

## CREDIT OPINION

5 August 2021

Update

 Rate this Research

### RATINGS

#### South Coast British Columbia Transport. Auth

Domicile	Vancouver, British Columbia, Canada
Long Term Rating	Aa2
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# South Coast British Columbia Transport. Auth (Canada)

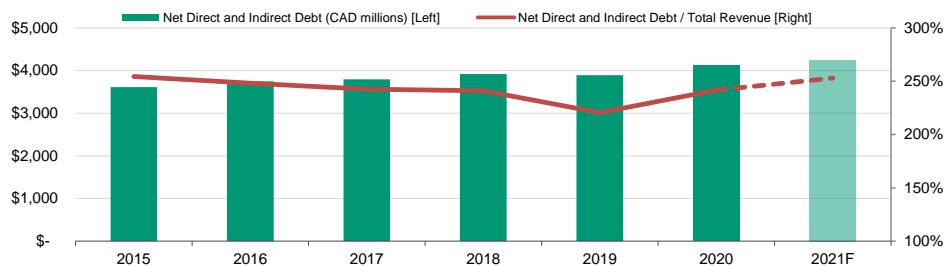
Update to credit analysis

## Summary

The credit profile of the [South Coast British Columbia Transportation Authority](#) (TransLink, Aa2 negative) reflects its strategic importance as the main provider of transportation services in the Greater Vancouver region, a strong institutional framework and its unique status as a taxing authority which allows it to sustain a higher debt burden than peers. However, a significant drop in passenger volumes and a related decline in transit revenues as a result of the coronavirus pandemic will result in longer-term operating pressures. Additional coronavirus waves and permanent changes in passengers' willingness to travel by transit could further hinder recovery, although federal and provincial funding support for 2020 and 2021 related to the pandemic provide temporary offset. TransLink's debt burden, which is high relative to Moody's rated global peers, will reach approximately 253% in 2021.

Exhibit 1

### Following a period of improving debt profile, the debt burden will gradually rise



Sources: TransLink and Moody's Investors Service

## Credit strengths

- » Strategic importance as the main regional transportation provider
- » Taxing power allows access to diversified revenue sources
- » Strong governance and institutional characteristics

## Credit challenges

- » Reduced transit demand could lead to long-term revenue loss, although government funding mitigates near-term challenges
- » Debt burden remains elevated relative to peers

## Rating outlook

The negative outlook on TransLink's ratings reflects significant coronavirus-related pressures which will lead to weaker fiscal results and higher debt burden across multiple years. It also reflects our view that the post-coronavirus recovery could be hindered by a subsequent reversal in travel demand and additional containment measures as a result of further waves of virus transmission.

## Factors that could lead to an upgrade

The outlook could be stabilized if increased ridership and commute levels lead to a faster fiscal recovery than we currently forecast, and if TransLink were able to maintain a debt burden below 300% of revenue.

## Factors that could lead to a downgrade

Downward pressure on the ratings could result from a slower than anticipated fiscal recovery and rising debt burden, evidenced by TransLink's inability to adapt to a changed environment. A long-term reversal in travel demand and additional containment measures as a result of further waves of virus transmission could also hinder recovery, along with potential permanent changes in passengers' willingness to travel by transit leading to weaker operating margins would also lead to downward rating pressure.

## Key indicators

### South Coast British Columbia Transportation Authority

(Calendar Year ending Dec 31)	2015	2016	2017	2018	2019	2020	2021F
Annual Ridership (millions) [1]	238.8	234.2	247.8	262.6	272.4	128.0	143.8
Net Debt (CAD millions)	3,613.2	3,747.9	3,792.1	3,915.6	3,888.0	4,125.9	4,244.4
Net Debt as a % of Revenues [2]	254.4	248.2	242.6	241.0	219.6	241.6	252.9
Interest Payment as % of Revenues [2]	12.4	11.9	11.7	11.4	10.6	11.2	10.8
Farebox Recovery Ratio (%) [3]	45.3	47.9	48.6	50.1	50.8	29.8	27.6
Days Cash on Hand	101.0	107.7	145.4	165.6	152.5	139.0	151.7

[1] Number of unconnected passenger trips (passenger journeys)

[2] Revenues are net of capital contributions

[3] Transit revenue as a percentage of operating expenses

Sources: TransLink audited financial statements and budget, Moody's Investors Service

## Detailed rating considerations

The credit profile of TransLink, as expressed by its Aa2 negative rating, combines a baseline credit assessment (BCA) of a1 and a high likelihood of extraordinary support coming from the [Province of British Columbia](#) (Aaa stable) in the event that the authority faced acute liquidity stress.

