MOODY'S INVESTORS SERVICE

Credit Opinion: North Bay, City of

Global Credit Research - 20 Dec 2011

Canada

Ratings

Category	Moody's Rating
Outlook	Negative
Bonds -Dom Curr	Aa1

Contacts

Analyst	Phone
Michael Yake/Toronto	1.416.214.1635
Jennifer A. Wong/Toronto	
David Rubinoff/London	44.20.7772.5454

Key Indicators

North Bay, City of

(Year Ending 12/31)	2006	2007	[1]2008	2009	2010
Net Direct and Indirect Debt/Operating Revenue (%)	23.2	35.3	41.9	43.7	46.0
Gross Operating Balance/Operating Revenue (%)	14.5	6.5	18.2	15.4	12.6
Cash Financing Surplus (Requirement)/ Total Revenues (%)	1.9	(8.7)	1.4	(8.6)	(2.1)
Interest Payments/Operating Revenue (%)	1.1	1.1	1.7	1.9	2.0
Debt Service/Total Revenue (%)	4.9	5.3	6.1	6.7	6.7
Capital Expenditures/Total Expenditures (%)	29.9	29.9	31.2	33.1	28.9
Self-Financing Ratio	1.1	0.7	1.1	0.7	0.9

[1] Accounting changes were introduced in 2009; 2009 and restated 2008 figures are not directly comparable to prior years. Accounting changes in 2009 include the adoption of PSAB section 3150 Tangible Capital Assets and changes in the presentation of financial statements, including the elimination of fund accounting.

Opinion

SUMMARY RATING RATIONALE

The City of North Bay's Aa1 debt rating reflects a prudent fiscal plan as well as stable operations. North Bay has been successful in funding priority programs and infrastructure, while recording strong financial outcomes and maintaining a solid balance sheet with adequate liquidity. Although the city's debt burden is expected to rise over the medium term, it is expected to remain relatively low. Finally, North Bay's small yet diverse economy also supports the Aa1 debt rating.

National Peer Comparisons

North Bay is rated in the mid-range of Canadian municipalities, whose ratings remain in a narrow range of Aaa -Aa2. When compared with other Canadian municipalities, North Bay exhibits low debt and low debt service ratios; the city's low debt burden, however, is offset by lower-than-average levels of liquidity. The institutional framework governing the way municipalities operate in Ontario is mature and well-developed, similar to that in other Canadian provinces.

Credit Strengths

Credit strengths include:

- Prudent and forward-looking approach to fiscal planning

- Low debt and debt servicing costs

- Adequate liquidity provided by cash and investments

- Mature, supportive, institutional framework governing municipalities in Ontario

Credit Challenges

Credit challenges include:

- Additional debt required to fund capital plan

Rating Outlook

The outlook is negative. Given our assessment of the strong linkages between the City of North Bay and the Province of Ontario, and the role these linkages play in assigning the credit rating, the negative outlook reflects the change in the outlook on the Province of Ontario. On 15 December 2011, Moody's changed the outlook on the province's ratings to negative from stable. The negative outlook reflects the risks surrounding the province's ability to meet its medium term fiscal targets given the recent slowdown in provincial economic growth, and the risks to the province's ability to stabilize and reverse the recent accumulation in debt.

What Could Change the Rating - Up

Performance in excess of current expectations, including sustained and significant increases in holdings of liquid reserves, could apply upward pressure on the rating.

What Could Change the Rating - Down

Given our assumption on extraordinary support, a downgrade of the Province of Ontario's Aa1 rating could lead to a downgrade of the city's rating. A sustained loss of fiscal discipline and a substantially expanded capital program requiring materially higher than anticipated levels of new debt issuance, or a substantial deterioration in liquidity, while unlikely, could exert downward pressure on the city's rating.

Recent Developments

In 2010 North Bay generated a surplus equivalent to a healthy 12% of total revenues. Capital expenditures declined relative to 2009 but remains elevated, and on a cash basis, the city generated a cash financing requirement of C$2.9 million (2.1 % of total revenues), compared to C$12 million (8.6% of total revenues) in 2009. North Bay's net direct and indirect debt measured 39.4% of total revenues at December 31, 2010, little changed from 2009. Total debt service--which includes principal and interest payments--as a percentage of total revenues remains unchanged at 6.7%.

DETAILED RATING CONSIDERATIONS

The rating assigned to North Bay reflects the application of Moody's Joint-Default Analysis (JDA) rating methodology for regional and local governments. In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the city and then considers the likelihood of extraordinary support coming from the Province of Ontario (Aa1, negative outlook) to avoid an imminent default by North Bay, should this extreme situation ever occur.

