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METHODOLOGY

Rating Canadian Municipal Governments

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Scope and Limitations

This methodology represents the current DBRS approach for ratings of Canada municipal governments. It describes the DBRS approach to credit analysis, which includes consideration of historical and expected critical rating and financial risk factors as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. Our approach incorporates a combination of both quantitative and qualitative factors. The methods described herein may not be applicable in all cases; the considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. In certain cases, a major strength can compensate for a weakness and, conversely, a single weakness can override major strengths of the issuer in other areas. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

Introduction to DBRS Methodologies

- DBRS publishes rating methodologies to give issuers and investors' insight into the rationale behind DBRS's rating opinions.
- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. DBRS ratings assess an issuer's ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation. In some cases (e.g., non-investment grade corporate issuers), DBRS ratings may also address recovery prospects for a specific instrument given the assumption of an issuer default.
- DBRS operates with a stable rating philosophy; in other words, DBRS strives to factor the impact of a cyclical economic environment into its ratings wherever possible, which minimizes rating changes due to economic cycles. Rating revisions do occur, however, when more structural changes, either positive or negative, have occurred, or appear likely to occur in the near future.
- DBRS also publishes criteria which are an important part of the rating process. Criteria typically cover areas that apply to more than one industry. Both methodologies and criteria are publicly available on the DBRS website and many criteria are listed below under "Rating the Specific Instrument and Other Criteria."

Rating Canadian Municipalities – Overview

- This methodology applies to Canadian municipalities covered by DBRS. Large local governments, in particular, have a number of similarities and differences that can have a significant influence on the outcome of the rating process. Similarities include: a stable revenue base owing to well-defined though relatively limited taxing powers, a wide array of responsibilities for the provision of relatively customary public services, fairly stable political systems and local economies and a generally meaningful reliance on provincial governments, which share their tax base and have a considerable influence over the funding and operating environments of municipalities.
- While municipalities benefit from their relationship with senior government levels—and this is evident in certain pillars of the rating—municipal governments are primarily rated based on their own merits, and DBRS does not assume any implicit senior government support.
- The level of economic diversification and overall financial strength can vary substantially among Canadian municipalities, 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, large Canadian municipalities currently rank solidly in the investment-grade category.

Critical Rating Factors

- The table below presents the key factors defining municipal government ratings. It is followed by a brief overview of the characteristics of each factor expected for the various rating categories.

Critical Rating Factors

Rating Category	AAA	AA	A	BBB
Economic Structure	• Population and taxable assessment growth has been consistently above the provincial 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 cyclicality in GDP growth. • Income and taxable assessment per capita stand out relative to peers. • The labour force is highly skilled and unemployment is below average.	• Population and taxable assessment growth are sound and fairly consistent year over year. • The economy boasts a relatively diversifi ed 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. • Income and taxable assessment per capita are consistent with other large peers. • The labour force is skilled and unemployment is low and stable.	• Population and/or taxable assessment growth has been steadily below average or inconsistent in recent years. • The economy may be relatively 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. • Income and taxable assessment per capita may be below average. • The job market is dynamic, although the unemployment rate may be above average.	• Population is small and/or has been steadily declining in recent years. • The economy is relatively small and far from major urban centres, with one seasonal or challenged industry accounting for a substantial portion of economic activity. • Income and taxable assessment per capita are markedly below the provincial average, highlighting low wealth levels. • The job market is characterized by an unemployment rate that may be above the provincial average.
Fiscal Management	• Budgets are consistently balanced using very conservative assumptions and incorporating meaningful contingencies to help manage unforeseen events. • Very tight expenditure management, with a strong track record of surpluses as measured by DBRS. • Demonstrated ability to address unexpected adverse budget deviations to protect fiscal balance. • Property taxes and user fees are low, providing ample room to raise taxes if necessary. • Transparency and timeliness in reporting are exemplary.	• Fiscal sustainability is emphasized by the government, but reliance on one-time funding or sizable tax increases may be exhibited at times to balance the bud- get. • Budget contingencies vary year to year, although assumptions are generally prudent. • Results, as measured by DBRS, maintain a balanced position year over year. • Expenditure management is prudent, with limited in-year slippage. • Property taxes and user fees are in line with peers, providing moderate flexibility to raise taxes. • Transparency is good and financial reporting is timely.	• The fiscal management framework is well developed, but some key planning documents or reports may lack details. • Budget pressures tend to linger but are viewed as sustainable, al- though reliance on one-time funding and/ or sizable tax increases to balance the budget is high. • Fiscal results may exhibit greater volatility due to lower ability to manage in- year budgetary pressures. • Budget assumptions are deemed conservative, although the use of contingencies may be limited. • Reduced ability and/ or willingness to manage downturns through meaningful expenditure restraint or revenue-raising initiatives. • Property tax and user fee burdens may already be somewhat high, limiting the ability to further raise taxes and fees if needed.	• The fiscal management framework lacks structure and transparency, with only limited planning documents. • Budget pressures tend to linger and are viewed as potentially unsustainable, resulting in steady reliance on one- time funding and/or sizable tax increases to balance the budget. • Reduced ability and/ or willingness to manage downturns through meaningful expenditure restraint or revenue- raising initiatives. • Tax and user-fee bur- dens are high and delinquencies are building up.