## Baseline credit assessment

### Strategic importance as the main transportation provider for the Greater Vancouver economy

TransLink's services are essential to the functioning of the Greater Vancouver economy. It is the main provider of transportation services in the Greater Vancouver region and serves a large population of 2.7 million. TransLink is responsible for around 90% of the region's transit and therefore does not have viable competitors. TransLink's growth has been strongly correlated to long-term demand for public transit from a growing regional population as evidenced by historically robust ridership.

TransLink operates an extensive bus and rail network, including the SkyTrain rapid light-rail transit system, passenger ferries, an express commuter rail and transit for mobility-impaired passengers. Prior to the coronavirus pandemic, its network provided around 272 million rides annually with a utilization ratio of 101% (annual ridership relative to the service area population). The farebox recovery ratio (farebox revenues relative to operating expenses) stood at 51% in 2019, a level we consider strong, although it declined to 30% in 2020 during the pandemic.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

TransLink 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 it, TransLink operates fairly independently from the provincial government. TransLink is responsible for (1) planning, constructing, funding, operating and maintaining a regional transport system, (2) constructing and maintaining a major road network that crosses the boundaries of several area municipalities, as well as (3) managing transportation demand-management strategies and programs.

#### **Taxing power allows access to diversified revenue sources**

TransLink's governing legislation allows it to raise property taxes or access any legislated revenue source at the discretion of its board of directors in order to meet its debt obligations. TransLink's taxation powers also allow it to have diverse revenue sources, including property taxes that partly cushion it from ridership revenue declines. Property taxes tend not to fluctuate with economic shocks, insulating it from pandemic-related economic weakness and ridership declines. TransLink also receives revenue from fuel tax and parking rights tax.

As a transit agency with taxing powers, TransLink's institutional characteristics correspond to those of both a transit authority (farebox revenues) and a municipal government (legislated balanced budget requirements, taxing authority) in Canada, making it unique among the majority of mass transit providers. TransLink does not rely on operating grants from local governments or the province, and we view the pandemic-related provincial and federal funding in 2020 and 2021 as temporary support.

Further, TransLink's status as a taxing authority enables it to raise taxes and revenue sources which could be used to compensate for lost passenger revenues. Although we note that TransLink may have limited willingness to raise taxes during a stressed environment (including the coronavirus pandemic), this status nevertheless provides fiscal flexibility and in turn a capacity to maintain a higher debt burden than many other mass transit agencies in our rated portfolio. TransLink also has significant unutilized revenue sources such as vehicle levies and area benefit taxes that could be used to meet future financial requirements.

#### **Strong governance and institutional characteristics**

TransLink's governance and management practices, which we consider to be strong, are subject to oversight by the Mayors' Council which reviews and approves TransLink's long-term transportation plans and provides certain oversight responsibilities for fares, executive compensation and customer surveys and complaints. The Mayors' Council, which primarily includes the mayors (or their representatives) from the 21 municipalities in Metro Vancouver, has substantial oversight responsibilities, and appoints 7 of TransLink's 11 directors. The Mayors' Council Chair and Vice Chair also sit on the Board. The Province of British Columbia has the right to appoint another 2 board members. We do not expect significant governance and policy changes in the near term under TransLink's new CEO (effective 19 July 2021).

TransLink uses multi-stage long-term investment plans that allow for a phased approach to future infrastructure investments, closely linking expenses to anticipated funding sources. Forecasting is done through its 30-year long-term regional transportation strategy (updated every 5 years) and 10-year fully funded investment plans (updated at least every 3 years). TransLink's 2022-2031 capital plan (named 'economic recovery plan') will address its long-term strategic capital priorities and funding in the anticipated post-pandemic years.

Debt accumulation is constrained by a legislated debt ceiling (currently CAD5.5 billion in gross debt) as well as an internal policy limit of 20% of gross interest costs as a percentage of operating revenues. Increases in TransLink's borrowing limit are subject to approval by the board of directors and Mayors' Council, although the debt ceiling has been increased several times since 2014 to accommodate higher debt requirements for capital costs, highlighting the authority's requirement for high levels of debt. The Mayors' Council also approves annual fare increases beyond the legislated limit and annual property tax revenue increases beyond a legislated limit. However, given that raising taxes during the coronavirus pandemic could be politically unpopular, we do not anticipate significant fare or tax increases beyond legislated limits in the near term. The terms of the federal/provincial pandemic support will require TransLink to limit fare increases to 2.3% annually until 2024.

#### **Reduced transit demand could lead to long-term revenue loss, although government funding mitigates near-term challenges**

Leading up to the pandemic, transit fares (33% in 2019), and various taxes and levies (fuel taxes, property and replacement taxes, parking taxes, hydro levy, combined 43% in 2019) accounted for 75-80% of TransLink's operating revenues. Operating grants from senior governments contributed just under 4%.

