

Methodology

*Rating Canadian Provincial
Governments*

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Insight beyond the rating.

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All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.



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Introduction to DBRS Methodologies

- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. They are opinions based on forward-looking measurements that assess an issuer's ability and willingness to make timely payments on outstanding obligations (whether principal, interest, dividend or distributions) with respect to the terms of an obligation.
- DBRS rating methodologies include consideration of general operating and financial risk factors applicable to most sectors as well as sector-specific issues and more subjective factors, nuances and intangible considerations. Our approach is not based solely on statistical analysis but includes a combination of both quantitative and qualitative considerations.
- The considerations outlined in DBRS methodologies are not intended to be exhaustive. In certain cases, a major strength can compensate for a weakness that would be more critical for a peer issuer and may also differ depending on the sector being considered. Conversely, there are cases where one weakness is so critical that it overrides the fact that the issuer may be strong in most other areas.
- DBRS rating methodology is underpinned by a stable rating philosophy, which means that in order to minimize the rating changes due primarily to economic changes, DBRS strives to factor the impact of a cyclical economic environment into its rating as applicable. Consequently, DBRS takes a longer-term "through the cycle" view of an issuer and, as such, rating changes are not based solely on normal economic cycles.
- Rating revisions do occur, however, when it is clear that a structural change, either positive or negative, has transpired or appears likely to transpire in the near future. An equally important aspect of DBRS analysis is its broad sector coverage, which it undertakes in order to understand the major differences and subtle nuances within a particular industry and to form an appropriate rating of an issuer relative to its peers.
- Critical in the determination of a rating is the application of the analyst's experience and expertise in forming an initial rating opinion and recommendation for the DBRS rating committee and the role of the rating committee as the final decision maker.
- DBRS rating committees, which comprise experienced and knowledgeable DBRS personnel, strive to provide objective and independent rating decisions that are based on all relevant information and factors, incorporate both global and local considerations, apply DBRS-approved methodologies and constitute the opinion of DBRS.

Rating Canadian Provinces Overview

- This methodology applies to the ten Canadian provinces covered by DBRS. Canadian provinces have a number of similarities and differences that can influence the outcome of the rating process. Similarities include a broad array of taxing powers and responsibilities for the provision of a wide basket of services, fairly stable political systems and economies, and a meaningful reliance on federal support.
- However, the level of economic diversification and overall financial strength can vary notably among provinces, which partly explains the wide range of ratings in the sector. These are just a few of the important attributes assessed during the rating process; overall, Canadian provinces rank solidly in the investment-grade category.

Issuer-Specific Operating Risk Factors

- DBRS's ratings incorporate a considerable number of general and issuer-specific rating drivers. By focusing on the key drivers, which vary on a sector-by-sector basis, we believe that DBRS methodologies capture essential strengths and challenges of each industry in an accurate fashion, providing transparency for outside readers.
- The table below presents the key factors defining provincial government ratings, along with a brief overview of the characteristics of each factor expected for the various rating categories relevant to provincial ratings. Although important considerations in the determination of a province's rating, these factors only represent a portion of considerations factored into the assessment process, as explained throughout this methodology.
- Therefore, a province does not have to consistently fit within a rating category for each factor in order to achieve a given rating. A weak factor can be offset by strength in other critical or non-critical indicators, although material weakness in one of those considerations may eventually become an impediment to achieving a higher rating.

Critical Rating Factors

Rating Category Fundamental Strength ¹	AAA Exceptional	AA Exceptional	A Superior
Economic Structure	<ul style="list-style-type: none"> • GDP growth has been consistently above average over the last five to ten years. • The economy comprises a broad mix of industries, with no undue reliance on any single sector, which helps reduce volatility and cyclicalities in GDP growth. • Demonstrated access to diverse international export markets, with a broad mix of products. • Solid population growth supported by solid immigration patterns. • The labour force is highly skilled, unemployment is below average and income per capita stands out relative to peers. 	<ul style="list-style-type: none"> • GDP growth is sound and fairly consistent year-over-year. • The economy boasts a relatively diversified mix of industries but may be influenced by a few large industries, resulting in average volatility overall. The economy is dynamic and constantly evolving but certain sectors may require reform to secure long-term growth prospects. • The economy may be reliant on a limited number of key export markets or products, which leads to trade volatility. • Population growth and immigration patterns have been reasonably sound over the years. • The labour force is skilled and unemployment is low and stable. 	<ul style="list-style-type: none"> • GDP growth tends to be sound but may have been steadily below average or inconsistent in recent years. • The economy may be small or reliant on seasonal industries, with a limited number of key industries accounting for a substantial portion of economic activity, resulting in above-average volatility. • Lack of diversity in provincial export products and markets, which leaves the province susceptible to external factors. • Demographic growth may be below the national average, due in part to low immigration. • The job market is dynamic and characterized by above-average growth, though still moderate unemployment levels.