Critical Rating Factors (CONTINUED)

Financial Management – Debt and Liquidity	• Debt is low and capital requirements for the foreseeable future are manageable and are not expected to pressure debt materially. • Debt and liquidity management practices are exemplary and very conservative. • The debt structure is very prudent, with low refi nancing risk, a smooth maturity profi le and minimal unhedged exposure to interest rate reset risk and foreign currency fluctuations. • The borrowing platform is well established and recognized. • Liquidity is substantial and in excess of short-term debt outstanding. • Unfunded pension liabilities, if any, are low and being addressed.	• Debt is moderately low. • Although capital requirements may be sizable, they are not expected to put excessive pressure on debt. • Debt and liquidity management practices are sophisticated and conservative. • The debt structure is prudent but may at times entail sizable refi nancing needs, an uneven maturity profi le or material exposure to interest rate reset risk. • The borrowing platform is well established and recognized. • Liquidity is significant relative to short-term debt and refinancing needs. • Unfunded pension liabilities may be sizable but are being addressed.	• Debt is sizable, and although management may have been successful at containing upward pressure in recent years, significant capital requirements have the potential to lead to significant increases going forward. • Interest costs consume a material portion of the budget. • 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 sizable refi nancing due to an uneven maturity profi le or material exposure to interest rate reset risk. • The borrowing platform is not well established, although the track record of execution of annual borrowing programs may be good. • Liquidity is limited. • Unfunded pension liabilities may be considerable and steadily growing.	• Debt is sizable and steadily growing, owing to large capital needs. • Interest costs may already consume a material portion of the budget. • Debt and liquidity management practices are lacking structure and sophistication relative to those of frequent borrowers. • The debt structure is prudent but may at times entail sizable refi nancing due to an uneven maturity profi le or material exposure to interest rate reset risk. • There is no established borrowing platform since the municipality infrequently accesses the debt market. • Liquidity is negligible. • Unfunded pension liabilities may be considerable and steadily growing.
Relations with Senior Government	• The legislative framework defining municipal responsibilities and revenue-generating powers is supportive and fosters financial sustainability. • Adequate provincial monitoring is provided. • Sizable and reliable funding support may be provided by the provincial government, especially for capital investments. • Cooperative relationship with senior government and track record of supportive tax and program policy objectives. • Limited interference in areas of municipal responsibility.	• The legislative framework defining municipal responsibilities and revenue- generating powers is supportive and fosters financial sustainability. • Adequate provincial monitoring is provided. • Senior government funding support is meaningful but may display volatility depending on the economic and fiscal environment. • Reasonable level of cooperation with senior government, although policy objectives may diverge in some areas.	• The legislative framewor defining municipal responsibilities and revenue- generating powers is rigid and may lack the guidelines necessary to foster fi nancial sustainability. • Provincial monitoring is limited. • Less cooperative relationship with senior government. • History of downloading of responsibilities or interruption of funding programs by the provincial government during downturns.	• The legislative framework defi ning municipal responsibilities and revenue- generating powers is inadequate and lacks the guidelines necessary to foster financial sustainability. • Provincial monitoring is absent. • Less cooperative relationship with senior government. • History of downloading of responsibilities or interruption of funding programs by the provincial government during downturns.