As part of pan-Canadian pandemic related support, TransLink received CAD644 million in combined federal and provincial operating funding which fully mitigated its revenue shortfalls (net of expense savings) including covering its CAD337 million net loss for 2020, with the balance carried over to 2021 to cover anticipated revenue shortfalls and lower planned fare increases over the next four years.

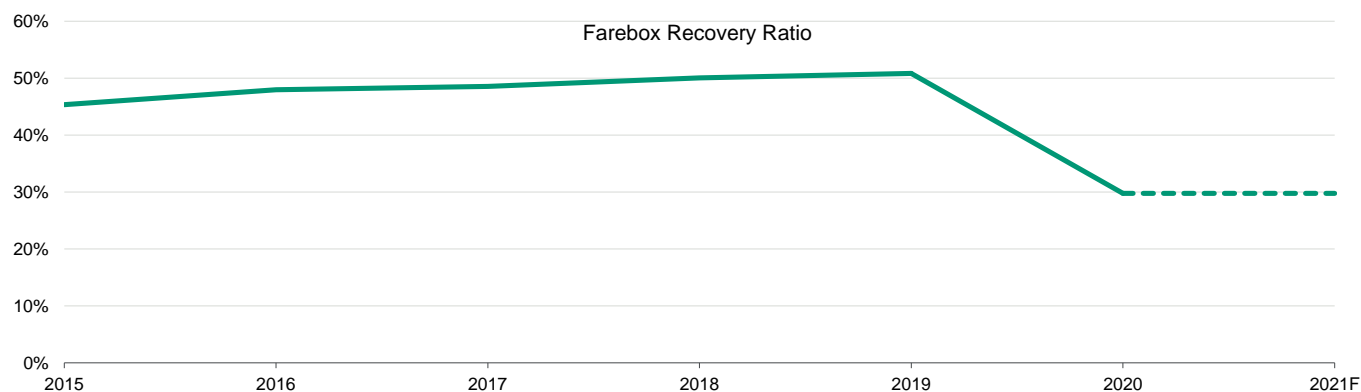
Given the high dependence on transit fares in addition to taxes that depend on commute (fuel and parking taxes), TransLink's operating profile is highly sensitive to ridership declines. Ridership on its bus, and SkyTrain routes at June 2021 was approximately 50% below February 2020 levels, with a significant drop in passenger revenue in 2020 with only partial recovery in 2021 which was hindered by multiple waves of COVID-19 outbreaks.

Although TransLink has flexibility to reduce operating costs to cushion some of these pressures, sustained changes in passengers' willingness to travel by public transit or a permanent shift away from the use of office space and toward more flexible working patterns could lead to long-term declines in ridership and an impairment in passenger revenues, leading to long-term adverse changes in TransLink's fiscal profile. We estimate that a 20% sustained ridership decline would lead to an approximately 8% loss in own-source revenues.

A relatively high share of fixed costs reduces some of TransLink's flexibility to adjust operating costs changes in the operating environment due to the pandemic, without affecting the service levels. Nevertheless in order to improve its long-term financial sustainability, TransLink has identified a combined CAD220 million in expense savings primarily from reduced operating spending including a hiring freeze and service reductions in 2020.

Exhibit 3

**The farebox recovery ratio will remain below pre-pandemic levels in 2021**  
(Transit revenues as a % of operating expense)



Sources: TransLink and Moody's Investors Service

**Debt burden remains elevated relative to peers**

TransLink's debt levels, which are high for its rating category, will rise following a recent period of gradual decline as the authority issues debt to fund a significant portion of its long-term capital projects. We expect that the notional level of outstanding debt will rise by about CAD200-300 million annually (net of refinancing) over the next two years primarily to support new expansion capital projects, including the expansion of the SkyTrain lines, under its investment plan. These levels represent a return to more predictable increases following TransLink's slightly elevated CAD400 million (net of refinancing) in debenture issuances in 2020 which reflect a combination of funding for capital spending in the year as well as pre-borrowing for future years.

In 2020 TransLink's debt burden, as measured by net direct and indirect debt relative to operating revenue, stood at 242%, above its pre-pandemic level of 221% in 2019. TransLink relies primarily on long-term debt for capital funding purposes. We project that its large capital plans will drive further increases in the debt burden in the coming years, including a projected 253% in 2021, levels that are above the majority of its rated transit peers.

While debt accumulation is capped at the authority's legislated debt limit of CAD5.5 billion, the debt ceiling has been increased several times since 2014 to accommodate higher debt requirements for capital costs. We expect that the size of TransLink's capital program

may necessitate an additional increase in the debt ceiling over the next 3-4 years. Offsetting some of these pressures is the federal government's announcement to establish the Permanent Transit Fund (PTF) which aims to provide an additional CAD3 billion in annual funding for transit projects across Canada starting in 2026, increasing visibility into future funding support.

