

## Ontario Infrastructure Projects Corp.

### Issuer Credit Rating

AA+/Stable/A-1+

**Primary Credit Analyst:**

Paul Judson, CFA  
Toronto  
(1) 416-507-2523  
paul\_judson@  
standardandpoors.com

**Secondary Credit Analyst:**

Stephen Ogilvie  
Toronto  
(1) 416-507-2524  
stephen\_ogilvie@  
standardandpoors.com

### **Major Rating Factors**

**Strengths:**

- Very large debt service reserve relative to debt service obligations
- Loan portfolio's strong aggregate credit quality
- Setoff provision, which insulates loan portfolio from potential defaults
- Robust oversight of loan obligors

**Weaknesses:**

- Expansion of lending to types of obligors with weaker credit fundamentals
- Litigation and appropriation risks from project procurement and financing activities

### **Rationale**

The ratings on the Ontario Infrastructure Projects Corp. (IO or the company) principally reflect, in Standard & Poor's Ratings Services view, the very large debt service reserve (DSR) backstopping its loan program; the strong aggregate credit quality of loan obligors, the preponderance of which remain municipalities; and both IO and the Province of Ontario's (AA/Stable/A-1+) comprehensive oversight of loan obligors. The company's recent broadening of loan eligibility criteria to include new public sector segments with weaker credit

fundamentals, together with litigation and appropriation risks stemming from its project-finance department, tempers these strengths in our opinion.

IO's very large DSR of about C\$950 million continues to be the prime factor supporting the ratings. As of Dec. 31, 2008, the DSR exceeded annual debt obligations by about 14x, providing significant liquidity and insulation from potential loan obligor defaults. Assuming historical lending rates continue, we believe the DSR should offer coverage levels consistent with the 'AA+' level through our rating horizon.

Also supporting the ratings, in our opinion, is the loan portfolio's strong aggregate credit quality. While IO has recently extended the loan program to new public-sector entities with weaker credit fundamentals, municipalities still make up the overwhelming majority of the loan pool. In our judgment, Ontario municipalities tend to be of strong credit caliber—we rate many of them in the 'A' category or above—due to their generally significant financial strength and prudent financial practices. That IO has not encountered a single default in the loan portfolio since the loan program began in 2003 attests to the strong credit quality of municipalities as well as the conservative nature of its loan approval guidelines, in our view.

IO also has the legislated ability to setoff the unpaid principal and interest of a loan obligor against any grant or transfers from the Ontario government to the obligor, known as the intercept provision. We think this is an important credit support because of the large stream of money flowing from the province to the various public-sector entities. For many, the provincial funds they receive outweigh their annual loan service obligations significantly. As a result, we view the intercept provision as a powerful tool against many borrowers, motivating them to honor their loan commitments in a timely fashion or recouping losses if they do not.

The Ontario government's robust legislative framework and oversight also fosters strong credit quality, in our judgment. We believe the province's comprehensive control over municipalities and other public-sector entities, through its ability to set and revise governing legislation, reduces the probability of default among entities participating in the company's loan program. The province's powers include control over financial practices, borrowing capacity, and grant making (in conjunction with the intercept provision specific to IO). We also think Ontario's strong oversight provides a prudent double-check against the company's own comprehensive credit surveillance system.

However, we believe the loan portfolio's aggregate credit quality could moderately erode in the near term as the lending program gains more traction with recently added public-sector segments, including not-for-profit long-term care homes, nonprofit professional arts training organizations, and hospices. In our view, these sectors tend to possess weak credit fundamentals relative to those of municipalities. What's more, some of these newly eligible borrowers receive less provincial funding support than municipalities, thus lessening the effectiveness of the intercept provision and raising the importance of IO's DSR and credit approval guidelines. Nevertheless, while the concentration of these segments in the portfolio could increase, we expect municipalities to continue to be the dominant public sector segment for the foreseeable future. Accordingly, we expect aggregate credit quality to remain fairly sound, barring further expansions of the loan program's mandate to include other public-sector segments.