- A well-defined basket of responsibilities, developed and diverse economic and taxable assessment bases and relatively supportive provincial governments characterize Canada's largest municipal governments and lend support to their credit ratings. Nonetheless, economic disparities and varying fiscal management styles and capital needs are only a few of the considerations that lead to differing credit quality among major Canadian cities.
- DBRS endeavours to rate each issuer through the cycle and does not penalize an issuer at economic troughs nor reward it at economic 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 municipal governments.

Primary Factors

Economic Structure

- Similar to provinces, the economy of a municipality 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. Both the composition and the location of a municipal economy provide valuable insight into the volatility, dynamism and growth potential of a municipality and its propensity to create jobs and generate wealth. A diversified economy located close to other large and dynamic urban centres and well integrated into the provincial transportation network will generally tend to fare better and experience more consistent population and taxable assessment growth over the longer term than a more isolated commodity-based economy.

Critical Rating Factors (CONTINUED)

- In its analysis of the economic structure, DBRS focuses on (1) gross domestic product (GDP) and employment breakdown by major industry and major employer; (2) prospects of key industries and employers with competitive advantages; (3) track record of employment creation; and (4) adequacy of major infrastructure (e.g., roads, transit, land availability, electricity generation).
- Structural distortions within the economy, such as burdensome tax or regulatory systems, are also considered in the analysis. In the case of a small suburban commuter municipality highly reliant on a neighbouring urban centre for employment, DBRS may incorporate in its analysis consideration of some of the larger city's economic fundamentals, provided the municipality being rated is strongly integrated into its larger neighbour and is likely to retain this relationship over time, thanks to its close proximity, competitive taxes and/or considerable land availability, for example.

Fiscal Management

- The review of the fiscal management framework is aimed at assessing the government's fiscal sustain- ability and prospects, looking at revenue generation, program responsibilities and fiscal discipline, as well as at the coherence and appropriateness of the strategies, policies and processes governing the planning and allocation of public funds. Particular attention is paid to the quality of the fiscal management framework in place, the service responsibilities entrusted by the provincial government to its municipalities, the adequacy of revenues to cover core programs and interest charges and the level of fiscal flexibility afforded by the system (i.e., 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 comprehensive- ness of the government's planning, reporting and monitoring systems, as well as the ability of fiscal authorities to control in-year expenditure pressures. 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 with original budget estimates, putting emphasis on the frequency and extent of major budget deviations.

Financial Management – Debt and Liquidity

- The sustainability of a government's debt burden is a central consideration in the determination of the rating. DBRS carefully examines current and projected levels of capital investments and borrowing needs, and con- siders 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. Self-supporting debt, which is issued by or for the purpose of commercial or potentially commercial government enterprises and serviced by distinct user fees (e.g., electric utility or water service fees), is analyzed separately.
- A look into a government's financial management strategy, including the level of sophistication of its borrowing practices and overall debt structure, helps 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 rates and exchange rates. DBRS aims to develop an outlook for debt and debt-servicing requirements to assess overall affordability.
- As a result of their fairly predictable expenditure base and steady stream of revenue, some municipal governments tend to minimize their cash balances. Large municipalities, in particular, also often benefit from superior access to capital markets because of high investor receptivity, which considerably reduces refinancing risk and further reduces the need for backup liquidity.
- Nonetheless, municipalities will often have sizable reserve funds in place, which, although generally ear- marked for specific capital projects, could be temporarily allocated to other purposes in the event of severe liquidity stress. DBRS analyzes cash balances and reserves in relation to expenditures, scheduled debt repayments and availability of external liquidity sources such as bank facilities. Liquid assets will generally only be netted against debt if the funds are unrestricted and earmarked for debt retirement.