1. The fundamental strength is relative to DBRS's other rating categories and is consistent with those identified in other DBRS rating methodologies.

2. Refer to Appendix A for an explanation of DBRS adjustments to reported financial figures.



Critical Rating Factors

Rating Category	AAA Exceptional	AA Exceptional	A Superior
Fundamental Strength¹			
Fiscal Management	<ul style="list-style-type: none"> • Tight management of expenditures, with a strong track record of balanced results as measured by DBRS² and proven ability to manage in-year budgetary pressure. • Budgets are based on very conservative assumptions with the use of meaningful contingencies to help manage unforeseen events. • Demonstrated ability to control deficits in recessionary periods and restore fiscal balance on a timely basis. • Maintains sufficient room and willingness to raise taxes if necessary. • Transparency and timeliness in reporting is exemplary. 	<ul style="list-style-type: none"> • Results as measured by DBRS² hover around a balanced position year-over-year and expenditure management is generally prudent, with limited in-year slippage. • Budget contingencies vary year to year, although assumptions are generally prudent. • Fiscal sustainability is emphasized by the government but addressing unforeseen deficits may not be an immediate priority. • Moderate ability and/or willingness to raise taxes. • Transparency is good and financial reporting is timely. 	<ul style="list-style-type: none"> • The fiscal management framework is well developed but some key planning documents or reports lack details. • DBRS-adjusted² deficits tend to linger but are viewed as sustainable. Fiscal results may also exhibit greater volatility due to lower ability to manage in-year budgetary pressures. • Budget assumptions are in line with private-sector consensus, although the use of contingencies may be limited. • Reduced ability and/or willingness to manage downturns through meaningful expenditure restraint or revenue-raising initiatives. • Tax burdens may already be somewhat high, limiting ability or willingness of the government to raise taxes if needed.
Financial Management	<ul style="list-style-type: none"> • Debt and liquidity management practices are exemplary and very conservative. • The debt structure is very prudent, with low refinancing risk, a smooth maturity profile and minimal unhedged exposure to interest rate reset risk and foreign currency fluctuations. • The borrowing platform is well established and recognized, with access to multiple domestic and international programs and several liquid benchmark issues. • Liquidity is substantial and well in excess of short-term debt outstanding. • Unfunded pension liabilities are low and being addressed. 	<ul style="list-style-type: none"> • Debt and liquidity management practices are sophisticated and conservative. • The debt structure is prudent but may at times entail sizeable refinancing needs, an uneven maturity profile or material exposure to interest rate reset risk and foreign currency fluctuations. • The borrowing platform is well established and recognized, with access to domestic and international programs and liquid benchmark issues. • Liquidity is significant relative to short-term debt and refinancing needs. • Unfunded pension liabilities may be sizeable but are being addressed. 	<ul style="list-style-type: none"> • Debt and liquidity management practices are conservative but may lack formality or sophistication relative to those of frequent borrowers. • The debt structure is prudent but may at times entail sizeable refinancing due to an uneven maturity profile, or material exposure to interest rate reset risk or foreign currency fluctuations. • The borrowing platform may be somewhat narrow, mostly limited to Canada, although the track record of execution of annual borrowing programs is good. • Liquidity is limited. • Unfunded public sector liabilities may large and growing.

1. The fundamental strength is relative to DBRS's other rating categories and is consistent with those identified in other DBRS rating methodologies.
2. Refer to Appendix A for an explanation of DBRS adjustments to reported financial figures.



