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Research Update:

Territory of Yukon 'AA' Rating Affirmed; Outlook Is Stable

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Overview

- We expect Yukon's finances to remain sound over the next few years, despite a potential mild loosening in fiscal policy under the newly elected Liberal government, with continued strong liquidity, low debt, and modest contingent liabilities.
- As a result, we are affirming our 'AA' long-term issuer credit rating on the Territory of Yukon.
- We are also affirming our 'AA' issue-level rating on Yukon Development Corp.'s senior unsecured debt.
- The stable outlook reflects our expectation that Yukon will produce modest operating surpluses and small after-capital deficits, liquidity will remain high despite some drawdowns in the next two years, and the debt burden will remain well under 30% of operating revenues.

Rating Action

On Sept. 27, 2017, S&P Global Ratings affirmed its 'AA' long-term issuer credit rating on the Territory of Yukon. The outlook is stable. At the same time, S&P Global Ratings affirmed its 'AA' issue-level rating on the senior unsecured debt of Yukon Development Corp. (YDC), the territory's wholly owned electric utility.

Outlook

The stable outlook reflects our expectation that, in the next two years, Yukon will produce modest operating surpluses and small after-capital deficits, partially because economic growth is very modest. We also expect that liquidity will remain substantial despite some drawdowns in the next two years, remaining many times above 100% of the next 12 months' debt service; and that the territory's debt burden will remain low, at well under 30% of operating revenues.

Downside scenario

Although we believe it is unlikely during the next two years, we might consider a negative rating action if financial discipline deteriorates coupled with a significant and sustained weakening of budgetary performance such that the territory records average operating balances of less than 5% of operating revenues, after-capital deficits are greater than 10% of total revenues, and the tax-supported debt burden exceeds 30% of operating revenues.

Upside scenario

We could raise the ratings if Yukon's economic prospects materially improve, leading to a growing share of modifiable revenues and operating balances consistently exceeding 5% of operating revenues.

Rationale

We have updated our base-case scenario for Yukon and extended our forecasting horizon to fiscal 2020. We believe that the economy will be essentially static in the next two years with real GDP recording very low-but-positive growth. Operating revenue growth should be modest. Potentially looser fiscal policy could lead to weaker operating and after-capital results. We expect that the territory's relatively substantial cash and investments will fund after-capital deficits, and the debt burden will not materially increase.

Economic growth will be negligible in 2017 and 2018 with faster growth expected in 2019.

For 2017 and 2018, Yukon's real GDP growth should be very low-but-positive, with faster growth returning in 2019. Labor force results will be less rosy than those in 2016: We expect the unemployment rate to slowly rise in 2017 and 2018 because employment is unable to keep up the pace of growth in the labor force. The choppiness of real GDP growth rates notwithstanding, we believe that local GDP per capita will be close to C$77,000 in 2017. Yukon's concentration in the mining sector and the sector's volatility temper our assessment of the strength of the territory's economy and operating revenue growth. Mining sector output in 2016 represented 19% of output at basic prices and we expect this share to be close to or above 20% in 2017 and 2018. Our view of the territory's growth prospects, which we continue to assess as below average, also tempers our overall assessment.

Yukon's financial management is sound, in our view. The government has a long track record of strong management that produces solid financial results. However, we believe that fiscal policy could loosen somewhat as the new Liberal government implements its election commitments. Nevertheless, an experienced and capable administration implements policy. Budgets provide good prospective visibility but are detailed for only one year. Fully consolidated budgets use realistic assumptions, but the key mining sector is volatile, introducing uncertainty into medium-term revenue forecasts. Nevertheless, the territory has produced good financial results. We believe that the territory's debt policy is prudent: Debt limits are legislated and outstanding balances are well below the limits. Cash and debt management are integrated. Yukon has only one significant government-related entity, YDC, which has a strong policy rationale and has been run prudently.

We believe Canadian territories benefit from a very predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Yukon benefits from significant revenue support through the Territorial Formula Financing (TFF) grant, Canada Health Transfer, and Canada Social Transfer payments from the federal government. In fiscal 2017, total transfers represented 79% of total revenues. We expect total federal transfers will continue to increase modestly in the next two years.

Budgetary performances will neither improve nor deteriorate as debt remains low.

The territory's debt burden will remain low in the next two fiscal years, especially in comparison with that of peers. Tax-supported debt, which includes direct debt, capital leases, and the debt of YDC, should be about C$180 million or about 14% of operating revenues by fiscal year-end 2018. In fiscal 2019, tax-supported debt should rise on issuance by YDC to about C$215 million (or 15% of operating revenues) but begin to decline slowly thereafter. Direct debt should continue to decline over the next two years, reaching less than C$40 million or 3% of operating revenues by fiscal 2020. Interest expense will remain below 1% of operating revenues and unfunded pension liabilities will continue to be modest.

