CREDIT OPINION
15 October 2024

Update

Send Your Feedback

RATINGS

First Nations Finance Authority

Domicile	Kelowna, British Columbia, Canada
Long Term Rating	Aa3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Adam Hardi, CFA +1.416.214.3636
Vice President-Senior Analyst
adam.hardi@moodys.com

Jonathan Holmes +1 647.417.6302
Ratings Associate
jonathan.holmes@moodys.com

Michael Yake +1.416.214.3865
Associate Managing Director
michael.yake@moodys.com

First Nations Finance Authority (Canada)

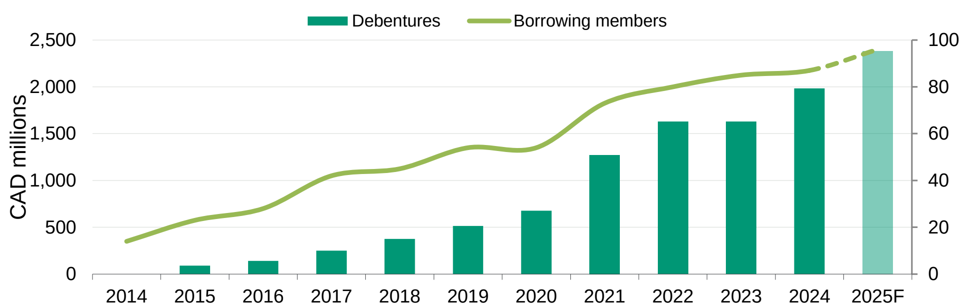
Update to credit analysis

Summary

The credit profile of the First Nations Finance Authority (FNFA, Aa3 stable) reflects a growing loan portfolio with improving member diversification. FNFA's stringent monitoring process and robust structural mechanisms ensures that the credit quality of borrowing members remains strong. Very high levels of intercepted revenues, which gives FNFA priority over cash flows, ensures strong interest and debt service coverage ratios. FNFA's credit profile also reflects both the direct and implicit support of the Government of Canada (Aaa stable). The credit profile is constrained by the challenges of monitoring a dynamic and growing pool of borrowing members and heightened due diligence in monitoring borrowers with weak financials. Further, a single-name concentration in the loan portfolio constrains credit quality.

Exhibit 1

FNFA's outstanding debt continues to grow with the growth of its borrowing pool and First Nations' need for low cost lending



Year ending March 31
Sources: FNFA and Moody's Ratings

Credit strengths

» Stringent review of pool participants' credit quality enhance loan portfolio quality

» Robust structural credit protection mechanisms support high cash flow coverage

» Additional backstops provide bondholder protection

» Continued borrowing member and debenture growth due to increased demand for loans

Credit challenges

» Credit challenges by some borrowers requires heightened monitoring and due diligence

» Single name borrower concentration has increased, mitigated by overall loan diversity

Rating outlook

The stable outlook on FNFA's rating reflects that the strong institutional framework and robust member onboarding process ensure continued high loan portfolio quality despite rapid loan growth. At the same time, significant credit protection mechanisms ensure sufficient cash flows to provide high coverage of debt service throughout the life of the loans.

Factors that could lead to an upgrade

A material improvement in the credit quality and default tolerance of the pool participants, including improving credit conditions of borrowers that require heightened due diligence, together with further diversification of the borrower member pool could lead to upward pressure on the rating. Rising liquidity and coverage ratios would also result in upward rating pressure.

Factors that could lead to a downgrade

A deterioration of the credit quality and default tolerance, size and diversity of the participant pool (such as increased geographic or borrower concentration), or a change in our view that FNFA can effectively monitor borrowers with weaker credit quality, would put downward pressure on the rating. Indications of lower support from the federal government including adverse changes to FNFA's Act would also result in downward rating pressure.

