MOODY'S
INVESTORS SERVICE

Credit Opinion: South Coast British Columbia Transport. Auth

Global Credit Research - 19 Nov 2014

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)	2009	2010	2011	2012	2013
Net Debt (C$000)	3,306,575	3,458,742	3,544,341	3,589,025	3,577,233
Net Debt per Revenue Passenger (C$) [1]	17.5	15.8	15.2	15.0	15.3
Growth in Revenue Passengers (%) [1]	5.0	15.7	6.6	2.4	(2.1)
Net Debt as a % of Revenues [2]	327.4	278.6	282.3	264.6	259.5
Interest Payment as % of Revenues	10.3	10.0	12.2	12.0	12.0
Farebox Recovery Ratio (%) [3]	44.1	48.0	47.6	47.4	51.0

[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") is supported by (1) its strong market position as the key provider of transportation services in the Greater Vancouver region with a robust ridership, (2) the authority's access to diverse revenue sources, including its status as a taxing authority, and (3) solid governance and management practices requiring 10-year investment plans and a long-term strategy.

TransLink continues to operate in a difficult environment characterized by high fixed costs, the ongoing need to find operating efficiencies to offset cost inflation and pressures to increase service levels in a region with a growing population. TransLink also needs to secure future capital resources to fund growing infrastructure needs. These challenges have resulted in modest consolidated deficits in most of the last 5 years despite a solid track record of realizing cost savings. We expect TransLink to post small consolidated deficits or balanced consolidated outcomes in the medium term.

TransLink is highly leveraged and we expect its debt burden to increase further as future capital needs will likely remain substantial. TransLink's institutional characteristics, including its status as a taxing authority, make it analogous to a local government undergoing a phase of rapid expansion. TransLink's financial flexibility is tight although we note the authority's ability to tap various revenue sources to meet its financial obligations in case of need. However, short-term fare increases beyond a 2% legislative limit need to be approved by the Mayors' Council. Other revenue sources such as property tax receipts and fuel tax revenues have not kept pace with TransLink's funding needs for expansionary capital investments. Lack of committed capital grants and insufficient own-source revenue sources to fund all desired expansionary capital projects tends to result in a deferral of large projects until such funding can be secured through a combination of additional own-source revenues, government funding or capital funding.

Credit Strengths

- Access to a wide variety of revenue sources stemming from its status as a taxing authority

- Sound governance practices and financial planning policies

- Track record of finding cost efficiencies

Credit Challenges

- Lack of sustainable funding for transit expansion that will require additional cost savings or access to new revenue sources

- High debt and interest burden

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

The identification of new sustainable revenue sources for capital projects, including additional funding commitments from various levels of governments, could apply upward pressure on TransLink's rating. A gradual easing of TransLink's debt burden could also exert upward pressure on the rating.

What Could Change the Rating - Down

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, would apply downward pressure to the rating. Operating deficits, in conjunction with a lack of sustainable funding in terms of own-source revenues or government grants for capital projects resulting in substantial debt financing, could also exert downward pressure on the rating.

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 on April 1st, 1999. Despite the provincial government's role in creating the authority, TransLink operates 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) Intelligent Transportation System programs.

DETAILED RATING CONSIDERATIONS

The 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 the entity and then considers the likelihood of support coming from the Province of British Columbia (Aaa, negative outlook) 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 credit profile benefits from its access to a variety of revenue sources. TransLink's institutional characteristics correspond to both those defining municipal governments in Canada (legislated balanced budget requirements, taxing authority) and transit authorities (fare box revenues), thereby making TransLink somewhat unique among mass transit providers.

The company does not rely on operating grants from local government or the province. Fare revenues, fuel tax revenues, property tax receipts, toll fees, and parking rights tax revenues account for about 90% of revenues. Operating grants from governments represent only around 1% of revenues. Fare revenues account for around 36% of revenues, providing TransLink with some flexibility to adjust service levels and spending despite a potentially negative impact on ridership and fare revenues. 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 that is not contemplated by its strategic plan if its board considers it necessary to do so in order to meet a financial obligation.

SOUND GOVERNANCE PRACTICES AND FINANCIAL PLANNING POLICIES

TransLink has recently had a legislative change in its governance structure and financial planning policies, targeting a more formal relationship with the province and increased engagement with the Mayor's Council. One of the larger changes was the elimination of the independent commissioner, which was previously appointed by the Mayors' Council. The governance structure includes a board of directors and a Mayors' Council. The Mayors' Council, made up of all the mayors from the 21 municipalities in Metro Vancouver and the Chief of the Tsawwassen First Nation, appoints 7 of the 11 board of directors (from a list of candidates identified by a screening panel). The Chair and Vice Chair of the Mayors' Council also sit on the board. In addition, the Province of British Columbia now has the right to appoint 2 board members.

