

## CREDIT ANALYSIS

# Ontario Infrastructure Projects Corporation

Ontario, Canada

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### Summary Rating Rationale

The Aa1 debt rating assigned to the Ontario Infrastructure Projects Corporation (OIPC) reflects its high quality portfolio of loans to regulated public sector entities. Credit strength is supported by a reserve fund, providing liquidity, and an intercept mechanism, whereby provincial grants destined to a public sector entity that has missed a payment would be redirected to OIPC. Furthermore, the rating reflects the province's ultimate control of the reserve fund, a characteristic that links, closely, OIPC to the province. Moody's also assigns a Prime-1 (P-1) rating to OIPC's C\$750 million commercial paper program.

### Rating Outlook

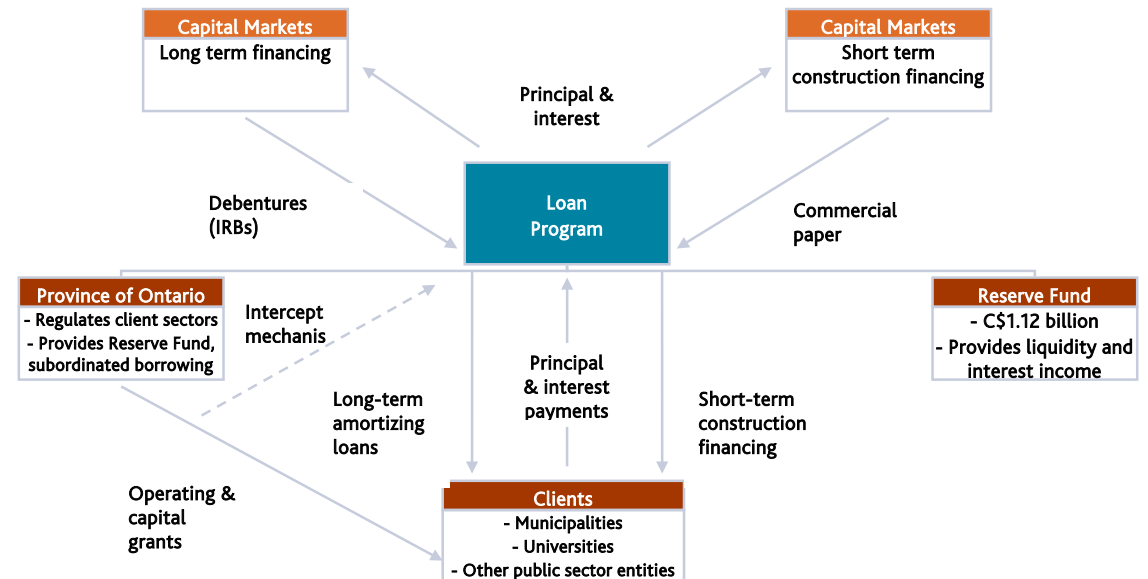
The outlook on OIPC's Aa1 rating is stable.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Ontario Infrastructure Projects Corporation and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](http://www.moodys.com).

## Issuer Overview

Ontario Infrastructure Projects Corporation (OIPC, also known as “Infrastructure Ontario”) is a non-share capital provincial crown corporation dedicated to the renewal and maintenance of infrastructure in the Canadian province of Ontario. The corporation’s objectives – as stated in the *Ontario Infrastructure Projects Corporation Act, 2006* – include providing financing for municipalities and other public sector entities as well as offering advisory services with respect to infrastructure procurement and project management in Ontario. As such, OIPC operates in two broad lines of business: project management (including alternative financing and procurement, or “public-private partnerships”) and a loan program. OIPC does not fund the projects undertaken under its project management mandate, but uses an Alternative Financing and Procurement (AFP) model, where private financing is employed while expenses and AFP project costs are recovered from individual projects at completion. OIPC issues commercial paper and debentures in support of its loan program for municipalities and public sector entities in the province. OIPC’s debt securities do not carry a provincial guarantee.