IO also remains exposed to litigation and appropriation risks due to its responsibilities in facilitating the project procurement portion of the Ontario government's infrastructure renewal initiative. As a direct signatory to some of the project agreements between private project companies and the province, IO could conceivably be named in lawsuits if ever material disputes between private companies and the

province arise. IO is also responsible for temporarily financing the facilitation costs for projects using a C\$200 million subordinated revolving credit facility with the Ontario Financing Authority (OFA) up to substantial completion of the projects, after which time the province fully reimburses the company.

### ***Outlook***

The stable outlook reflects our expectation that IO's DSR will remain appropriate for the 'AA+' rating. It also reflects our belief that municipalities with strong investment-grade fundamentals will continue to dominate the loan pool, and the portfolio's loan concentration will remain relatively well-dispersed. We also assume the Ontario government will not materially change IO's mandate. A rapid expansion in lending activities without a commensurate augmentation in the DSR, or new responsibilities could place downward pressure on the rating. Conversely, removing project procurement and project financing activities in tandem with slower-than-expected lending activity is a precondition for an upgrade.

### ***IO's Mandate***

The Ontario Infrastructure Projects Corporation Act is the primary piece of legislation governing IO, which was incorporated in November 2005 as a company without share capital, and is an agent of the Crown with natural person powers. Crown status notwithstanding, the act permits IO to declare for an agreement or security that is not acting as a Crown agent in respect of that particular agreement or security. The act also merged all assets and liabilities of the former Ontario Strategic Infrastructure Projections Corporation (OSIFA) with those of IO. The company's financial results are consolidated with those of the province, highlighting the close relationship that exists between the two entities.

The act gives IO the mandate to lend to municipalities and other public entities for infrastructure renewal, to obtain funding for those lending operations, and to undertake project and contract management of Ontario's infrastructure projects. The company's dual mandate effectively divides its activities into two separate spheres: the traditional lending to municipalities (and other public entities) that the former OSIFA performed; and procuring and managing major infrastructure projects using an approach known as alternative financing and procurement (AFP).

IO was created in July 2006 when it was merged with OSIFA, itself the successor to the Ontario Municipal Economic Infrastructure Financing Authority (OMEIFA). Its funding mandate has been expanded multiple times, and now covers lending for municipal hard infrastructure (water and sewer networks, roads and bridges, waste management facilities, and public transit), municipal long-term care homes, municipal social housing, nonprofit social housing (nonmunicipal), culture, tourism, recreation facilities, municipal service companies (local electricity distributors and district heating companies, for example), local service boards (unorganized municipalities), universities, federated and affiliated colleges, hospices, not-for-profit long-term care homes, and nonprofit professional arts training organizations.

Public-sector infrastructure renewal continues to be an important priority for the provincial Liberal government. The government has taken additional steps in municipal infrastructure renewal by sharing provincial gas taxes with municipal governments starting in 2004. In 2005, the government announced its ReNew Ontario 2005-2010 infrastructure plan, which calls for more than C\$30 billion of spending to help address the major infrastructure deficiency in Ontario as well as to prepare for growth. Major