Critical Rating Factors

Rating Category	AAA Exceptional	AA Exceptional	A Superior
Fundamental Strength¹			
Intergovernmental Relations	<ul style="list-style-type: none"> • Low reliance on senior government funding. • Cooperative relationship with senior government and supportive tax and social policy objectives. • Limited interference in areas of provincial responsibility. • The financial demands of municipal governments are viewed as sustainable and well understood. 	<ul style="list-style-type: none"> • Low reliance on senior government funding, which displays volatility depending on economic and fiscal environment. • Reasonable level of cooperation with senior government, though policy objectives may diverge in some areas. • Local governments have moderate financial demands but are nonetheless expected to be manageable. 	<ul style="list-style-type: none"> • Moderate to high reliance on senior government funding sources to fulfill service obligations. • Less cooperative relationship with senior government and overlapping areas of responsibility. • Financial requirements of municipal governments are viewed as more onerous and may require more attention at the provincial level.

1. The fundamental strength is relative to DBRS's other rating categories and is consistent with those identified in other DBRS rating methodologies.
2. Refer to Appendix A for an explanation of DBRS adjustments to reported financial figures.

- A well-defined basket of responsibilities, broad taxing and revenue-generating powers, a developed and diverse economic base, a supportive federal government and a stable political environment characterize Canadian provincial governments and lend support to their credit ratings. Nonetheless, varying management styles and fiscal priorities and economic disparities are only a few of the considerations that lead to differing credit quality among provinces.
- DBRS endeavours to rate each issuer through the cycle and does not penalize an issuer at market troughs nor reward it at market peaks unless such changes are structural and are expected to materially alter future financial metrics and/or qualitative rating considerations. Below is a summary of the key considerations and drivers of DBRS ratings that characterize Canadian provincial governments.

PRIMARY INDUSTRY-SPECIFIC FACTORS

Economic Structure

- The economy of a province constitutes a key consideration in the credit assessment of its government, as it is the primary determinant of the capacity of a government to raise the revenue necessary to fulfill its service responsibilities and carry its debt. The composition of a provincial economy provides valuable insight into the volatility, dynamism and growth potential of a province, and its propensity to create jobs and generate wealth. A well-diversified economy with a strong emphasis on value-added industries will generally tend to fare better and experience more consistently robust growth over the longer term than a commodity-based economy.
- In its analysis of the economic structure, DBRS focuses on (a) gross domestic product (GDP) and employment breakdown by major industry; (b) prospects of key cities, industries and sectors with competitive advantages; (c) track record of employment creation; (d) trade flows; and (e) adequacy of major infrastructure (e.g., roads, electricity generation). Structural distortions within the economy, such as burdensome tax or regulatory systems, are also considered in the analysis.

Fiscal Management

- The review of the fiscal management framework is aimed at assessing the government's fiscal sustainability and prospects, looking at revenue generation and spending discipline, as well as the coherence and appropriateness of the strategies, policies and processes governing the planning and allocation of public resources. Particular attention is paid to the quality of the fiscal management framework in place, prudence of key budget assumptions, adequacy of revenues to cover core programs and interest charges, and the level of fiscal flexibility afforded; that is, the degree to which expenditures can be contained or revenues increased in order to protect fiscal soundness.
- DBRS also analyzes the volatility of fiscal results and the government's fiscal track record, which provides an indication of the government's commitment to fiscal soundness.
- DBRS reviews the effectiveness of the budgetary process, including the timeliness and comprehensiveness of the government's planning, reporting and monitoring systems, as well as the ability of fiscal authorities to control expenditures. Additional considerations include the allocation of responsibilities and controls within the government organization, adherence to budget policies (e.g., balanced budget legislation), and the coherence and consistency of social and fiscal policies, with frequent changes in strategic goals generally perceived as weakness in the policy framework.
- In assessing the quality of the fiscal planning framework, DBRS compares recent years' fiscal results against original budget estimates, putting emphasis on the frequency and extent of major budget deviations.