Baseline Credit Assessment

North Bay's BCA of 3 (on a scale of 1-21, in which 1 represents the lowest level of credit risk) reflects the following factors:

Financial Position and Performance

North Bay's revenue profile is stable and diversified. In 2009, property taxes represented around half of operating revenues, user fees approximately 21 % and provincial grants approximately 16%. Between 2003 and 2008, operating revenues expanded at a compound average growth rate (CAGR) of 5.4%, driven primarily by growth in property tax receipts as well as utility charges. The mix of residential tax receipts, utility rates and provincial grants generates dependable revenue flows for the city.

North Bay's operating expense base is well managed, having expanded at a CAGR of 2.5% between 2003 and 2008, considerably below the comparable rate of revenue growth. In 2009, social and family services made up approximately 16% of operating expenses, while public safety and transportation services each represented roughly 30%.

While lower than the previous year, the surplus for 2009 was a healthy 11.4% of total revenues. On a cash basis, North Bay's capital expenditures exceeded cash flow generated from the city's operating activities, resulting in a cash financing requirement of C$12 million (8.6% of total revenues). As capital expenditures are expected to remain elevated in the medium term, we expect North Bay to face periodic cash financing requirements which would be financed by borrowing (discussed below). However, the city's generally positive operating outcomes should support pay-as-you-go capital financing and help North Bay limit the accumulation of debt to finance capital projects.

Reductions in Ontario Municipal Partnership Fund (OMPF) transfers, which is the Province of Ontario's main transfer payment to municipalities for social programs and other measures, is partially offset by the phased transfer of some of North Bay's social assistance responsibilities to the province. While North Bay faces pressure from lower OMPF funding and potential increases to personnel costs, we expect North Bay to manage these cost pressures successfully and continue to post stable results.

Debt Profile

North Bay's net direct and indirect debt measured 39.7% of total revenues at December 31, 2009, up from 36.9% a year earlier. The city's debt-to-total revenues ratio was up from its 2003 level of 32.4%, reflecting primarily the recognition of the city's commitment to contribute, starting in 2007, C$1 million per year over 20 years to the North Bay Regional Health Centre. Despite the modest increase in the city's net direct and indirect debt resulting from the commitment, North Bay's debt burden remains low in the Canadian context. Total debt service--which includes principal and interest payments--as a percentage of total revenues rose slightly to 6.7% in 2009 from 6.1 % in 2008. This relatively low debt servicing cost adds to the city's fiscal flexibility.

North Bay's 2010-19 capital plan calls for total capital expenditures of C$493 million, which will rely primarily on pay-as-you-go capital financing as well as modest borrowing. If North Bay's current capital plan comes to fruition, we expect that net direct and indirect debt as a percentage of total revenues to increase to about 50% by 2014, a level that is considered manageable at the current rating level. Debt servicing costs are also expected to rise over this period but remain relatively low.

At December 31, 2009, cash and investments measured C$34.7 million, down from C$45.4 million in 2008, partly due to the use of about C$5 million in funds received from the Province of Ontario in 2008 under the Investing in Ontario Act and applied to capital projects in 2009, as well as the use of cash balances to finance part of the city's cash financing requirement. Accordingly, reserve fund levels declined in 2009, but remains close to the level observed from 2005 to 2007. North Bay's reserve position has improved over the past decade, and the city has set targets to continue increasing its reserves, which would help improve liquidity. As at December 31, 2009, North Bay's reserves represent about 38% of net direct and indirect debt.

Governance and Management Factors

North Bay displays strong governance and management characteristics. In addition to multi-year operating and capital planning and a recent history of exceeding fiscal targets, management adheres to conservative debt and investment management policies, which limits the city's exposure to market-related risks and helps to ensure relatively smooth debt servicing costs. These fiscal management measures are also supported by comprehensive, transparent and timely financial reporting.

Economic Fundamentals

North Bay is located about 300 kilometers north of Toronto and is home to approximately 56,000 residents. While the city's northern location increases transportation costs and constrains certain economic opportunities, the local economy remains diversified. The city's economy includes manufacturing, aerospace, a military base as well as a substantial service sector. The presence of a regional airport in North Bay--which is wholly-owned by the city--increases opportunities in the aerospace sector. Employment is also diversified across a number of employers and the city's economy does not face significant "single employer risk".

The presence of Nipissing University and Canadore College also adds to the city's institutional base and helps to graduate workers with skills that are tailored to the needs of the local labour market. The twinning of Highway 11, which connects North Bay to Toronto, is expected to be completed in 2012 and will improve the city's transportation infrastructure.