Key indicators

Exhibit 2

First Nations Finance Authority

(Year Ending 3/31)	2020	2021	2022	2023	2024	2025F
Total Direct Debt (CAD millions)	753	1,303	2,026	2,026	2,383	2,783
Loans Outstanding to Clients (CAD millions)	711	1,235	1,541	1,677	1,908	2,330
Total Cash and Investments (CAD millions)	157	222	729	592	747	822
Interest Income as % of Revenues	75.2	83.6	81.6	82.8	81.0	86.1
Net interest margin (%)	0.16	0.15	0.24	0.21	0.22	0.28
Operating Margin as % of Revenues	13.8	7.4	12.9	9.1	10.4	5.2
Cash and Investments as % of Net Debt	25.3	19.9	41.8	35.3	38.1	35.9

Sources: FNFA and Moody's Ratings

Detailed rating considerations

The credit profile of FNFA, as expressed in its Aa3 stable rating, combines a Baseline Credit Assessment (BCA) of a1, and a strong likelihood of extraordinary support from the Government of Canada in the event that FNFA faced acute liquidity stress, should this unlikely scenario occur.

Baseline credit assessment

Stringent review of pool participants' credit quality enhance loan portfolio quality

FNFA acts as a central borrowing agency for financing capital requirements and economic and social infrastructure development projects of member First Nations. In addition to providing long-term capital financing for member First Nations, FNFA includes the provision of interim financing and short-term investment opportunities for First Nations.

FNFA is one of three First Nation-led national institutions legislated under the First Nations Fiscal Management Act by the Government of Canada. It is not an agent of the crown and its obligations are not guaranteed by the federal government, although the federal government continues to provide direct support to FNFA. The First Nations Fiscal Management Act (FNFMA) came into force on 1 April 2006 and established three institutions (1) First Nations Finance Authority (FNFA), (2) First Nations Tax Commission (FNTC) and (3) the First Nations Financial Management Board (FMB), which is responsible for financial management system certification for First Nations.

FNFA's rating is supported by the pool program management attributes inherent in FNFA's structure and the stringent qualification process for becoming a borrowing member. This includes a comprehensive onboarding process and FNFA's regular monitoring of the pool participants' credit quality to ensure borrowers' timely cash flow payment of debt service obligations. FNFA also has intervention powers granted to the authority under its Act.

A First Nation must first request to the Minister of Crown-Indigenous Relations and Northern Affairs Canada to be scheduled to the FNFMA, pass a band council resolution, and satisfy certification requirements with the FMB. As part of this certification process, FMB analyzes the financial performance of the First Nation. FMB also aids the First Nation in developing a Financial Administration Law, which outlines the decision making, management, monitoring and reporting with respect to financial administration of the First Nation. Moreover, a First Nation must also gain unanimous approval of the FNFA board before becoming a member.

The FMB conducts regular monitoring and oversight of borrowing members and has the power to intervene and arrange a co-management arrangement or third-party management of a First Nation's revenues if necessary. The FNFA also has the power to request intervention by the FMB if the First Nation fails to make a payment or fulfill an obligation under its Borrowing Agreement. The FMB has the power to take control over the treasury functions of a borrowing member that has received a loan and can access all revenue streams of that borrowing member.

Robust structural credit protection mechanisms support high cash flow coverage

FNFA's structure includes robust mechanisms that ensure cash flow provides for high coverage of debt service through the life of the loans. Once a borrowing agreement is signed with a borrowing member, an irrevocable intercept mechanism, a Secured Revenues Trust Account (SRTA), is put in place to capture the revenue stream used to support the First Nation's loan. Any non-performing revenue stream must be replaced with a performing revenue stream. The trust account diverts the gross revenues of those revenues that will be used against borrowing following minimum coverage ratios; anything in excess of that needed for the borrowing is then diverted back to the First Nation.

FNFA's objective is to have intercepted revenues that at any given time provide at least 2x debt service coverage and 3x interest coverage (2.1x and 3.6x, respectively, at April 24, 2024). We consider these coverage levels to be strong, which also reflect improvements in FNFA's due diligence and loan monitoring and stability of the borrower revenue base.

These coverage ratios depend on the type of pledged revenues in support of the loan, i.e. higher debt coverage ratios are required for higher risk revenues such as land benefit agreements versus government transfers. Invoicing is also based on revenue frequency, so if revenue streams are received monthly, monies toward repayment will be collected monthly and prior to debt service payments. This allows extra time to resolve any issues prior to any debt service payments. FNFA has not experienced payment issues related to the pandemic to date.