Financial Management

- A look into a government's financial management strategy, including the level of sophistication of its borrowing practices and overall debt structure, helps to assess the potential volatility of debt servicing requirements. In particular, analysts examine the composition and maturity structure of the debt stock and its sensitivity to changes in inflation, interest and exchange rates. DBRS aims to develop an outlook for debt and debt-servicing requirements to assess overall affordability. (See Appendix A for DBRS's definition of tax-supported debt.)
- Due to their fairly predictable expenditure base and steady stream of revenue, provincial governments generally tend to minimize the amount of liquidity they carry on their balance sheet. Provincial governments also benefit from superior access to capital markets due to high investor receptivity, which considerably reduces refinancing risk and further reduces the need for back-up liquidity.
- Nonetheless, the presence of liquidity on a government balance sheet is viewed positively by DBRS. The primary sources of internal liquidity considered by DBRS include operating cash balances and investment portfolios, and are analyzed in relation to fiscal conditions, scheduled debt repayments and availability of external liquidity sources like bank facilities. Liquid assets will generally only be netted against debt if the funds are unrestricted and earmarked for debt retirement, or originate from pre-financing activities conducted for next year's purposes. In certain cases, funds set aside in investment portfolios, excluding those intended for fiscal stabilization, may also be netted against debt if they are expected to be available over the longer term.

Intergovernmental Relations

- Relations between the government and its counterparts at both the federal and municipal levels are analyzed for their potential to alter the political landscape in the province and the fiscal position of the government.
- In particular, the provincial governments receive substantial funding from the federal government for key social programs within provincial jurisdiction such as health care and education, and through the equalization program, which enables the less prosperous provinces to offer public services comparable to those in other provinces at reasonably comparable levels of taxation. Therefore, a marked change in the funding envelope or in the allocation mechanism of one the key transfer programs could have material implications for provincial governments.
- Conflicting tax or social policy objectives between levels of government may also introduce challenges in fiscal management, as the provinces share their tax base and responsibility for certain programs with their senior counterpart. DBRS analysts pay particular attention to a government's dependence on federal and provincial policy making.

ADDITIONAL FACTORS

Priorities of Government in Power

- DBRS reviews the priorities of the government in power to gain insight into future tax strategies, projected spending and the overall impact on provincial debt. Ambitious tax reductions or spending initiatives to address political priorities, or a consistent lack of restraint, can have a meaningful impact on fiscal results, and ultimately, provincial debt.

Tax Competitiveness

- The structure and level of taxation can have a bearing on a province's ability to attract and retain business investment and a skilled labour force, which can in turn have implications for longer-term growth prospects or the government's ability to implement tax increases in the future, if necessary.
- DBRS looks at a province's tax competitiveness, particularly in relation to neighbouring jurisdictions, and at the composition of income, consumption and property taxes and any barriers the framework may pose to growth. For example, an inefficient tax system may limit future budget flexibility and create distortions in the economy by exacerbating tax evasion, distorting business decision making and discouraging investment.

Economic Potential

- In its analysis of this risk category, DBRS focuses on the resilience, flexibility and propensity for growth of the economy, as well as on any impediments that could foster volatility or impair growth. A sound record of sustained economic growth is prime evidence of a province's ability to generate wealth for its population and fiscal resources for its government.
- DBRS looks at the level and trend of key summary indicators and seeks to understand the growth trend and potential of the province in relation to that of the country, as defined by an array of variables, including (a) per capita GDP and income; (b) real GDP and employment growth; and (c) private-sector investment. Availability of electricity at a competitive rate is also a key tool of economic development.

Demographics and Social Structure

- Demographic and social trends can influence political stability and have a significant impact on a government's fiscal position by affecting the labour force, income distribution and demand for social services.
- For example, provinces with a rapidly growing population will often enjoy an expanding labour force and tax base, but may also face greater popular pressure to expand public services and build appropriate economic infrastructure. In contrast, mature provinces will generally face less capital growth pressure provided they have adequately maintained their infrastructure base, but their aging population may translate into rising pension and health-care expenditures and a shrinking tax-paying workforce.
- Demographic and social indicators assessed by DBRS include (a) average age of the population; (b) dependence ratios; (c) migration trends; (d) education attainment; (e) unionization rate; (f) welfare caseloads; and (g) income and wealth distribution.

Political Environment

- Canada enjoys one of the most stable political environments in the world. Nevertheless, a closer look at the political landscape may provide insight into the balance of power within government, the possibility of major shifts in government priorities and, ultimately, the fiscal prospects of a province.
- DBRS's review of the political environment focuses on the province's track record of political stability, the public approval of the governing party, the stage of the election cycle as well as the influence exerted by, and the philosophy of, the official opposition party.
- Another important consideration is whether the governing administration is in a majority or minority position, as it can significantly impair the responsiveness of the government and adversely affect its ability to introduce needed policy changes.