Operating Environment

The national operating environment in which North Bay operates is typical of advanced industrial economies, characterized by high GDP per capita, low GDP volatility and high ranking on the World Bank's Government Effectiveness Index, all of which suggest a minimal level of systemic economic, financial and political risk. As evidenced by Canada's record of continued economic expansion and political stability, the macroeconomic environment is robust and federal government institutions are responsive. Accordingly, the conditions that have historically preceded national crises associated with widespread defaults of regional and local governments are not present in Canada.

Institutional Framework

The institutional framework governing municipalities in Ontario is mature and highly developed. The division of roles and responsibilities between the province and municipalities is clearly articulated. Historically, changes to the institutional framework have occurred at a measured, evolutionary pace, following discussions between both parties. Nevertheless, in certain cases, changes have occurred more rapidly.

North Bay's creditworthiness benefits from the stability inherent in the provincial institutional framework. Provincial legislation dictates a high degree of oversight, including limits on debt servicing costs, while policy flexibility, on both the revenue and expenditure sides of the ledger, helps North Bay to manage pressures as they arise.

Extraordinary Support Considerations

Moody's assigns a very high likelihood of extraordinary support from the Province of Ontario (Aa1, outlook), in order to avoid a default by North Bay, or any municipality, should this extreme situation ever occur. The very high likelihood of support reflects our assessment of the risk to Ontario's reputation as a regulator of municipalities if North Bay were to default.

Moody's also assigns a high default dependence level, reflecting a medium level of provincial fiscal transfers, distinct own source revenues and the overlap of the economies of the city and the province.

Output of the Baseline Credit Assessment Scorecard

In the case of North Bay, the BCA scorecard (presented below) generates an estimated BCA of 2, roughly in line with the BCA of 3 assigned by the rating committee.

The BCA scorecard, which generates estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, is a tool used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by the scorecard provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in the scorecard cannot fully capture the breadth and depth of our credit analysis.

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 ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Implementation Guidance published in August 2010 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.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the government's intrinsic credit strength and accounts for ongoing operating subsidies and transfers from the supporting government. In effect, the baseline assessment reflects the likelihood that a local government would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) 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%), high (51 % - 70%), very high (71 % - 95%) or fully supported (96% - 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 RLGs, default dependence reflects the tendency of the RLG and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the higher-tier government to provide extraordinary support and prevent a default by an RLG is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' baseline default risks, the lower the benefits achieved from joint support. In most cases, the close economic links and/or overlapping tax bases and/or close intergovernmental fiscal arrangements between different levels of government result in a moderate to very high degree of default dependence.

Default dependence is described as either low (0% - 30%), moderate (31 % - 50%), high (51 % - 70%) or very high (71 % - 100%).

Rating Factors

North Bay, City of

Baseline Credit Assessment Scorecard - 2010	**Value**	**Score**	**Sub-Factor Weighting**	**Sub-Factor Total**	**Factor Weighting**	**Total**
Factor 1: Operating Environment						
National GDP per capita (PPP basis, $US)	38,813	1	50.0%	1.50	50.0%	0.75
National GDP Volatility (%)	2.9	3	25.0%			
National Govt Effectiveness Index (World Bank)	1.87	1	25.0%			
Factor 2: Institutional Framework						
Predictability, Stability, Responsiveness	1	1	50.0%	1.00	10.0%	0.10
Fiscal Flexibility (A): Own-Source Revenues	1	1	16.7%			
Fiscal Flexibility (B): Spending	1	1	16.7%			
Fiscal Flexibility (C): Extent of Borrowing	1	1	16.6%			
Factor 3: Financial Position & Performance						
Interest Payments/Operating Revenue (%)	1.9	1	25.0%	4.25	10.0%	0.43
Cash Financing Surplus(Req)/Total Revenue (%)	-3.5	9	25.0%			
Gross Operating Balance/Operating Revenue (%)	14.2	6	25.0%			

Net Working Capital/Total Expenditures	22.4	1	25.0%			
Factor 4: Debt Profile						
Net Direct and Indirect Debt/Operating Revenue	46.0	3	50.0%	5.25	10.0%	0.53
Short-Term Direct Debt/Direct Debt (%)	13.0	3	25.0%			
Net Debt/Operating Revenue Trend	8.0	12	25.0%			
Factor 5: Governance & Management						
Fiscal Management	1	1	40.0%			
Investment & Debt Management	1	1	20.0%			
Transparency & Disclosure (A)	1	1	15.0%	1.00	10.0%	0.10
Transparency & Disclosure (B)	1	1	15.0%			
Institutional Capacity	1	1	10.0%			
Factor 6: Economic Fundamentals						
Regional or Local GDP pc PPP - estimated ($US)	37,683	1	100.0%	1.00	10.0%	0.10
Estimated BCA						**2**