-out the electronic payment system could increase efficiency and provide the authority with valuable data to optimize service levels. As part of the project TransLink will also move to a one fare zone for buses in the Metro Vancouver area which potentially could lead to a minor drop in fare revenue in 2016 if not offset by an increase in bus ridership or future fare increases.

#### LIMITED PROSPECTS FOR DELEVERAGING DUE TO HIGH EXPANSIONARY CAPITAL REQUIREMENTS

We expect that TransLink will move forward with a number of critical projects over the next few years once a revised capital plan is approved, including replacing or repairing the Pattullo bridge, improving bus services, and potentially adding future light rail services to accommodate expected population growth. The federal and provincial governments have each previously provided one third of the funding for TransLink's major capital expansions in the past, and will likely continue to do so.

Until the Mayor's Council will have approved a new capital plan, TransLink continues to operate under its existing 10-year 2014 base plan. The 2014 base plan foresees only limited future increases in debt mainly in the period of 2015-2017 and would lead to a gradual deleveraging starting in 2018.

TransLink's wider responsibilities and status as a taxing authority allow it to sustain a higher debt burden (259% of revenue net of capital contributions) than other public mass transit enterprises at the same rating level. However,

new borrowing leading to an increase in its debt burden beyond 300% of revenue would be credit negative. Any gross debt increase beyond CAD3.5 billion (CAD2.7 billion according to applicable definition in 2014), excluding public private partnership (P3) liabilities, requires the approval of the Mayors' Council.

## **Other Considerations**

### Global Mass Transit Rating Methodology Scorecard Output

The Global Mass Transit Rating Methodology, dated February 2015, indicates a score of a1, which is consistent to the assigned BCA of a1. Under the methodology, TransLink is a positive outlier in terms of size, operating environment, market share, service level characteristics and level of self-support. However, at the same time TransLink scores weakly in terms of budget flexibility, budget balance and its leverage is high for its rating category.

Please see the Credit Policy page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

## **Extraordinary Support Considerations**

Moody's assigns a high likelihood of extraordinary support from the Province of British Columbia (Aaa, negative) to prevent a default by TransLink, reflecting the major public policy role played by TransLink in providing mass transit services as well as key roads and bridges to the largest metropolitan area in Western Canada. The high likelihood of support also reflects the province's strong regulatory oversight over TransLink. A default by TransLink would likely lead to a sharp increase in borrowing costs for public sector entities in British Columbia, thereby providing incentive to the province to act to prevent a default by TransLink.

Moody's also assigns a very high level of default dependence between the province and TransLink, reflecting the two entities' shared exposures to common economic and financial risks.

## **ABOUT MOODY'S SUB-SOVEREIGN RATINGS**

### National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in June 2014 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

### Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

### Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 - 70%), high (71 - 90%) and very high (91 - 100%).

### Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated.

Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

## Rating Factors

### South Coast British Columbia Transport. Auth

Global Mass Transit Enterprises Methodology Grid [1]	Weight	Current 12/31/2014	
<b>Factor 1 : Size (15%)</b>		<b>Measure</b>	<b>Score</b>
a) Issuer Size - Annual Ridership (Million)	10%	235	Aa
b) Market Size - Service Area Population (Million)	5%	3	Aa
<b>Factor 2 : Market Position (35%)</b>			
a) Operating Environment	20%	Aa	Aa
b) Service Area Characteristics	5%	Aa	Aa
c) Market Share - Utilization (%)	10%	94	Aa
<b>Factor 3 : Financial Flexibility (20%)</b>			
a) Level of Self-Support - Farebox Recovery Ratio (%)	10%	49.0%	Aa
b) Budget Flexibility (3 Year Avg Fixed Costs as % of Oper. Exp.)	10%	23.4%	Baa
<b>Factor 4 : Debt &amp; Financial Metrics (30%)</b>			
a) Leverage - Debt/Revenues	15%	2.6x	Ba
b) Budget Balance - (US) Debt Service Coverage (3 Year Avg) / (Int'l) Interest as a % of Operating Revenues (3 Year Avg)	5%	12.1%	Ba
c) Budget Balance - Net Margin (3 Year Avg)	5%	21.1%	Aaa
d) Liquidity - Days Cash on Hand	5%	105	A
<b>Baseline Credit Assessment (BCA):</b>			
Additional Adjustments/Notching Factors			0.5
a) Indicated BCA from Grid			a1
b) Actual BCA Assigned			a1

[1] As of fiscal year 2014.

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