Transparency

- An examination of financial reporting practices provides an indication of how transparent a province's financial reports are and the degree to which they can be relied upon.
- Characteristics demonstrated by transparent financial reporting practices generally include the consolidation of broader government entities, timely financial reporting, the adherence to high accounting and reporting standards, compliance with accounting guidelines for public sector entities and the early adoption of new rules. In addition, the full comparability of budget estimates with public accounts provides for an evaluation of results. A reliance on fiscal smoothing mechanisms to balance budgets is generally viewed as a weakness.

Ownership of Crown Corporations

- DBRS also aims to evaluate the benefits of Crown corporation ownership. Crown corporations that generate a recurring revenue stream for provincial governments contribute positively to fiscal results and could likely be monetized, if needed, to significantly reduce debt. In contrast, ownership of poorly performing Crown corporations can represent a drain on provincial resources, political distractions and, potentially, additional tax-supported debt obligations.
- The sustainability of rates and user fees are viewed as key factors in the determination of the level of self-sufficiency for Crown corporations.

Issuer-Specific Financial Risk Factors

KEY METRICS

- Recognizing that any analysis of financial metrics may be prone to misplaced precision, we have limited our review of key metrics to a small universe of critical ratios. For each of these ratios, DBRS provides a range within which the variable would be considered as supportive of the rating at the top of the column.
- To be clear, the ratings in the matrix below should not be understood as the final rating for an entity with matching metrics. This would only be the case to the extent that the operating risk of the province and a wide range of other financial metrics were also supportive. The final rating is a blend of both the operating risk and financial risk considerations in their entirety.

Canadian Provincial Government Industry Financial Metrics

Key Ratio	AAA	AA	A
DBRS-adjusted Debt-to-GDP ¹	Less than 15%	10% to 40%	30% to 70%
DBRS-adjusted surplus/(deficit)-to-GDP ¹	Recurring surpluses	3.0% to -3.0%	Persistent deficits
Real GDP growth rate	At or above national average	At national average	Below national average
Federal transfers-to-total revenue	Less than 20%	10% to 30%	20% to 50%
Interest costs-to-total revenue	Less than 5%	3% to 10%	5% to 20%

1. Refer to Appendix A for an explanation of DBRS adjustments to reported financial figures.

- While the metrics in the above table are recognized as key factors, they are not sufficient to provide a complete overview of the financial risk pertaining to a particular government. The nature of credit analysis is such that it must incorporate a broad range of financial considerations, and this cannot be boiled down to a limited number of metrics, regardless of how critical these may be. We would also note that DBRS ratings are based heavily on future performance expectations, so while past metrics are important, any final rating will incorporate our opinion on future metrics, a subjective but critical consideration. Nevertheless, the key ratios are very useful in providing a good starting point in assessing a government's financial risk.

- A government's financial risk is largely a quantitative assessment of the government's present financial strength and an estimation of its future profile over a reasonable time horizon. Recognizing that the metrics in the table above do not represent the entire universe of considerations that DBRS considers when evaluating the financial risk profile of a government, we now provide a general overview that encompasses a broader range of metrics and considerations that could be meaningful in some cases.
- DBRS's review includes four key areas: fiscal balance, revenues, expenditures and additional measures for balance-sheet and financial flexibility. Within each area, DBRS focuses on key metrics and considerations that are assessed over time, recognizing that the trend in the ratios is also important to the rating, and that ratios alone cannot be used as an absolute test of financial strength.

Key General Considerations in Evaluating a Canadian Provincial Government's Financial Risk Profile

In addition to the information already provided with respect to key financial metrics, the following financial considerations and ratios are typically part of the analysis for Canadian provincial governments.