Relations with Senior Government

- While the creditworthiness of a Canadian municipality is primarily driven by the fundamentals of that municipality, the credit profile of the provincial government may also have a material influence on the rating since municipalities share their taxpayer base with their provincial counterparts and receive substantial provincial funding for capital projects and the delivery of certain programs. As a result, a fiscally and financially healthier provincial government will often have more resources to share with its municipalities and will do so in a more consistent fashion.

Critical Rating Factors (CONTINUED)

- Service responsibilities, revenue-generating powers and all other determining features of the operating framework of municipalities are defined by the provincial government. As a result, the responsiveness of a provincial government to the realities faced by municipal governments, as well as the various constraints or flexibilities provided through the legislated framework, may also have significant implications for the credit profile of municipalities, highlighting the importance of carefully analyzing the dynamic between municipalities and their respective provincial governments.
- Conflicting tax or social policy objectives between levels of government may also introduce challenges in fiscal management, as municipalities share their tax base and, in certain jurisdictions, responsibility for certain programs with their senior counterparts. DBRS analysts pay particular attention to the sustainability and consistency of key provincial policies aimed at municipalities.

Additional Factors

Tax Competitiveness

- The structure and level of taxation can have a bearing on a municipality's ability to attract and retain residents and businesses, 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 municipality's tax competitiveness, particularly in relation to neighbouring jurisdictions, and at the composition and level of key user fees and any barriers the framework may pose to future growth.

Demographics and Social Structure

- Demographic and social trends have a significant impact on a government's fiscal position by affecting the labour force, income distribution and demand for municipal services.
- For example, cities with a rapidly growing population will often enjoy an expanding taxable assessment base, but they may also face greater public pressure to expand public services, such as transit, and infrastructure, roads and water plants. In contrast, mature cities will generally face less capital growth pressure, but their aging population may translate into out-migration, declining property values and a shrinking tax base.

Ownership of Valuable Municipal Corporations

- DBRS also incorporates into its analysis material benefits generated by the ownership of self-supporting corporations fulfilling commercial mandates. Electric utilities are the most common type of valuable corporations owned by major Canadian municipalities. These entities often generate steady dividend streams that contribute positively to fiscal results and could be monetized, if needed, to significantly reduce debt. However, ownership of poorly performing corporations can represent a drain on municipal resources and potentially add to tax-supported debt obligations.

Transparency and Governance

- An examination of budgeting practices and financial reporting provides an indication of how transparent a municipal government is and the degree to which it can be relied on.
- Characteristics demonstrating transparent management and reporting practices generally include a well- structured budgeting process, adequate and timely financial reporting, the adherence to high accounting and reporting standards and early adoption of new rules.
- DBRS considers the framework and track record of municipal governance, including the accountability, internal controls and oversight of the governing body, along with the expertise, integrity and ethics of senior management and elected officials, as part of the rating process.
- The presence of a risk management framework to assess and mitigate strategic, financial, operational, legal and reputational risks is also considered.
- Material weaknesses with respect to transparency or governance could result in downward pressure on the rating, or in rare cases, critical issues may prevent DBRS from being able to provide a rating at all.

Financial Risk Factors

Key Metrics

- Recognizing that any analysis of financial metrics may be prone to misplaced precision, DBRS has limited its matrix of the key metrics below to a small sample of critical ratios. For each of these ratios, DBRS provides a range within which the issuer's financial risk would be considered as supportive for the rating category. However, the wide range of municipalities in existence throughout Canada, especially in terms of size, location, economic diversification and wealth, makes any attempt at generalization challenging and potentially misleading. As such, the values provided below are for Canada's larger cities, with populations exceeding 300,000, as their credit profiles are generally supported by diversified economies and sophisticated management frameworks.
- This rating methodology can still be used for smaller municipalities, although unique strengths or weak- nesses, such as over-reliance on a single industry or location in a shrinking, economically challenged region, may distort the analysis and reduce the relevance of the guidelines significantly, requiring financial metrics considerably stronger than noted below for a rating category.
- Furthermore, the ratings in the matrix below should not be understood as the final rating for a large city with matching metrics. The final rating is a blend of both the operating risk and financial risk considerations in their entirety.
- While DBRS does not have any set weightings for how these key metrics are considered in the final rating, it is typical that an entity's operating risk will carry moderately more weight in the final issuer rating than will its financial risk.