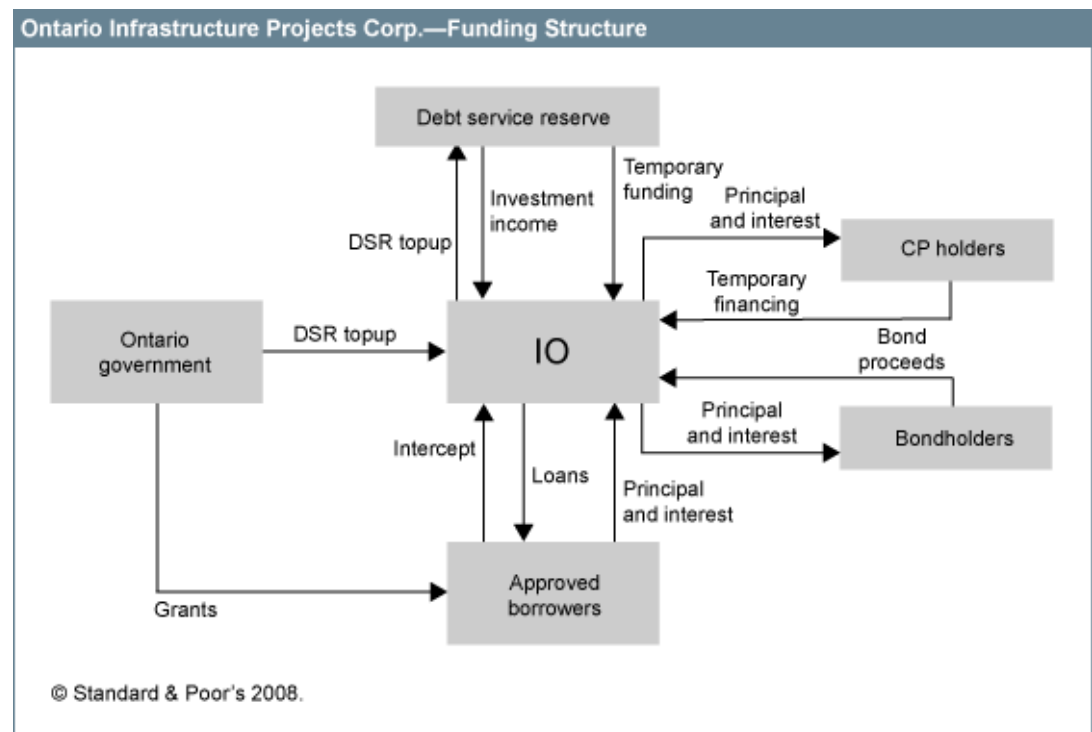
projects focus on hospitals, schools, colleges, universities, transportation, affordable housing, and justice system facilities.

***IO's Structure***

***Lending***

IO obtains its funding primarily by selling infrastructure renewal bonds (IRBs) to institutional investors. IO then lends the IRB sale proceeds to approved applicants, who will in turn use the funds to finance priority infrastructure projects (see chart 1). The loans IO makes to applicants are generally amortizing, with maturities ranging from 5-40 years, although most are 15-20 years.

Chart 1



IRBs have no call or put provisions and pay interest semiannually, with principal repaid at maturity. Terms will likely vary depending on the terms of loans to entities and investors' appetite. IO intends to sell IRBs to investors regularly. While it previously issued a series Ontario Opportunity Bonds (OOBs) featuring a provincial tax exemption to retail investors, that tranche matured in May 2008.

IO subjects all potential borrowers to an internal credit assessment, and grants loans only to those entities with sufficient financial strength and borrowing capacity. The company performs an ongoing credit monitoring of each borrower throughout the loan's duration. As part of this process, all borrowers must, at a minimum, provide IO with comprehensive financial information.

IO has assumed the assets and liabilities of the former OSIFA, including the subordinated loan that OMEIFA received from the Ontario government when the loan program was established in 2003. The company uses the subordinated loan as a DSR to backstop the loan pool. The DSR stood at around C\$950 million at Dec. 31, 2008.

IO invests the DSR funds in marketable securities. The company has developed and implemented comprehensive investment policies. The OFA, an agency of the Ontario government, performs all investment and associated risk management transactions on IO's behalf. The company enters all derivative contracts directly with OFA (under a master International Swaps and Derivatives Association agreement), which then interacts with the market. This arrangement ensures IO conducts its derivatives with a strong counterparty in the Ontario government.

Capital preservation is IO's predominant investment objective. After that, the most important objective is income generation so the company can pay interest on the subordinated loan, partially defray the cost of the one-time interest subsidy that municipalities receive, and recover its operating costs.