Additional backstops provide bondholder protection

FNFA maintains two important reserve funds which provide credit protection to bond investors: five percent of all loan requests are held in the Debt Reserve Fund (DRF) and the Canadian government has provided funding to a Credit Enhancement Fund (CEF) which was set up to enhance FNFA's creditworthiness and act as a backstop to the DRF. Should there be a non-payment on an obligation, FNFA would first work to recover the payment but can also tap into the DRF. In case of a shortfall in the DRF, the CEF could be used to temporarily offset shortfalls, while a joint and several obligation of borrowing members requires them to replenish the DRF without limit.

The DRF continues to grow in proportion with the loan portfolio growth, reaching CAD119 million at March 31, 2024, with continued increases projected as the aggregate loan amount increases. The DRF can be used for debt service in the event of non-payment by a borrowing member. Assets in the DRF are invested mostly in liquid securities.

The CEF totaled CAD53 million at March 31, 2024 following multiple contributions by the Government of Canada since its inception, which provides evidence of the federal government's strong support of FNFA. The explicit federal support benefits FNFA's credit profile and we anticipate that the federal government would provide additional funding to the CEF as the loan portfolio grows.

Bondholder protection is further supported by a Contingency Fund, which totaled CAD37.1 million at March 31, 2024. The Contingency Fund provides 0% interest loans to FNFA borrowing members to ensure loan service payments are made in full in the event that a senior government regulatory action impacts a First Nations revenue streams, such as policy responses to pandemics or economic shocks.

FNFA also maintains a CAD600 million commercial paper (CP) program for financing loans to borrowing members. Usage of the CP program exposes FNFA to some rollover risk in the current high interest rate environment, although increases in CP rates are offset by higher short-term lending rates. In addition, the CP program is backstopped by a CAD600 million syndicated revolving credit facility syndicated across several Canadian chartered banks. Borrowing under the CP program and the credit facility is jointly limited to CAD600 million, limiting aggregate exposure.

Continued borrowing member and debenture growth due to increased demand for loans

We anticipate continued strong First Nations interest across Canada to borrow through FNFA and benefit from FNFA's favourable lending rates. FNFA's borrowing base has grown significantly over the last eight years, with the number of borrowing first nations growing to 87 in March 2024 from only 13 borrowers of its 2014 debenture issuance. FNFA now has scheduled or approved members across all ten Canadian provinces and the Northwest Territories, with 169 members at March 31, 2024 and 364 total scheduled members. Concurrently, loans to members grew to an estimated CAD1.9 billion at 31 March 2024, and Moody's anticipates this to exceed CAD2 billion at March 31, 2025.

On June 20, 2023 an amendment to the FNFMA (Bill C-45) became law, which expanded the definition of “borrowing member” as defined within the FNFMA, enabling FNFA to extend loans to non-profit organizations that provide indigenous public services including healthcare and utilities, and Treaty Bands. The expanded definition enhances the potential borrower base for FNFA and will likely result in additional loan growth.

FNFA finances its loans through typically annual debt issuances, with the total notional debt amount growing in line with the growth in loans. At March 31, 2024, the size of outstanding debentures was approximately CAD2.4 billion. In June 2024, FNFA refinanced approximately CAD180 million, its first debt refinance since it was created.

Credit challenges by some borrowers requires heightened monitoring and due diligence

Although we continue to view the overall borrowing pool as strong, there is notable variability in the credit quality between borrowers, which impacts the credit quality and default tolerance score in FNFA’s scorecard. Credit challenges include both balance sheet weakness (significant leverage resulting in very high debt burdens and/or weak liquidity) and operating weakness (revenue shortfalls and high expenses).

FNFA monitors the financial condition of borrowers closely, nevertheless rapid growth in the borrowing pool due to rising demand for loans have resulted in an increased number of borrowers that require heightened due diligence and monitoring including the need to prudently analyze the fiscal health of current and pending members. FNFA’s expenses have also grown as it needs to ensure sufficient staff levels for monitoring.

The due diligence process is also challenged by late financial reporting by some borrowing members, often by multiple years, which makes evaluating their fiscal and credit health more difficult. Structural issues in recent years, including government policy compliance, legal disputes and staffing shortages by some First Nations have also contributed filing delays. However, it is FNFA's practice to deny new loans to these borrowing members until the requested financial statements are produced.