Canadian Municipal Government Financial Risk Metrics

Key Ratio	AAA	AA	A	BBB
Net tax-supported debt per capita 1	< $500	$500 to $2,500	$2,500 to $4,000	> $4,000
Net tax-supported debt as a percent- age of taxable assessment	< 0.5%	0.5% to 2%	2% to 6%	> 6%
Interest costs as a percentage of total revenues	< 1.5%	1.5% to 9%	9% to 15%	> 15%

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

- DBRS ratings are based heavily on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- It is also not uncommon for a government's key ratios to move in and out of the ranges noted in the ratio matrix above. In the application of this matrix, DBRS looks beyond the point in time ratio.
- Notwithstanding these potential limitations, 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.

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

- In addition to the information already provided with respect to key financial metrics, DBRS's broader financial risk review includes five key areas: economy, 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.

Economy

- A sound record of sustained economic growth is prime evidence of a municipality's ability to generate wealth for its population and fiscal resources for its government. DBRS looks at the level and trend of various summary indicators and seeks to understand the growth potential of the municipality in relation to that of the province and other municipalities across the country.

General Considerations in Evaluating a Canadian Municipal Government's Financial Risk Profile (CONTINUED)

Fiscal Balance

- Fiscal results are viewed by DBRS as a reliable indicator of management proficiency and commitment to fiscal soundness. Analysts look at the operating balance (operating revenues minus program expenditures and interest charges) as the primary indicator of fiscal flexibility, while the net fiscal balance (inclusive of capital expenditures) better reflects overall fiscal sustainability and the potential financing requirements in a given year.
- DBRS notes that in most provinces, municipalities are required under legislation to balance their operating budgets, although large capital investments may at times translate into sizable post-capex deficits and upward pressure on debt and tax rates. Analysts examine historical as well as prospective results, focusing on the cyclicality and sensitivity of the budget and financing requirements to adverse developments. While repeated sizable net shortfalls are perceived negatively by DBRS, the impact of such shortfalls will generally be discounted if the shortfalls are the result of catch-up capital investments or non-recurring events rather than a structural imbalance about which a government is showing little initiative. DBRS refers to this practice as "rating through the cycle."

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 municipal governments include residential, commercial and industrial property taxation; user fees for services such as water and waste management; senior government grants; and earnings from government enterprises. Since Canadian municipalities do not tax income, they generally benefit from a more stable revenue base than provincial governments, although it is at the expense of more limited revenue growth prospects.
- Special emphasis is put on the resilience of major revenue sources, on the overreliance on provincial government transfers and on the competitiveness of the city's tax rates relative to neighbouring jurisdictions. Constraints in revenue-generating powers, such as legislated caps on certain property tax rates, and structural defects in the government's tax system are also analyzed closely.
- DBRS may make certain adjustments to reported revenue figures in order to exclude non-recurring items and, ultimately, better reflect the underlying fiscal situation of a municipality.

Expenditures

- DBRS distinguishes between three major types of expenditures: service programs, capital investments 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 primary service responsibilities and the relationship between key expenditure items and factors such as demo- graphics and economic conditions in order to identify potential sources of fiscal volatility and cost pressure. Analysts review major program responsibilities established by the provincial government, focusing on the coherence and sustainability of each program and expected cost implications in relation to third-party revenue sources, if any, such as senior government grants.
- Relative to their provincial and federal counterparts, Canadian municipalities are responsible for a dis- proportionately large proportion of public infrastructure, including municipal roads, water and sewer facilities and transit assets. As a result, capital investments account for a considerable portion of municipal budgets and constitute the primary driver of debt. Historically, capital spending has been more cyclical than ongoing program expenditures, as capital funding from senior governments has fluctuated with their fiscal results and as municipalities in times of financial hardship have often opted to reduce capital spending to better their budget balance. This practice led to significant underinvestment at both the provincial and municipal levels in the 1980s and 1990s and to the accumulation of significant deferred maintenance deficits in most large Canadian municipalities despite the marked ramp-up in capital investments observed in recent years.
- DBRS analysts seek to get a clear understanding of current and future capital requirements faced by the municipality, focusing on the state of good repair of major public infrastructure and on the estimated future costs of addressing growth-related 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 municipalities.
- Of all three expenditure categories, debt servicing is definitely the most rigid and can constitute a meaningful portion of a government's budget. As a result, the stability and trend of a municipality's interest and debt payments are an especially important consideration.