FISCAL BALANCE

- Fiscal results are viewed by DBRS as a reliable indicator of the quality of management and commitment to fiscal soundness. Analysts look at the primary balance (revenues minus program expenditures) as the primary indicator of fiscal flexibility, while the overall fiscal balance (net of interest charges) better reflects overall fiscal sustainability and the potential financing requirements in a given year.
- Analysts examine historical as well as prospective results, focusing on the cyclical and sensitivity of the budget and financing requirements to adverse developments. While repeated budgetary shortfalls are perceived negatively by DBRS, the impact of a shortfall will generally be discounted if it is believed to be the result of an economic downturn or non-recurring events, as opposed to a structural imbalance about which a government is showing little initiative. DBRS refers to this practice as 'rating through the cycle'.

Key Indicators

- DBRS-adjusted fiscal surplus or (deficit) as a percentage of GDP. (See Appendix A for an explanation of DBRS adjustments.)
- Track record of fiscal results and medium-term outlook.

REVENUES

- The revenue analysis covers the major components of a government's revenue base, focusing on diversification, volatility and ability to grow key sources when needed, as well as the extent of the tax effort imposed on residents and corporations. Key revenue sources for provincial governments include taxation, royalties and user fees, as well as federal transfers and earnings from government enterprises. Special emphasis is placed on the resilience of major revenue sources, the degree of reliance on federal transfers, and the competitiveness of the tax system relative to neighbouring jurisdictions.
- DBRS may make certain adjustments to reported revenue figures in order to improve comparability across provinces, exclude non-recurring items and, ultimately, better reflect the underlying fiscal situation of the province. (See Appendix A for an explanation of DBRS adjustments.)

Key Indicators

- Tax revenues as a percentage of total revenues.
- Federal transfers as a percentage of total revenues.
- Natural resource revenues as a percentage of total revenues.
- Crown corporation earnings and stability of results.
- Revenue growth trends.

EXPENDITURES

- DBRS distinguishes between three major types of expenditures: programs, capital and debt servicing, with particular emphasis placed on identifying major trends, actual and potential areas of pressures and sources of rigidities.
- Through its analysis of program expenditures, DBRS seeks to understand the government's role and service responsibilities in the economy, and the relationship between key expenditure items and factors such as demographics and economic conditions in order to identify potential sources of pressure. Analysts review major government programs, focusing on the coherence and sustainability of each program, and expected cost implications.
- Given Canada's demographics trends and the significant portion of provincial program spending it represents, health-care expenditures warrant considerable attention from DBRS analysts and have over the last decade proved to be the most challenging item to contain for provincial governments. Spending in the sector has been growing at an annual rate of 5% to 8% in most provinces, well in excess of revenue growth, owing to steadily rising demand for services and above-average salary and cost inflation. As a result, a close look at the demographics trends of a province and at the efforts made by its government to contain salary increases, increase productivity and address labour shortages in the sector may provide valuable insight in the trajectory to be followed by fiscal spending over the years to come and in the sustainability of a government's fiscal strategy.
- Reported figures are reviewed to evaluate the treatment of non-recurring items and determine whether all material tax-supported activities within provincial jurisdiction are captured by the reporting entity. With the introduction of accrual accounting for capital expenditures in recent years, the incentives for deferring capital spending have dropped markedly. This has resulted in smoother capital spending patterns but also in a blurrier relationship between fiscal results and debt changes, as capital expenditures are recognized over several years through amortization while the cash implications are felt in the year the investment takes place.
- DBRS analysts seek to get a clear understanding of current and future capital requirements faced by the government, focusing on the state of good repair of major public infrastructure and on the estimated future costs of maintaining existing assets and addressing the growth-related and deferred maintenance needs. Financing methods and accounting rules for capital spending are also reviewed in order to fully appreciate the debt implications of projected capital needs and verify whether accrued costs are reported consistently across provinces.
- Of all three expenditure categories, debt servicing is definitely the most rigid and can constitute a substantial portion of a government's budget. As a result, the stability and trend of government's interest and debt payments are an especially important consideration.
- In analyzing debt servicing requirements, particular attention is paid to the government's debt structure and management strategy, incorporating findings from the analysis of the debt and liquidity profile. DBRS notes that in the current low-rate environment, the importance of debt-servicing requirements is probably understated, hence increased emphasis on a government's debt maturity profile and refinancing strategy is warranted.

Key Indicators

- Health-care spending as a percentage of total expenditures.
- Education spending as a percentage of total expenditures.
- Social services spending as a percentage of total expenditures.
- Interest expense as a percentage of total expenditures.
- Expenditure growth trends.