Yukon's liquidity should decline in the next two fiscal years as the government uses cash to support its capital programs. We expect that the territory will have cash and temporary investments of more than C$200 million by fiscal year-end 2018 and free cash and liquid assets will remain many times above 100% of the next 12 months' debt service. We estimate that the territory's free cash and liquid assets will represent more than 30x its next year's debt service as of fiscal year-end 2018. Our view that Yukon has strong access to Canada's well-developed capital markets and our favorable assessment of its robust cash flow generation also bolster our assessment of the territory's liquidity.

Yukon's contingent liabilities are very manageable and should stay so over the next two years. In fiscal 2016, the territory's liabilities for vested sick leave and vacation, severances, and known environmental liabilities totaled about C$147 million, or only 12% of operating revenues.

We expect that the territory's budgetary performances will be largely unchanged in the next two years and do not foresee a return anytime soon to the robust operating and after-capital surpluses seen before commodity prices fell in 2014 and 2015. We expect operating surpluses to decline to about 2% of operating revenues by fiscal 2020: The operating surplus for fiscal 2018 should be about 6% of operating revenues (unchanged from fiscal 2017). After-capital deficits will improve slightly to 4% of total revenues in fiscal 2018, 3% in fiscal 2019, and 2% in fiscal 2020. The improvement will come from lower capital spending programs, especially in fiscal years 2019 and 2020. For fiscal years 2016-2020, we expect that Yukon will record an average operating surplus of under 5% of operating revenues and average after-capital deficits of about 3% of total revenues.

Transfers from the federal government provide a considerable source of stable and predictable revenue but they lower the territory's budgetary flexibility.

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Total transfers, mainly from the TFF grant, the Canada Health Transfer, and the Canada Social Transfer, will continue to represent more than 80% of operating revenues over the next two fiscal years. Modifiable revenues will remain small, averaging about 17% of annual operating revenues in fiscal years 2016-2020. Capital spending will represent 11% of total expenditures in fiscal 2018 but decline to less than 5% by fiscal 2020. For the fiscal 2016-2020 base-case period, capital expenditures will average about 9% of annual total expenditures.

Key Statistics

Table 1

Territory of Yukon -- Selected Indicators

	--Budget year--				
(Mil. C$)	**2015**	**2016bc**	**2017bc**	**2018bc**	**2019bc**
Operating revenues	1,228	1,292	1,312	1,378	1,391
Operating expenditures	1,129	1,221	1,239	1,349	1,356
Operating balance	99	72	73	28	36
Operating balance (% of operating revenues)	8.0	5.6	5.6	2.1	2.6
Capital revenues	11	11	27	15	0
Capital expenditures	166	132	157	83	64
Balance after capital accounts	(56)	(49)	(57)	(39)	(28)
Balance after capital accounts (% of total revenues)	(4.5)	(3.8)	(4.3)	(2.8)	(2.0)
Debt repaid	6	5	5	5	5
Balance after borrowings	(62)	(54)	(62)	(44)	(33)
Modifiable revenues (% of operating revenues)	15.5	17.8	16.3	16.7	16.5
Capital expenditures (% of total expenditures)	12.8	9.8	11.3	5.8	4.5
Direct debt (outstanding at year-end)	56	52	47	42	37
Direct debt (% of operating revenues)	4.6	4.0	3.6	3.0	2.7
Tax-supported debt (outstanding at year-end)	200	190	183	215	208
Tax-supported debt (% of consolidated operating revenues)	15.8	14.3	13.5	15.2	14.5
Interest (% of operating revenues)	0.2	0.2	0.2	0.1	0.1
Local GDP per capita (C$)	72,460	76,314	76,765	68,956	77,524
National GDP per capita (C$)	55,405	55,876	57,800	59,340	60,780

Note: The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' 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 S&P Global Ratings' expectations of the most likely scenario. Downside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of S&P Global Ratings' scenarios that could be consistent with an upgrade. bc--Base case.

Ratings Score Snapshot

Table 2

Territory of Yukon -- Ratings Score Snapshot

Key rating factors	Assessment
Institutional Framework	Very predictable and well-balanced
Economy	Average
Financial Management	Strong
Budgetary Flexibility	Weak
Budgetary Performance	Average
Liquidity	Exceptional
Debt Burden	Very low
Contingent Liabilities	Very low

Note: S&P Global Ratings' credit 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, July 6, 2017. Interactive version available at http://www/spratings.com/sri

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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 Affirmed

Yukon (Territory of)	
Issuer credit rating	AA/Stable/--
Yukon Development Corp.	
Senior unsecured	AA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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