General Considerations in Evaluating a Canadian Municipal Government's Financial Risk Profile (CONTINUED)

- In analyzing debt-servicing requirements, particular attention is paid to the municipality'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; therefore, increased emphasis on a municipality's debt maturity profile and refinancing strategy is warranted.

Balance-Sheet And Financial Flexibility Considerations

- The sustainability of a municipality'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 municipality as well as the financial obligations of any other related tax-supported organization that is within municipal jurisdiction (e.g., transit authorities). Debt is measured by DBRS net of sinking funds and other quality assets set aside explicitly for debt-retirement purposes. The resulting debt figure is compared with the capacity to carry debt of the municipality as represented by its taxable assessment. It is also analyzed relative to total tax revenues on a per capita basis. Although other financial commitments, such as capital lease obligations and unfunded pension liabilities, are not included in the calculation of tax-supported debt, they are also considered in the analysis of debt affordability.
- Self-supporting debt, which is issued by or for the purpose of commercial or potentially commercial municipal government enterprises and serviced by distinct user fees (e.g., electric utilities or water services), is analyzed separately by DBRS for its affordability. Such debt is generally allocated a much smaller weighting in the credit review, provided the services clearly have a commercial value and are mostly (if not entirely) funded by user fees, and the burden is not excessive for the municipality and is highly unlikely to require government support.

Rating the Specific Instrument and Other Criteria

- The issuer rating (which is an indicator of the probability of default of an issuer's debt) is the basis for rating specific instruments of an issuer, where applicable. DBRS uses a hierarchy in rating long-term debt that affects issuers that have classes of debt that do not rank equally. In most cases, lower-ranking classes would receive a lower DBRS rating. For more detail on this subject, please refer to the general rating information contained in the DBRS rating policy Underlying Principles.
- For a discussion on the relationship between short- and long-term ratings and more detail on liquidity factors, please refer to the DBRS policy Short-Term and Long-Term Rating Relationships and the criteria Commercial Paper Liquidity Support Criteria for Corporate Non-Bank Issuers.
- Guarantees and other types of support are discussed in Guarantees and Other Forms of Explicit Support.

Appendix 1: DBRS Adjustments to Reported Financial Figures

In certain circumstances, DBRS may adjust the financial results reported by a municipal government in order to (1) allow for a better comparison among peers, (2) capture all material tax-supported debt, (3) exclude debt deemed to be self-supporting within the reporting entity and/or (4) present fiscal results that are more reflective of the impact of government activities on indebtedness. The most frequent adjustments relate to the following areas:

Tax-Supported Debt: In an effort to capture the full extent of debt obligations to the account of taxpayers, DBRS adds up the debt of all activities and entities supported in a significant fashion by tax proceeds, such as public transit, road investments and general facilities. However, DBRS excludes from its calculation of tax-supported debt certain debt items related to activities that are deemed self-supporting (i.e., activities that are funded in a significant fashion by user fees and that could potentially be monetized to repay the related debt obligations if the municipality faced a serious financial squeeze). These activities include electricity generation and distribution, water treatment and distribution and social housing.

In addition, DBRS may consider debt leveraged against long-term senior government grants (e.g., federal fuel tax grants) to be self-supported and may therefore exclude such debt from tax-supported debt calculations provided: (i) the grants fully cover debt servicing requirements of the related debt; (ii) the term of the debt does not exceed the useful life of the assets being funded; (iii) the municipality discloses the value of such debt in its financial statements; and (iv) the commitment from the senior government is secured in legislation or by established government policies.

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 municipal government spending and of external financing needs for a given year.

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-offs 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 municipality.

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