Borrowers must sign an intercept agreement as part of the loan documentation and approval process. If a borrower fails to make a debt service payment, the intercept would reassign provincial grants that would otherwise flow to the borrower. While the overwhelming majority of borrowers receive provincial grants, there are recent entrants to the borrowing pool from sectors, such as electricity distributors, that typically receive little or no grants whatsoever. We think this weakens the intercept provision and raises the importance of the company's DSR as a cushion to absorb potential loan defaults, of which there have been none to date.

#### ***Infrastructure procurement***

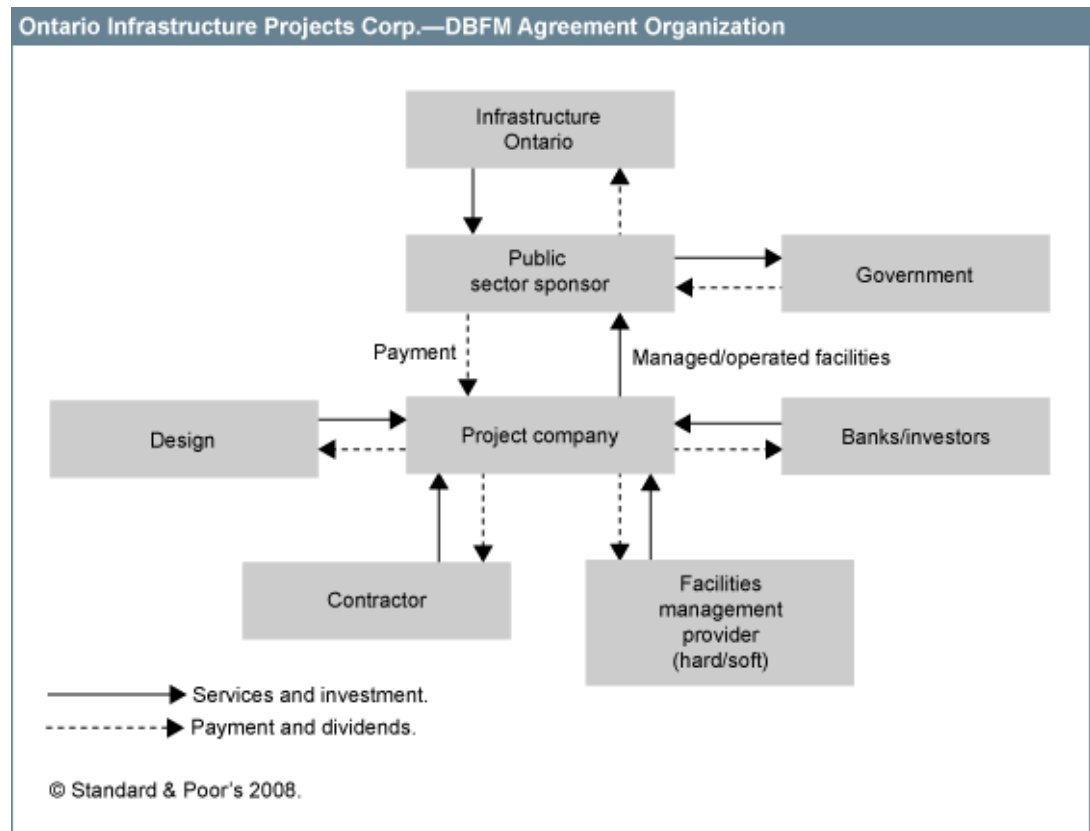
IO's project management division is staffed with experts from a variety of fields, including finance procurement, construction management, law, and health care administration. Its procurement mandate includes managing the pretransaction, transaction and, in the case of public works projects, construction phases of Ontario's AFP portfolio.