BALANCE-SHEET AND FINANCIAL FLEXIBILITY CONSIDERATIONS

- The sustainability of a government's debt burden is a central consideration in the determination of a credit rating. DBRS carefully examines current and projected levels of indebtedness and considers the full range of factors that could affect the debt burden and related servicing requirements.
- The primary focus is on tax-supported debt, which includes financial obligations for which taxpayers are directly accountable. This concept captures tax-supported debt directly issued by the government as well as the financial obligations of all related tax-supported organizations that are within provincial jurisdiction (e.g., universities, school boards, hospitals). Also included as part of tax-supported debt are other financial commitments such as capital lease obligations, unfunded pension liabilities and the debt of municipalities. The resulting debt figure is compared with the capacity to carry debt of the government as represented by the provincial GDP.
- Self-supporting debt, which is issued by commercial government enterprises and serviced by distinct user fees (e.g., electric utilities), is analyzed separately by DBRS and generally allocated a much smaller weighting in the credit review, provided the burden is not excessive for the organization and is highly unlikely to require government support.
- Interest charges are another important consideration in the analysis and are measured as a percentage of fiscal revenues in order to assess the affordability of outstanding debt.

Key Indicators

- Tax-supported debt as a percentage of GDP.
- Total debt as a percentage of GDP.
- Floating-rate debt as a percentage of tax-supported debt.
- Foreign currency-denominated debt (net of hedges) as a percentage of tax-supported debt.
- Debt maturity profile.
- Capital program and expected impact on debt.
- Gross borrowing needs and borrowing strategy.



Appendix 1: DBRS Adjustments to Reported Financial Figures

In certain circumstances, DBRS may adjust the financial results reported by provincial governments in order to allow for better inter-provincial comparisons, to incorporate all material tax-supported activities that are not part of the reporting entity, or to present fiscal results that are more reflective of the impact of government activities on indebtedness. The most frequent adjustments relate to the following areas:

(1) **Tax-Supported Debt:** Despite constantly improving provincial accounting rules, the level of consolidation continues to vary across provinces. In an effort to capture the full extent of a government's tax-supported financial liabilities, DBRS adds to a province's own tax-supported debt the debt of all material tax-supported entities, including school boards, hospitals, universities and provincial agencies conducting tax-supported activities. DBRS also includes municipal debt and unfunded pension liabilities, if any, as part of provincial tax-supported debt.

(2) **Capital Expenditure Treatment:** DBRS converts capital expenditures from an amortization basis to a "pay-as-you-go" basis to get fiscal results that are more reflective of the full extent of government spending and of external financing needs for a given year.

(3) **Non-Recurring Items:** Fiscal results sometimes include extraordinary items that introduce distortions in results and hinder year-over-year comparisons of results. These may include asset sales performed to boost revenues and balance budgets in challenging fiscal times, restructuring costs or write-off of tax receivables. DBRS attempts to remove all material non-recurring items from reported results in order to better understand the underlying fiscal position of a government.

(4) **Smoothing Mechanisms:** Some governments use contributions to/from reserves or fiscal stabilization funds to manage revenues and smooth fiscal results. Such contributions to and from smoothing reserves are excluded from reported results by DBRS in order to better appreciate the volatility of fiscal results and present the true trend followed by fiscal results.



Appendix 2: Short-Term and Long-Term Ratings

- There has been a marked increase in the sophistication of the management and borrowing practices of provincial governments over the last decade. In its rating approach, DBRS has increasingly placed emphasis on certain government-specific characteristics that provide those issuers with superior short-term credit stability relative to corporate credits with similar long-term ratings.
- These characteristics include (1) stable and predictable revenues and expenditure bases; (2) the ability to adjust taxes and levies, if needed; and (3) easy access to capital markets due to high investor receptivity. As a result, a higher short-term rating may be achievable for a government with a given long-term rating compared with a corporate credit with the same long-term rating.
- For a discussion on the relationship between short- and long-term ratings and more detail on liquidity factors, please refer to the DBRS policy entitled “[Short-Term and Long-Term Rating Relationships](#)” and the criteria *DBRS Commercial Paper Liquidity Support Criteria for Corporate Non-Bank Issuers*.

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