FIGURE 1  
OSIFA Loan Program Organization Structure



## Key Rating Considerations

### Institutional Framework

#### Activities Continue to Expand

In 2003-04, the first year of operations, the corporation made commitments for loans to municipalities totaling up to C\$922 million under the Ontario Municipal Economic Infrastructure Financing Authority (OMEIFA) loan program. Interest charged on OMEIFA loans was set at below-market rates, thereby providing a subsidy for participating municipalities. Loans were financed, initially, by a single issue (C\$323 million) of Ontario Opportunity Bonds (OOB), which was retired in May 2008. Interest earned on these bonds was exempt from provincial income tax.

OIPC's activities were expanded under the Ontario Strategic Infrastructure Financing Authority (OSIFA) loan program, which now operates as part of the Lending Division within Infrastructure Ontario. The loan program now includes the provision of infrastructure loans to qualified municipalities, universities, their federated and affiliated colleges, municipal corporations, not-for-profit professional training institutions for the arts, not-for-profit long-term care facilities, hospices and not-for-profit social and affordable housing providers. Other smaller sectors may potentially be added in the next few years, such as green energy and seniors housing. Financing activities are now being supported through the issuance of Infrastructure Renewal Bonds (IRBs), which do not have a tax-exempt status, and funding from the Province of Ontario. All non-OMEIFA loans are charged on a cost recovery basis.

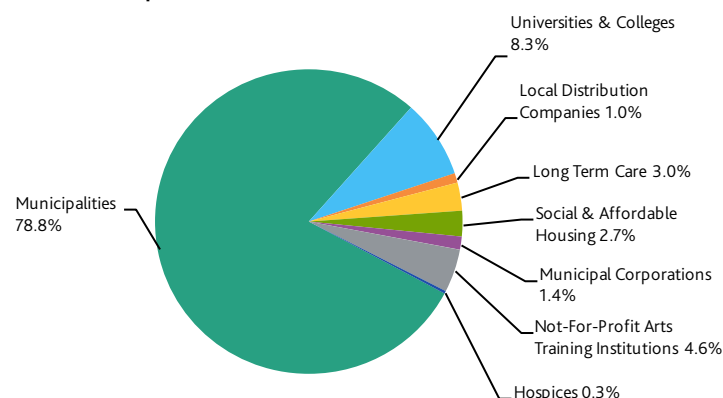
From inception to September 2009, a total of roughly C\$3.3 billion in loans had been approved and executed. Strong loan growth continues, with a 14 percent increase in approved and executed loans in the fiscal year 2008-09. Typically, cash is dispersed pursuant to loan agreements as the approved projects are constructed. These short-term construction advances, financed by the issuance of commercial paper, are then converted to long-term (from 5 to 40 years) amortizing loans financed by the issuance of IRBs. As these loans mature, cash received by OIPC is re-lent to other borrowers. As such, OIPC operates in a fashion similar to a revolving fund rather than a bond bank.

#### Loan Portfolio Comprised of Highly Regulated Public-Sector Entities

The province exercises considerable oversight over the financial affairs of the vast majority of the entities that borrow from OIPC, supporting the quality of its loan portfolio. In addition, an intercept mechanism is available whereby provincial grants destined for an entity that has missed a payment will be redirected to OIPC. This provides an added level of security for bondholders. Furthermore, OIPC conducts substantial oversight of borrowers. All potential borrowers are subject to a credit review and are monitored on a continuous basis. Loan approval varies by sector, with a larger proportion of municipal loan applications approved compared to the higher risk sectors. To date, there have been no defaults or missed payments in the portfolio.

While the proportion has declined slightly, the majority of OIPC's loan portfolio (78.8%) consists of loans to municipalities. The remainder comprises loans to universities, their affiliated colleges, municipal corporations, not-for-profit professional training institutions for the arts, not-for-profit long-term care facilities, hospices and social and affordable housing providers.

