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Research Update:

Territory of Yukon 'AA' Rating Affirmed On Exceptional Liquidity And Very Low Debt Burden

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Key Statistics

Ratings Score Snapshot

Key Sovereign Statistics

Related Criteria And Research

Ratings List

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Territory of Yukon 'AA' Rating Affirmed On Exceptional Liquidity And Very Low Debt Burden

Overview

- 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 ratings reflect our opinion of the territory's exceptional liquidity, very low debt burden and contingent liabilities, strong financial management, and average economic strength and budgetary performances.
- The stable outlook reflects our expectation that Yukon will produce modest operating surpluses and small after-capital deficits, liquidity will remain exceptional despite some drawdown in the next two years, and the debt burden will remain well under 30% of projected consolidated operating revenues.

Rating Action

On Sept. 28, 2016, S&P Global Ratings affirmed its 'AA' long-term issuer credit rating on the Territory of Yukon. 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. The outlook is stable.

Rationale

The ratings reflect S&P Global Ratings' opinion of Yukon's exceptional liquidity, very low debt burden, very low contingent liabilities, strong financial management, and average economic strength and budgetary performance. The ratings also reflect our view of the very predictable and well-balanced institutional framework for Canadian territories. In our opinion, Yukon's budgetary flexibility is weak.

We continue to view the territory's debt burden as very low, especially in comparison with that of peers. By our estimates, direct debt stood at C$56 million at the end of fiscal 2016; tax-supported debt, which includes direct debt, the debt of YDC, the territory's wholly owned utility, and Yukon Energy Corp., and capital leases, was C$200 million. The modest increase in debt in fiscal 2016 was due to an increase in YDC's debt -- direct debt decreased slightly during the year. Tax-supported debt represented 16% of consolidated adjusted operating revenues and direct debt was only 5% of adjusted operating revenues at that time. Interest expense was stable, at 0.2% of adjusted operating revenues. Given no new borrowing expected through the end of fiscal 2019 and Yukon's amortizing debt profile, we expect that the territory's direct debt will continue to decrease modestly. We also expect, however, that YDC will borrow funds in the next two years to help finance its capital expenditure requirements. Using our conservative base-case estimates, we expect total tax-supported debt to increase slightly in fiscal 2018 to about C$220 million and decline thereafter. Tax-supported debt will remain comfortably below 20% of consolidated adjusted operating revenues in the next two years. The territory's interest will also be stable, at less than 0.5% of adjusted operating revenue.

Yukon's contingent liabilities are very low, in our view. In fiscal 2015, the territory's liabilities for vested sick leave and vacation, severances, and known environmental liabilities that totaled about C$137 million, or 11% of adjusted operating revenues. Furthermore, we believe that in the event of financial stress, support for YDC would be limited to no greater than 2% of consolidated operating revenues.

Yukon's financial management is strong, in our opinion. The government has a long track record of strong management that produces solid financial results. An experienced and capable administration implements policy. Budgets provide good prospective visibility but are detailed for only one-year out. Multiyear capital planning is good. Fully consolidated budgets use realistic assumptions but the key mining sector is volatile, introducing uncertainty into medium-term revenue forecasts. Nevertheless, Yukon has been able to produce good financial results over the long term. Actual variations from budget typically have been modest. 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 2016, total transfers represented 83% of reported total revenues. We expect total federal transfers will continue to increase modestly in the next two years.

Yukon's economy is average, in our view, despite its high GDP per capita. Based on the average of data (as per our criteria), we believe that the territory's nominal GDP per capita averaged about US$60,000 for the 2013-2015 period. Our assessment of the strength of Yukon economy is tempered by its concentration in the mining sector and the related volatility; and our opinion that the territory's growth prospects are limited. We believe that the Yukon economy contracted in 2015 for a third consecutive year, as lowered mineral output and low prices continue to weaken the mining sector. We believe that real GDP fell about 4% in 2015 following a 1% decline in both 2013 and 2014.

The labor market began to show the effects in 2015 of the continuing economic contraction. While the labor force was unchanged in 2015, the number of employed workers fell 2% during the period. The unemployment rate rose to 6.3% from 4.3% in 2014. For 2016, we expect real GDP will expand by about 3% but contract again in 2017 by as much as 5%.

The territory's budgetary performances are average, in our opinion. We estimate that Yukon recorded an operating surplus of about 6% of adjusted operating revenues in fiscal 2016, which is notably lower than the fiscal 2014 and 2015 surpluses of about 11% of adjusted operating revenues. We also estimate that the government produced an after-capital deficit of about 4% of total revenues, which would be similarly lower than the 5% and 4% after-capital surpluses of fiscal years 2014 and 2015, respectively. The smaller operating surplus in fiscal 2016 resulted from operating expenditure growth outpacing operating revenue growth. Capital expenditures have been rising for the past three fiscal years, putting pressure on after-capital results. Capital spending reached close to C$160 million for fiscal 2016, up from close to C$100 million in fiscal 2015. According to our base-case forecast, we expect Yukon to produce somewhat smaller operating surpluses for the fiscal 2017-2019 period that should average about 3% of projected adjusted operating revenues. We further expect that the territory will produce after-capital deficits over the same period: 6% of total revenues in 2017 and about 2% for both fiscal years 2018 and 2019. Under our base-case scenario for fiscal years 2015-2019, the average operating balance will be close to 5% of annual adjusted operating revenues and the balance after-capital expenditures will average about negative 2% of total revenues.