The company's project management activities include the design, letting, awarding, and administration of contracts and agreements. Projects proceed through two models. The build-finance model is typically used when the project involves renovations or expansions to existing facilities with significant interconnectivity to existing structures. Conversely, in the case of new builds, the company uses a design, build, finance, and maintain (DBFM) approach. In its capacity as a Crown agent, IO will sign agreements for public works projects only, which includes courthouses and correctional facilities, among others, but not hospitals. Its policy is to assign public works projects that have an operational period, typically about 30 years, to the Ontario Realty Corp. (another Crown agent) once construction is complete, and IO is to be indemnified for any operating period risks.

All payments to private project companies for AFP contracts are government obligations. The relevant ministry is responsible to make government payments in conjunction with the appropriate project construction milestones, the timing of which is known well in advance. The Ontario government appropriates these forecast milestone payments, and the ministries pay the project companies those payments once they achieve the milestones. OFA has given IO a revolving C\$200 million subordinated credit facility to temporarily cover any other facilitation costs, such as the company's staffing and consulting expenses, which are not included in the milestone payments to the project companies. In turn, the government repays these OFA loans for IO's associated costs related to project management activities. As a result, the company's project management division ultimately operates on a full-cost-recovery basis, as it does not use any funds from its lending operations to

support its project management activities or payments. Chart 2 displays the organizational structure of a typical DBFM public works project. Chart 2 illustrates IO's DBFM agreement organization.

Chart 2



***Loan Portfolio Still Displays Strong Underlying Credit Quality***

We think the overall underlying credit quality of the loan portfolio remains solid. As of Dec. 31, 2008, the loan pool was overwhelmingly composed of municipalities. To a lesser extent, local electricity distribution companies (LDCs), long-term care homes (LTCs), universities, hospices, and nonprofit professional arts training organizations also borrowed.

Standard & Poor's believes municipalities in Ontario generally have very strong credit quality, reflecting their legislatively-mandated balanced operating budgets, low debt burdens, high liquidity levels, strong operating surpluses, and modest contingent liabilities. In fact, all the municipalities in Ontario that we rate have strong ratings—in the 'A' category or higher.

We view the credit landscape for universities as being quite similar. The large first-tier universities tend to be of strong credit quality; as such, their ratings usually fall in the 'A' category or above because of their relatively diversified revenue sources, strong student demand and favorable demographics, and large unrestricted net assets. On the other hand, we think smaller universities can have weaker credit profiles as a result of their more limited financial flexibility and less comprehensive financial oversight, although IO maintains rigorous credit surveillance over these and other borrowers.

LDCs also generally have good credit quality, in our opinion, owing to their supportive regulatory regimes and strong business profiles as monopoly suppliers of an essential service. Standard & Poor's

rates a number of the large Ontario LDCs, all of whom have ratings in the 'A' category. Smaller LDCs, of which there are many in Ontario, would be of lesser credit quality.

We believe overall credit quality is generally lower in both the LTC and nonprofit professional arts training organizations sectors, where business profiles are notably weaker—so much so that we think much of these sectors are generally not of investment-grade caliber.

The intercept provisions included in borrowing agreements with IO are important because of the large stream of grants to the broader public sector from the Ontario government. In fact, the annual grant stream for many borrowers dwarfs their debt service obligations to IO. For some borrowers, the grants stream is small or virtually nonexistent, making the intercept provision ineffective for IO. However, these sectors constitute a very small portion of the loan portfolio.

We also think IO's approval process is a very important credit feature. The company has designed this process to ensure that borrowers have the financial capacity to repay their loans. What's more, the Ontario government plays an important role in monitoring the credit quality of entities in the broader public sector. It has comprehensive control of the sector, both from an operational and financial standpoint, and extensive grant-making and supervisory powers. Standard & Poor's notes that the Ontario government has demonstrated its ability and willingness to intervene in the operations of a public sector entity experiencing financial difficulties.

### ***The Loan Portfolio Continues To Increase***

As of Dec. 31, 2008, the loan portfolio totaled C\$1.7 billion, up about 21% from the total of C\$1.4 billion as at fiscal year-end 2008 (March 31). About 17% of the portfolio was short-term commercial paper (CP)-funded variable-rate construction loans, while the remainder was IRB funded fixed-rate loans. The proportion of the total loan representing construction loans fell moderately from March 31 levels, as the conversion of construction loans to long-term loans exceeded the size of new construction loans.

