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Research Update:

City of Montreal Upgraded To 'AA-' From 'A+' On Exceptional Liquidity Position

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Research Update:

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Overview

- We are raising our long-term issuer credit and senior unsecured debt ratings on the City of Montreal to 'AA-' from 'A+'.
- The upgrade reflects our view of the city's exceptional liquidity and a more stable political environment.
- The stable outlook reflects our expectations that, in the next two years, Montreal's budgetary performance will remain strong, tax-supported debt will not exceed 160% of consolidated operating revenue, and liquidity levels will remain sufficient to fully cover its debt service.

Rating Action

On Oct. 21, 2015, Standard & Poor's Ratings Services raised its long-term issuer credit and senior unsecured debt ratings on the City of Montreal, in the Province of Quebec, to 'AA-' from 'A+'. The outlook is stable.

Rationale

The upgrade reflects our view of Montreal's exceptional liquidity and a more stable political environment. The ratings also reflect our positive view of the city's very strong economy, strong budgetary performance, low contingent liabilities, and the "very predictable and well-balanced" institutional framework for Canadian municipalities. We believe the city's satisfactory financial management and average budgetary flexibility are neutral to the ratings; however a high tax-supported debt burden constrains them.

In our opinion, Montreal has a very strong, deep, and diversified economy. Based on the median income as a proxy for GDP, we believe that the city's GDP per capita is close to or greater than the 2012-2014 provincial average of US$42,176. The local economy continued to experience a relatively slow growth in 2014, with falling employment and slightly higher unemployment rates (to 9.9% in 2014 from 9.6% in 2013). However, construction activity was what we consider fairly strong, with building permits up 30% in 2014, primarily supported by institutional and industrial sectors, which more than offset weaknesses in the commercial and housing sectors. After two years of decline, housing starts grew sharply, by 50% in 2014, with a focus on rental units. We estimate the city will continue to experience average, stable economic growth in the next two years, in line with projections for the province.

Montreal's budgetary performance is strong, in our view. The city added another year of strong operating surpluses, with the operating balance reaching 13.8% of its adjusted operating revenues. Lower-than-budgeted capital expenditures together with higher capital revenues, resulted in an after-capital surplus of 3.2% of total adjusted revenues in 2014, an improvement from the previous years' deficit of 3.9%. We expect Montreal will continue to produce strong budgetary results with operating balances exceeding 5% of adjusted operating revenues. With the city's capital plan calling for elevated spending in the next several years, under our base-case scenario, we forecast that after-capital deficits will occur again, but not exceed 5% of total adjusted revenues, on average.

We believe Canadian municipalities benefit from a "very predictable and well-balanced" local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

Montreal's contingent liabilities are low, in our view. The city, like all Canadian municipalities, has made commitments for goods and services it will receive. Those commitments, both operating and capital, totaled C$3.9 billion at the end of 2014. The city has sufficient funds (provisions, government subsidies or operating budget lines) to cover them entirely.

In our opinion, Montreal's financial management is satisfactory and has a neutral impact on creditworthiness. We believe budget information is very detailed and comprehensive, although it is only for the current budget year. The level of transparency and disclosure in independently audited financial statements is what we view as high. The city has a substantial number of financial policies covering debt and reserves, among others. A capable and experienced administration, which regularly monitors key external risks and updates senior management, implements council's decisions. We believe the political environment has stabilized in the past two years, and the administration has made inroads into a number of initiatives, particularly cost reductions, as reflected in the 2015 operating budget.

Montreal's budgetary flexibility is what we view as average. In fiscal 2014, modifiable (own-source) revenues represented 88.4% of operating revenues and capital spending accounted for 18.5% of total expenditures. We expect that these trends will continue in the near term. In our opinion, the city's budgetary flexibility is constrained on both the spending and revenue side. Historically, citizens have had a high resistance to spending or service cuts and the city has reduced leeway on infrastructure spending. As well, with a preset maximum annual tax increase of 2%, Montreal's ability to increase taxes more is somewhat limited. In addition, the citizens the city, much like those elsewhere, tend to be averse to tax increases.

At year-end 2014, Standard & Poor's-calculated total tax-supported debt totaled C$7.8 billion, or 137% of consolidated operating revenue, which we consider to high debt burden. This was slightly above the previous year's level of 132%. Our debt calculation comprises the temporary loans and the city's consolidated long-term debt, including the debt of public transit provider Societe de Transport de Montreal (STM), net of sinking funds (C$1.9 billion). The city's interest burden was relatively stable, at 8.1% of adjusted operating revenues in 2014. We expect tax-supported debt to increase moderately in the next two years, as debt issuance will exceed debt repayment. However we estimate tax-supported debt will remain below 160% of consolidated operating revenue. In addition, we expect that interest payments on the region's own-purpose debt will account for less than 9% of operating revenue, keeping the debt load adequate.