Although transfers from the federal government provide a stable and predictable revenue source, we believe Yukon's budgetary flexibility is weak. Total transfers, mainly from the TFF grant, the Canada Health Transfer, and the Canada Social Transfer, represented more than 80% of operating revenues, resulting in weak budgetary flexibility. Modifiable revenues are typically small. In fiscal 2016, modifiable revenues equaled about 15% of operating revenues. For our fiscal years 2015-2019 base-case period, modifiable revenues will average about 15% of annual operating revenues. Capital expenditures increased again for the second consecutive year, reaching about C$160 million in fiscal 2016. They also rose to 12% of total spending, and should stay close to that mark in fiscal 2017, at 11%. For the fiscal years 2015-2019 base-case period, capital expenditures will average about 9% of annual total expenditures.

Liquidity

Yukon's liquidity remains exceptional, in our view. By our estimates, the territory had cash, marketable securities, and portfolio investments of about C$300 million as of the end of fiscal 2016, which would be down from close to C$350 million a year earlier. Liquidity levels fell in fiscal 2016 as the government deployed some of its cash to support its capital program. We expect the government will similarly deploy some of its cash to help finance the fiscal 2017 capital program. Nevertheless, we expect that Yukon's free cash and liquid assets will remain easily above 100% of the next 12 months' debt service. We estimate that the territory's free cash and liquid assets represented close to 40x of its next year's debt service as of the end of fiscal 2016. We believe that Yukon has strong access to external liquidity, in line with that of many Canadian peers.

Outlook

The stable outlook reflects our expectation that, in the next two years, Yukon will produce modest operating surpluses and small after-capital deficits. We also expect that its liquidity will remain exceptional despite some drawdown in the next two years, remaining well above 100% of the next 12 months' debt service, and that the territory's debt burden will remain low, well under 30% of projected consolidated operating revenues.

Although we believe it very unlikely, we might consider a negative rating action if, under our downside-case scenario, financial discipline deteriorates, and there is a significant and sustained weakening of budgetary performance such that Yukon records average operating balances of less than 5% of consolidated operating revenues and after-capital deficits of greater than 5%, leading in turn to lower liquidity or a higher debt burden.

We could raise the ratings if the territory's economy expands so that the concentration and volatility risk fall and economic prospects improve, leading to a growing share of modifiable revenues.

Key Statistics

Table 1

Territory of Yukon -- Economic Statistics					
Fiscal year end	**--Fiscal year ended March 31--**				
	2014	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Population	37,000	37,400	37,774	38,152	38,533
Population growth (%)	1.6	1.1	1.0	1.0	1.0
GDP per capita (C$)	70,351	68,346	70,918	67,617	68,956
Real GDP growth (%)	N/A	(2)	2.0	2.0	N/A
Unemployment rate (%)	4.3	4.8	6.3	6.3	6.3

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. Sources typically include Statistics Canada. N/A--Not applicable.

Table 2

Territory of Yukon -- Financial Statistics					
	--Fiscal year ended March 31--				
(Mil. C$)	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Operating revenues	1,228	1,247	1,277	1,305	1,331

Table 2

Territory of Yukon -- Financial Statistics (cont.)

	--Fiscal year ended March 31--				
(Mil. C$)	**2014**	**2015bc**	**2016bc**	**2017bc**	**2018bc**
Operating expenditures	1,097	1,168	1,243	1,272	1,298
Operating balance	131	79	35	33	33
Operating balance (% of operating revenues)	10.7	6.4	2.7	2.5	2.5
Capital revenues	17	31	35	35	35
Capital expenditures	103	157	148	101	101
Balance after capital accounts	45	(47)	(78)	(33)	(32)
Balance after capital accounts (% of total revenues)	3.6	(3.6)	(6.0)	(2.4)	(2.4)
Debt repaid	6.2	4.7	3.9	3.8	3.9
Balance after debt repayment and onlending	39	(51)	(82)	(36)	(36)
Balance after debt repayment and onlending (% of total revenues)	3.1	(4.0)	(6.3)	(2.7)	(2.7)
Gross borrowings	0	3	0	0	0
Balance after borrowings	39	(48)	(82)	(36)	(36)
Operating revenue growth (%)	2.1	1.6	2.4	2.2	2.0
Operating expenditure growth (%)	2.5	6.5	6.4	2.4	2.0
Modifiable revenues (% of operating revenues)	16.2	14.9	15.0	14.8	14.5
Capital expenditures (% of total expenditures)	8.6	11.8	10.6	7.3	7.2
Direct debt (outstanding at year-end)	59	56	51	46	41
Direct debt (% of operating revenues)	4.8	4.5	4.0	3.6	3.1
Tax-supported debt (% of consolidated operating revenues)	14.7	15.6	14.4	16.4	15.7
Interest (% of operating revenues)	0.2	0.2	0.2	0.2	0.2
Debt service (% of operating revenues)	0.7	0.6	0.5	0.4	0.4

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 3

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

Table 3

Territory of Yukon -- Ratings Score Snapshot (cont.)	
Key rating factors	**Assessment**
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 S&P Global Ratings' "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, 2016. Interactive version available at http://www/spratings.com/sri

Related Criteria And Research

Related Criteria

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

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Ratings Affirmed

Yukon (Territory of)
 Issuer credit rating                   AA/Stable/--

Yukon Development Corp.
 Senior unsecured                       AA
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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.