FIGURE 2  
OIPC Loan Portfolio as at September 30, 2009



The institutional framework governing municipalities in Ontario is mature and highly developed with the division of roles and responsibilities between the province and municipalities clearly articulated. Provincial legislation dictates a high degree of oversight, including limits on debt service costs, and the government retains the authority to assign an administrator over the financial affairs of any municipality. All of these factors support the creditworthiness of municipalities, and in turn, OIPC's loan portfolio. In addition, municipalities receive ongoing operating grants from the province, thereby validating the intercept mechanism described previously. Moreover, most municipalities in Ontario are fiscally conservative and rely on pay-as-you-go capital financing, limiting borrowing requirements.

While the province is ultimately responsible, constitutionally, for the delivery of post-secondary education, universities operate at arms-length from the province. The provincial government establishes broad strategies and targets for each university, provides operating grants and has the authority to control tuition fees, but each university retains autonomy to carry out its activities. Nonetheless, the majority of Ontario universities tend to exhibit strong internal governance and management characteristics that support steady financial performance. These characteristics, in addition to the intercept mechanism, ensure the loans made to universities are of high quality.

Loans made to some municipal corporations, not-for-profit long-term care facilities, hospices and not-for-profit professional training institutions for the arts are considered of higher risk given the revenue bases of these entities, which in the case of hospices and arts training institutions, can include a heavy reliance on charitable donations, a weaker revenue stream. In the case of municipal corporations, the province does not provide any ongoing grants that could be intercepted in the event of non-payment; however, the business risk profile of municipal corporations is low and provincial oversight is high. Conversely, loans to these entities constitute a much smaller proportion of total loans.

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## Financial Position and Performance

### Continued Loss from Operations as Expected

The first loan agreements between OIPC and its clients were set at below-market rates and financed with a combination of OOBs and IRBs (under the OMEIFA loan program). These concessionary loans continue to generate a net loss each year and these losses are expected to continue in the near term as previously approved loans at below-market rates are disbursed to clients. All non-OMEIFA loans operate on a cost recovery basis. Meanwhile, AFP projects and expenses are recovered from individual projects at completion, with working capital financed through a \$200 million revolving credit facility through the Ontario Financing Authority (OFA). Corporate expenses are recovered through a grant from the Ministry of Energy and Infrastructure. In 2008-09, OIPC's operations generated a loss of \$12.9 million, following a loss of \$20.6 million the previous year. Losses are expected to decline as costs on concessionary loans decrease and revenues increase to cover operating expenses. To fund the expected losses, OIPC is expected to sell securities held in the reserve fund described below.

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## Debt & Liquidity

### Debt Increasing with Loan Growth but Substantial Liquidity Provided by Reserve Fund

OIPC's outstanding debt totaled C\$1.7 billion at March 31, 2009, up from \$1.6 billion a year earlier. In November 2009 and January 2010, OIPC issued subordinated bonds to the Province of Ontario; these bonds are subordinated to OIPC's capital market debt, namely IRBs and CP. OIPC expects to meet its long term funding requirements for the remainder of 2009-10 through this route. To make further room for growth in its loan program, OIPC's short-term commercial paper program limit was increased from C\$500 million to C\$750 million.

Investments at March 31, 2009 totaled C\$974 million, down from C\$1.2 billion a year earlier. A portion of short-term investments were liquidated in 2008 to redeem the Ontario Opportunity Bonds that matured in May 2008. Investments provided 0.6 times coverage of OIPC's outstanding debt (at March 31, 2009). This ratio has been declining and is expected to continue to do so as the loan portfolio and debt grow.

Investments mainly reflect a reserve fund comprising a C\$1 billion 50-year subordinated loan from the Province of Ontario and a C\$120 million 20-year subordinated loan from the Ontario Clean Water Agency (OCWA). Interest on this provincial government loan is reset quarterly at the Province's three-month treasury bill rate, while interest on the OCWA loan is reset monthly at four basis points below the one month Canadian Dealer Offer Rate. The reserve fund is largely invested in short-term, liquid instruments and provides substantial liquidity and strengthens OIPC's credit quality. The absolute amount in the reserve fund is expected to continue to decline as OIPC absorbs losses associated with the below-market rate loans and funds its losses from operations; however, the reserve fund, given its magnitude, should continue to provide additional security for bondholders.