The balance of the long-term loan pool was C\$1.4 billion. It comprised more than 300 individual loans spread across 148 borrowers. Of these borrowers, 136 were municipalities, two were universities, three were long-term care homes, four were LDCs, two were nonprofit professional arts training organizations, and one was a hospice. Average and median loan exposures per obligor were C\$9.5 million and C\$2.3 million, respectively, with a minimum of C\$35,000 and a maximum of C\$114 million. We think these exposures are manageable and appropriate for the ratings.

The balance of the construction loan pool was C\$291 million. Average and median loan exposures per obligor were C\$4.9 million and C\$2 million, respectively, with a maximum of C\$47 million. We also think these exposures are manageable for the ratings. Construction loans typically become long-term loans when the underlying construction project is complete.

Concentration of borrowers in the loan pool continues to improve. As of Dec. 31, 2008, the top 10 obligors represented 49% of the long-term loan portfolio, down from 55% in March 2008. We note that concentration in the loan pool has fallen dramatically in the past four years. Although borrowers will remain confined to Ontario, geographical diversification should continue to increase as new municipalities join and the uptake of loans in nonmunicipal segments increases.

We expect the loan pool to expand again this year, as approved entities begin to draw down funds. As of Dec. 31, IO had about C\$668 million in loan commitments that were not yet disbursed, pointing to moderate near-term growth in the loan portfolio.

### ***Debt Service Reserve Remains Very Substantial Despite Decline***

IO's DSR totals C\$950 million. It is held in cash and marketable securities, and administered by the OFA. The conservative policies that guide the investment of the DSR monies are similar to those the OFA uses to manage its own cash and investments. The top investment objective is capital preservation.

The DSR has decreased modestly in recent years, reflecting the company's obligation to absorb spread losses related to its inherited C\$757 million subsidized loan program. Under the now-closed program, the company (then known as OMEIFA) offered loan rates to municipalities based on what it could obtain through the sale of tax-exempt OOBs. However, the then-incoming provincial Liberal government ended the company's powers to issue tax-exempt OOBs in 2004, when it reorganized OMEIFA into OSIFA. The province subsequently transferred the responsibility for supporting these subsidized loans through the sale of nontax-exempt IRB to IO in 2006 (along with all assets and liabilities of OSIFA). IO intends to cover the spread losses related to supporting these subsidized loans with the DSR.

Nevertheless, we continue to view IO's DSR as being very substantial relative to required reserve levels. As of Dec. 31, 2008, the DSR represented about 14x annual debt service obligations. We think this level of coverage will diminish in concert with loan portfolio expansions. However, if we extrapolate growth in the loan portfolio from that observed in recent years, DSR augmentation will not be necessary to maintain the rating for a number of years.

### ***Debt Platform***

#### ***Long-term debt***

IO's long-term funding platform features two main components: senior ranking public bond issues (IRBs) that fund the long-term loan portfolio, and very long-term subordinated loans used to seed the DSR. As of Dec. 31, 2008, IRBs outstanding comprised C\$650 million maturing June 1, 2015; C\$300 million maturing June 3, 2013; and C\$300 million maturing June 1, 2037. The bonds pay interest semiannually, with principal repaid through a lump-sum payment at maturity. IO has indicated that it expects to issue about C\$300 million-C\$600 million per year in IRBs to fund the long-term loan portfolio's continued expansion. We expect the term of bond issues to vary. As part of its strategy to hedge interest rate risk, the company intends to ladder its debt maturities to approximately match the expected loan portfolio duration.

The subordinated loans the Ontario government supplied to seed to DSR consist of a C\$1 billion, 50-year loan directly from the province and a C\$120 million 20-year loan from the Ontario Clean Water Agency (OCWA). The company must pay interest quarterly to the province on the subordinated loan, which matures in 2053, but has the option to delay principal repayment until maturity. The loans are subordinated to the interest and principal repayments made to IRB holders.