Single name borrower concentration has increased, mitigated by overall loan diversity

Over the last 5 years, FNFA has significantly increased the size of notional loan values to single borrowing members in support of various infrastructure and equity participation projects. For example, in 2020 it provided a CAD250 million loan to 7 First Nations, as part of a CAD594 million loan envelope to support the Mi’kmaq coalition for a 50% stake in a seafood company. Further, in 2022 and 2023, it provided a combined CAD270 in loans to Enoch Cree Nation for capital spending related to band business enterprises, including a resort and casino. As a result, the loan concentration to the top five borrowers has increased significantly, rising to 42% in July 2024 (28% in 2019).

Nevertheless, the distribution of borrowing composition continues to diversify with the growth of FNFA's loan portfolio, exhibiting solid credit quality of the pool of borrowing members. The loan portfolio continues to diversify away from a previous significant concentration in the province of British Columbia, which in 2014 accounted for 65% of borrowers, removing some of the geographic concentration risk of the agency's lending portfolio. Over the last seven years, borrower concentration has significantly improved, with borrowers across 9 provinces and 1 territory.

Extraordinary support considerations

Moody's assigns a strong likelihood of extraordinary support from the Government of Canada to prevent a default by the FNFA and the creation and support of FNFA and supporting institutions by Canada through legislation as well as the important government-defined mandate of the FNFA in providing financing for First Nations in Canada. Moody's also assigns a very high default dependence level between FNFA and the Government of Canada, reflecting the two entities' shared exposure to common economic and financial risks.

ESG considerations

How environmental, social and governance risks inform our credit analysis of FNFA

Moody's takes into account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of FNFA, the materiality of ESG to the credit profile is as follows:

FNFA has limited exposure to environmental risks given its function as a financial authority. It is not exposed to natural capital, water management or other environmental risks. Although some of the borrowing First Nations bands may be exposed to environmental risks including wildfires or flood risk, disaster relief from the provincial and federal governments mitigate this risk.

As a finance authority, FNFA has limited exposure to social risks, such as demographics and health and safety related risks. While it is exposed to changes in its borrowing members' financial health and their ability to pay their loan obligations to FNFA, significant credit protection mechanisms mitigate this risk.

We characterize FNFA's governance as strong, with a well-established institutional and borrowing framework and a stringent member onboarding process with strict guidelines on lending. However, the constantly changing borrower pool landscape and weak or late financials by some borrowers, coupled with a need to evaluate a high volume of member applications, requires a more active monitoring of member credit quality than other rated pools. FNFA recently expanded the size of its monitoring team which mitigates this risk.

Further details are provided in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology 'General Principles for Assessing Environmental, Social and Governance Risks'.

Rating methodology and scorecard factors

The assigned BCA of a1 is in line with the scorecard-indicated BCA outcome. For details about our rating approach, please refer to the Public Sector Pool Programs and Financings Methodology (August 2024) and Government-Related Issuers Methodology (January 2024).

Exhibit 3

First Nations Finance Authority - 2024 Scorecard

Public Sector Pool Programs and Financings Methodology

Baseline Credit Assessment (BCA) – Scorecard	Base Weight	Sub Factor	Score
Factor 1: Credit Strength and Default Tolerance (50%)			
Credit Quality and Default Tolerance Score	50%	A	A
Factor 2: Diversity of Portfolio (20%)			
Number of Borrowers	10%	87	Aa
Percentage of Loan Principal to Borrowers that Represent Less than 1% of the Pool	5%	27.35%	Aaa
Percentage of Loan Principal to the Top 5 Borrowers	5%	41.51%	A
Factor 3: Debt Structure (30%)			
Cash Flows	20%	Aa	Aa
Counterparties	10%	A	A
Notching Factors			
Unusually Strong or Weak Management		0	
Concentration of Pool Participants in a Volatile Sector		0	
Total Notching Adjustments		0	
Scorecard-Indicated BCA Outcome			a1

Fiscal year-end 31 March 2024
Source: Moody's Ratings

Ratings

Exhibit 4

Category	Moody's Rating
FIRST NATIONS FINANCE AUTHORITY	
Outlook	Stable
Baseline Credit Assessment	a1
Issuer Rating -Dom Curr	Aa3
Senior Secured -Dom Curr	Aa3

Source: Moody's Ratings

REPORT NUMBER 1415826

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454