Total short-term borrowing stood at approximately CAD100 million at year-end 2020, including CAD60 million used of its unsecured credit line, which is backstopped by a CAD500 million commercial paper program (unused in 2020). Short-term borrowing represented only 2% of its overall outstanding borrowing in 2020.

As we highlighted, TransLink's revenue diversity 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. Additional safeguards include the requirement that the Mayors' Council approve any gross debt increases beyond the debt ceiling, excluding public private partnership (P3) liabilities. In addition, at the end of 2020 TransLink maintained CAD1.04 billion in sinking funds and debt reserve funds which provide support to bondholders.

### Extraordinary support considerations

Moody's assigns a high likelihood of extraordinary support from the Province of British Columbia 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 the authority.

### ESG considerations

#### How environmental, social and governance risks inform our credit analysis of TransLink

Moody's takes into account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of TransLink, we assess the materiality of ESG to the credit profile as follows:

Environmental considerations are material to TransLink's credit profile given that its large fleet of gas and diesel powered vehicles require significant capital expenditures. However, TransLink incorporates environmental sustainability and green initiatives into its strategic plans, including efforts to reduce greenhouse gas emissions by 80% and utilizing 100% renewable energy in all of its operations, both by 2050. In addition, TransLink has issued two green bonds (2018 and 2019) to finance its low carbon capital initiatives including procurement of electric buses and construction of new rail rapid transit lines.

Social considerations are material to TransLink's credit profile, and we regard the coronavirus outbreak as a social risk under the ESG framework, given the substantial implications for public health and safety. TransLink is significantly exposed to the impacts of the coronavirus outbreak including long-term changes in passenger demand and pandemic-related health and safety costs. Nevertheless, increasing population levels and predictable demographic trends in the Greater Vancouver region serviced by TransLink have supported historical increases in ridership.

Governance considerations are material to TransLink's profile but we view governance risk as low. Governance considerations include robust planning and financial management through a 30-year long term regional transportation strategy and rolling 10-year capital investment plans. In recent years, strong management has resulted in improved brand image and public perception of TransLink. Nevertheless, a sophisticated cyberattack in December 2020 gained access to restricted employee data and significantly impacted its operations for a prolonged period of time.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing Environmental, Social and Governance Risks](#).

### Rating methodology

The assigned BCA of a1 is close to the scorecard-indicated BCA of a2. For details about our rating approach, please refer to the [Mass Transit Enterprises Methodology](#) (December 2017) and [Government-Related Issuers Methodology](#) (February 2020).

Exhibit 4

## TransLink - 2020 scorecard

## Mass Transit Enterprises Methodology

Factor 1 : Size (15%)	Measure	Score
a) Issuer Size - Annual Ridership (Million)	128	Aa
b) Market Size - Service Area Population (Million)	2.7	Aa
<b>Factor 2 : Market Position (35%)</b>		
a) Operating Environment	Aa	Aa
b) Service Area Characteristics	Aaa	Aaa
c) Market Share - Utilization (%)	46.8	A
<b>Factor 3 : Financial Flexibility (20%)</b>		
a) Level of Self-Support - Farebox Recovery Ratio (%)	29.8%	A
b) Budget Flexibility (3 Year Avg Fixed Costs as % of Oper. Exp.)	15.1%	A
<b>Factor 4 : Debt &amp; Financial Metrics (30%)</b>		
a) Leverage - Net Debt/Revenues	2.42	Baa
b) Budget Balance -Interest as a % of Operating Revenues (3 Year Avg)	11.1%	Baa
c) Budget Balance - Net Margin (3 Year Avg)	23.2%	Aaa
d) Liquidity - Days Cash on Hand	139.0	A
Baseline Credit Assessment (BCA):		
<b>Adjustments / Notching Factors</b>		
<b>Factor 3: Budget flexibility</b>		
2) Independent taxing authority	0.5	
<b>Other</b>		
3) Credit event / Trend not yet reflected in existing data set	-1	
<b>Baseline Credit Assessment (BCA)</b>		
a) Indicated Rating from Grid After Notching Adjustment		a2
b) BCA assigned		a1

Financial year-end 31 December 2020

Source: Moody's Investors Service

## Ratings

Exhibit 5

Category	Moody's Rating
<b>SOUTH COAST BRITISH COLUMBIA TRANSPORT.</b>	
<b>AUTH</b>	
Outlook	Negative
Issuer Rating -Dom Curr	Aa2
Senior Unsecured -Dom Curr	Aa2

Source: Moody's Investors Service

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