The responsibilities of the board remain largely unchanged. The Mayor's Council has gained some additional responsibilities including (1) approving short-term fare increases beyond a 2% legislative limit which was previously the responsibility of the independent commissioner; (2) approving TransLink's long-term strategy (30+ years) and (3) approving a 10-year fully-funded investment plan (previously only 3-years out of 10 needed to be fully funded).

At least once every three years TransLink must provide to the Mayors' Council a 10-year investment plan for their approval. The investment plan must lay out the funding sources for outlined strategic initiatives.

In the fully funded 10-year plan, deficits not covered by drawdown of surpluses accumulated in previous years are disallowed.

TRACK RECORD OF FINDING COST EFFICIENCIES

While TransLink has been successful in balancing its budgets as required in its legislation, moderate consolidated deficits have been recorded in recent years as the authority addresses financial pressures resulting from providing services to a growing region. The authority has so far made significant progress in realizing cost efficiencies through measures such as workforce adjustments and service scheduling changes, and has successfully maintained conventional transit operating costs per revenue passenger at similar levels as in 2008 ($3.83 in 2013).

In 2013, TransLink achieved its first consolidated surplus since 2009 of CAD36.8 million (2.7% of revenues net of capital contributions) as a result of (1) cost savings, (2) deferral of certain expenditures, and (3) modestly higher revenues from fuel taxes, including the full year impact of a rate increase, property taxes and fare increases.

In 2014, the authority expects to return to a small consolidated deficit as deferred costs will be expensed and high fixed costs, cost inflation and a fairly stable revenue base create a difficult operating environment. In 2014, no fare increase has been implemented, which makes transit fare revenue growth more dependent on growth in ridership. Ridership has been slightly below budgeted assumptions year-to-date June 30, 2014.

LACK OF SUSTAINABLE FUNDING FOR TRANSIT EXPANSION REQUIRES ADDITIONAL COST SAVINGS OR ACCESS TO NEW REVENUE SOURCES

Future capital needs will remain substantial. The Mayors' Council vision for the next 10 years foresees capital investment needs for expansion and upgrades of around CAD7.5 billion in total. The recent municipal elections in the region could however, result in changes to the Mayors' council strategic directions. The realization of these investments will also depend on the availability of funding, underscoring the challenges of addressing the system's infrastructure expansion needs.

In order to generate revenue for service expansion, address cost inflation and a reduced outlook for fuel tax revenues, TransLink is targeting access to new revenue sources and fare increases. Previous intentions to increase fares beyond the 2% per year legislative limit were rejected by the commissioner, an independent regulator of the authority. The provincial and municipal governments were also unable to commit additional revenue sources, and subsequently, the mayors of the 21 municipalities in Metro Vancouver collectively passed a motion to eliminate the original plan to raise property taxes.

A referendum on new funding for regional transportation is expected to be held no later than June 30, 2015. The referendum will submit for consideration potential new revenues for TransLink . A new 10-year investment plan will be prepared following the referendum.

Until new funding is approved, the authority's capital program will be focused on keeping existing infrastructure in a state of good repair, maintaining service levels, and investing in minor upgrades. Major projects that have committed funding, such as the Evergreen Line and the new automated fare collection system Compass Card will be maintained as well.

HIGH DEBT AND INTEREST BURDEN

TransLink is highly leveraged with a debt burden of CAD3.6 billion (259.5% of revenues net of capital contributions) and an interest burden of 12% of revenues net of capital contributions.

As TransLink targets future investments to expand its network, we expect debt levels to remain elevated. Under the current 10-year 2014 Base Plan, we estimate that net direct and indirect debt could peak at around CAD4.1 billion (around 290% of revenues net of capital contributions) over the next few years and gradually decline thereafter. However, we expect the 2014 Base Plan to be updated following the planned referendum in 2015.

TransLink's liquidity cushion is adequate. The authority has been able to generate a modest positive free cash flow (after capex and capital contributions) over the last three years and has sufficient cash on hand to cover day-to-day operations (around 28% of operating expenses). In addition, TransLink has access to a CAD500 million commercial paper program, which is backstopped by an unsecured committed credit facility from a syndicate of Canadian banks. At December 31, 2013, C$90 million was outstanding under this program.

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%).

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 http://www.moodys.com for the most updated credit rating action information and rating history.

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