Liquidity

In our opinion, Montreal has exceptional liquidity, as our criteria define the term. Adjusted free cash and liquid assets improved considerably in 2015 and, at fiscal year-end, we estimate it will reach about C$1.7 billion; they totaled C$1.1 billion in 2014. Lower levels in 2014 were primarily the result of an exceptional delay in tax payments following the 2013 elections, which have deferred the budget approval for the year. Higher liquidity levels in 2015, combined with a lower projected debt service, led to a ratio of free cash and liquid assets to debt service of about 146%, significantly higher than the 88% in 2014. The city also has committed bank lines of credit totaling C$300.1 million, of which C$13.6 million had been used at year-end 2014.

As one of the largest municipal issuers in the country, Montreal also has what we view as strong access to Canada's well-developed capital markets, which it maintained throughout the recession. Nevertheless, the city has high funding needs owing to its substantial planned capital spending on its infrastructure deficiency and for STM.

Outlook

The stable outlook reflects our base-case scenario. Under the scenario, we expect that, in the next two years, Montreal's budgetary performance will remain strong, with average after-capital deficits smaller than 5% of total revenue; tax-supported debt will not exceed 160% of consolidated operating revenue; and liquidity levels will remain sufficient to fully cover debt service. We also expect that the city's political and managerial characteristics will be stable, and it economy will remain very strong. We could revise the outlook to positive or raise the ratings if the city's budgetary performance continues to improve, resulting in consistent after-capital surpluses, or if the government continues to make progress in strengthening financial management, in addition to maintaining stable debt and liquidity profiles. Conversely, although unlikely in the next two years, we could lower the ratings if we note an erosion in financial management, free cash and liquid assets weaken to a level at which they cover less than 100% of next 12 months debt service, tax-supported debt to consolidated operating revenues exceeds 180%, and after-capital deficits rise to an average above 5% of total adjusted revenues.

Key Statistics

Table 1

City of Montreal -- Economic Statistics

	--Fiscal year ended Dec. 31--		
(%)	**2012**	**2013**	**2014**
Population (total)	1,940,700	1,964,700	1,988,243
Population growth	1.3	1.2	1.4
Unemployment rate	10.2	9.6	9.9

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include Statistics Canada.

Table 2

City of Montreal -- Financial Statistics

	--Fiscal year ended Dec. 31--					
(Mil. C$)	**2012**	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	5,814	5,782	5,727	5,788	5,923	6,036
Operating expenditures	5,014	5,272	4,936	4,924	5,023	5,203
Operating balance	799	510	791	864	900	833
Operating balance (% of operating revenues)	13.8	8.8	13.8	14.9	15.2	13.8
Capital revenues	371	377	531	500	523	534
Capital expenditures	1,074	1,128	1,123	1,322	1,384	1,570
Balance after capital accounts	96	(241)	199	42	39	(203)
Balance after capital accounts (% of total revenues)	1.6	(3.9)	3.2	0.7	0.6	(3.1)
Debt repaid	476	648	775	672	475	946
Balance after debt repayment and onlending	(379)	(888)	(575)	(631)	(435)	(1,149)
Balance after debt repayment and onlending (% of total revenues)	(6.1)	(14.4)	(9.2)	(10.0)	(6.8)	(17.5)
Gross borrowings	695	964	1,076	925	815	1,028
Balance after borrowings	315	76	500	294	379	(121)
Operating revenue growth (%)	6.2	(0.5)	(1.0)	1.1	2.3	1.9
Operating expenditure growth (%)	7.7	5.1	(6.4)	(0.2)	2.0	3.6
Modifiable revenues (% of operating revenues)	86.7	86.8	88.4	89.5	89.4	89.7
Capital expenditures (% of total expenditures)	17.6	17.6	18.5	21.2	21.6	23.2
Direct debt (outstanding at year-end)	6,770	7,077	7,259	7,865	7,992	8,335
Direct debt (% of operating revenues)	116.4	122.4	126.7	135.9	134.9	138.1
Tax-supported debt (outstanding at year-end)	7,321.0	7,601.0	7,845.0	8,456.0	8,597.0	9,259.0

Table 2

City of Montreal -- Financial Statistics (cont.)						
Tax-supported debt (% of consolidated operating revenues)	125.9	131.5	137.0	146.1	145.1	153.4
Interest (% of operating revenues)	7.7	7.9	8.1	8.1	7.9	7.7
Debt service (% of operating revenues)	15.9	19.1	21.7	19.7	15.9	23.4

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. Base case reflects Standard & Poor's expectations of the most likely scenario. Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with an upgrade. bc--Base case.

Ratings Score Snapshot

Table 3

City of Montreal -- Ratings Score Snapshot	
Key rating factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Satisfactory
Budgetary Flexibility	Averagge
Budgetary Performance	Strong
Liquidity	Exceptional
Debt Burden	High
Contingent Liabilities	Low

Note: Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, Oct. 12, 2015. Interactive version available at http://www/spratings.com/sri

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

Related Research

- 2014 Annual International Public Finance Default Study And Rating Transitions, June 8, 2015
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Feb. 5, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Raised

	To	From
Montreal (City of)		
Issuer credit rating	AA-/Stable/--	A+/Stable/--
Senior unsecured debt	AA-	A+

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