### ***CP program***

IO's rationale for using CP as a financing source is primarily to provide financing to obligors during the construction phase of their IO-approved construction program. To a lesser extent, the company may use CP to fund the short end of its long-term loan portfolio. The CP program is authorized up to C\$500 million. IO expects to have about C\$400 million in CP outstanding at any given time. We think IO might need to increase its CP limit to the extent lending in recently added public sector segments increases and overall loan volumes increase.

Although the company's CP program is not formally supported by an irrevocable letter of credit, it is backstopped by a C\$500 million intraday bank facility. In addition, the DSR represents a source of liquidity, if needed. Our ratings assume there would be no further liquidity support from the Ontario government.

The government has said the company's bond issues do not carry a provincial guarantee; but we think investors will likely associate these bonds with the Ontario government. As a result, if the company were to experience financial difficulties, we think investors would pressure the Ontario government to provide additional assistance to IO.

### ***Risk Factors***

We understand that IO will be a signatory to public work projects only, which tend to be smaller in scope than hospital projects, and will be signing these projects in its capacity as a Crown agent. Under the Ontario Infrastructure Projects Company Act, the government is responsible for judgments against IO for those agreements the company has undertaken as a Crown agent. While we expect that a private project company would name the government and IO in any lawsuit, the costs of such litigation and any judgment payable would ultimately be the government's responsibility.

Despite the company's considerable efforts to match assets with liabilities, we expect some minimal mismatch to exist between the loan portfolio and CP and IRBs outstanding. This mismatch could potentially result in IO having to roll over some IRBs at higher interest rates than what borrowers have been paying, and the necessity to fund this gap. Hedging activities arranged through the OFA mitigates the lion's share of this risk.

We continue to observe that the range of obligor credit quality is widening as lending extends into new areas of the public sector. The risk of lending to small rural or remote northern Ontario municipalities has existed since the inception of IO's loan program. However, we believe that lending into segments such as long-term care homes, whose broad credit quality is generally below that of municipalities, will likely continue to reduce the loan portfolio's underlying credit quality. In response to this concern, the company has adapted its credit approval process to adjust for quality differentials between the various public sectors, and has instituted caps on its exposure to certain segments. We also note that IO has not experienced any defaults on its loan portfolio since its inception. We also take comfort in its large DSR.

***Ratings Detail (As Of 30-Jan-2009)\****

Ontario Infrastructure Projects Corp	
Issuer Credit Rating	AA+/Stable/A-1+
Commercial Paper	
Local Currency	A-1+
Canadian National Scale Commercial Paper Rating	A-1(HIGH)
Senior Unsecured (2 Issues)	AA+

***Issuer Credit Ratings History***

13-Oct-2004	AA+/Stable/A-1+
23-Jul-2003	AA+/Stable/—

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2009 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.

Standard & Poor's uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from Standard & Poor's, our parent, The McGraw-Hill Companies, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 800-852-1641 or write us at: [privacy@standardandpoors.com](mailto:privacy@standardandpoors.com). For more information about The McGraw-Hill Companies Privacy Policy please visit [www.mcgraw-hill.com/privacy.html](http://www.mcgraw-hill.com/privacy.html).

Analytic services provided by Standard & Poor's Ratings Services ("Ratings Services") are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. Credit ratings issued by Ratings Services are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of credit ratings issued by Ratings Services should not rely on any such ratings or other opinion issued by Ratings Services in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or by the underwriters participating in the distribution thereof. The fees generally vary from US\$2,000 to over US\$1,500,000. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications.

Permissions: To reprint, translate, or quote Standard & Poor's publications, contact: Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280; or by e-mail to: [research\\_request@standardandpoors.com](mailto:research_request@standardandpoors.com).

**The McGraw-Hill Companies**