OIPC's financial assets are managed by the Ontario Financing Authority (the entity responsible for executing treasury functions on behalf of the province) on behalf of OIPC. The investment policy governing the management of these assets is comprehensive and all control rests with OIPC's board. However, if the province were faced with a stress scenario, the government, through a change in policy, could require the OIPC board to liquidate assets and use the funds to purchase provincial securities. This ties OIPC closer to the province, reflected in the Aa1 rating (which is the same as the province).

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## Governance and Management Factors

### Governance Structure

OIPC's corporate governance structure is set out in the *Ontario Infrastructure Projects Corporation Act, 2006*. Members of the board are appointed by the government, as is the chief executive officer, thereby ensuring OIPC's activities conform to government policies and directives. OIPC reports to the Minister of Energy and Infrastructure.

### Risk Management Policies

The Board of Directors is responsible for approving policies related to risk assessment/management. OIPC's credit risk management policies include a thorough due diligence process for each loan request that includes review of: the proposed project; past financial performance of the entity; governance and management; and the business case for the project. Once a loan has been made and construction begun, OIPC requires borrowers to submit project reporting updates. While lending has expanded to areas considered higher risk (such as some municipal corporations, not-for-profit long-term care facilities, hospices and not-for-profit professional training institutions for the arts), lending policies for new sectors are approved before any loans are extended to borrowers from these sectors in compliance with OIPC's Credit Risk Policy.

OIPC has also introduced a new Capital Management Policy in the fall of 2009 which includes the introduction of risk-weighted sector and individual concentration limits based on a new Risk Reserve Factor methodology to manage portfolio concentration risk. The Capital Management Policy also establishes a minimum capital to loans ratio of 25% (capital to outstanding loans).

In addition, OIPC manages interest rate risk, primarily by entering into fixed-for-floating swaps for both its long-term liabilities (fixed-rate IRBs) and its long-term assets (long-dated amortizing loans to clients). The corporation's only swap counterparty is the Ontario Financing Authority. While not eliminated, interest rate risk is minimized and monitored to ensure it remains at a conservative level.

Liquidity risk is managed by establishing maximum relative levels of reliance on refinancing over different time horizons. At any given time, OIPC cannot rely on net refinancing over the following 30 days for more than 10% of its total capital markets debt outstanding; this limit increases to 20% for a 60-day period and to 30% for any period of over 90 days. These maximum limits on refinancing ensure that OIPC keeps a sufficient level of liquidity to retire short-term and long-term obligations as they come due.

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### Application of Joint Default Analysis

Reflecting the application of Moody's joint default analysis (JDA) methodology for government-related issuers, OIPC's rating is comprised of two principle inputs: a baseline credit assessment (BCA) of 4 (on a scale of 1 to 21, where 1 represents the lowest credit risk), and a high likelihood that the Province of Ontario (Aa1, stable) would act to prevent a default by the corporation. A high support level reflects the strategic importance of OIPC in delivering a provincially mandated program as well as the perceived risk to the province's reputation if OIPC were to default.

### Rating History

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#### Ontario Infrastructure Projects Corporation

| DATE          | RATING |
|---------------|--------|
| November 2006 | Aa1    |
| July 2006     | Aa2    |

## Annual Statistics

## Ontario Infrastructure Projects Corporation

| DEBT STATEMENT<br>(C\$000, AS AT MARCH 31)     | 2005             | 2006 [1]         | 2007             | 2008             | 2009             |
|--|------------------|------------------|------------------|------------------|------------------|
| <b>Debt</b>                                    |                  |                  |                  |                  |                  |
| Ontario Opportunity Bonds                      | 323,364          | 323,354          | 323,284          | 323,032          | 0                |
| Infrastructure Renewal Bonds                   | 650,000          | 650,000          | 650,000          | 950,000          | 125,000          |
| Commercial Paper                               | 314,187          | 348,575          | 288,857          | 358,635          | 444,689          |
| <b>Total Debt</b>                              | <b>1,287,551</b> | <b>1,321,929</b> | <b>1,262,141</b> | <b>1,631,667</b> | <b>1,694,689</b> |
| <b>Investments</b>                             |                  |                  |                  |                  |                  |
| Short-term investments                         | 1,240,212        | 1,063,259        | 1,094,575        | 1,015,899        | 771,266          |
| Long-term investments                          | 676,611          | 402,695          | 98,427           | 207,501          | 203,005          |
| <b>Total</b>                                   | <b>1,916,823</b> | <b>1,465,954</b> | <b>1,193,002</b> | <b>1,223,400</b> | <b>974,271</b>   |
| <b>Loans Receivable</b>                        |                  |                  |                  |                  |                  |
| Construction advances                          | 218,851          | 364,498          | 277,670          | 401,724          | 314,701          |
| Debentures                                     | 239,492          | 581,222          | 814,990          | 990,319          | 1,334,489        |
| <b>Total</b>                                   | <b>458,343</b>   | <b>945,720</b>   | <b>1,092,660</b> | <b>1,392,043</b> | <b>1,649,190</b> |
| Investments/Total Debt (x)                     | 1.5              | 1.1              | 0.9              | 0.7              | 0.6              |
| Investments + Loans Receivables/Total Debt (x) | 1.8              | 1.8              | 1.8              | 1.6              | 1.5              |

[1] In 2005-06, OSIFA was subsumed by OIPC. Financial activities represent combined operations.

## Ontario Infrastructure Projects Corporation

| OPERATING ACTIVITIES<br>(C\$000, YEAR ENDING MARCH 31) | 2005            | 2006 [1]        | 2007            | 2008            | 2009            |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Revenues</b>  |                 |                 |                 |                 |                 |
| Interest   | 36,671          | 81,015          | 91,181          | 105,360         | 75,158          |
| Project recoveries                                     | --              | 591             | 28,197          | 45,792          | 69,739          |
| Other revenues   |                 | 8,270           | 12,735          | 11,840          | 19,668          |
| <b>Total</b>   | <b>36,671</b>   | <b>89,876</b>   | <b>132,113</b>  | <b>162,992</b>  | <b>164,565</b>  |
| <b>Expenses</b>  |                 |                 |                 |                 |                 |
| Interest   | 43,674          | 84,389          | 102,829         | 118,711         | 85,352          |
| Concession costs                                       | --              | 40,757          | 18,916          | 8,657           | 10,738          |
| Other  | 5,155           | 15,356          | 40,183          | 56,238          | 81,344          |
| <b>Total</b>   | <b>48,829</b>   | <b>140,502</b>  | <b>161,928</b>  | <b>183,606</b>  | <b>177,434</b>  |
| <b>(Loss) from Operations</b>                          | <b>(12,158)</b> | <b>(50,626)</b> | <b>(29,815)</b> | <b>(20,614)</b> | <b>(12,869)</b> |

[1] In 2005-06, OSIFA was subsumed by OIPC. Financial activities represent combined operations. In 2005-06, OIPC retroactively changed its accounting policy for concessionary loans to match the policy followed by the Province of Ontario. Under the new policy OIPC will record a concession expense at the time of the loan and then amortize it back into income over the life of the loan. The change in accounting policy resulted in an accounting adjustment of \$38.1 million in net concession costs in 2005-06.

## Moody's Related Research

### Credit Opinion:

- » Province of Ontario, November 2009

### Analysis:

- » Province of Ontario, April 2009 (116999)

### Special Comment:

- » Moody's 2010 Outlook for Sub-sovereigns, January 2010 (121563)

### Statistical Handbook:

- » Non-US Regional and Local Governments, December 2009 (100233)

### Rating Methodology:

- » Regional and Local Governments Outside the US, May 2008 (107844)
- » The Application of Joint-Default Analysis to Government-Related Issuers, April 2005

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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Report Number: 123018

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