Fitch Revises Province of Alberta's Rating Outlook to Positive; Affirms IDR at 'AA-'

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Fitch Ratings - New York - 27 Jul 2023: Fitch Ratings has affirmed the Province of Alberta, Canada's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'AA-'. The Rating Outlook has been revised to Positive from Stable. In addition, Fitch has affirmed the province's Short-Term IDR at 'F1+' and long-term ratings on senior unsecured bonds at 'AA-'.

The ratings are based on Alberta's 'High Midrange' risk profile and a debt sustainability assessment in the 'a' category, both unchanged from the previous review, which together warrant a Standalone Credit Profile (SCP) of 'a+'. The 'AA-' IDR reflects an additional one-notch uplift based on Fitch's expectation of temporary ad hoc federal action to support debt market access during episodes of market disruption.

The revision of the Outlook to Positive reflects economic and fiscal performance in fiscal 2023 (ending March 31), which was far above budget expectations, driven by higher energy price trends. Alberta used the windfall to repay debt, including CAD13.4 billion in fiscal 2023, equal to 18% of fiscal 2022 net adjusted debt. The rapid decline in debt, adherence to spending restraint in recent budgets and introduction of a new fiscal framework requiring balanced budgets and allocating surpluses to debt repayment, savings or one-time investment are likely to aid future resilience, despite Alberta's continuing vulnerability to oil price shocks.

**KEY RATING DRIVERS**

Risk Profile: 'High Midrange'

The 'High Midrange' assessment reflects a low risk relative to international peers that Alberta's ability to cover debt service from operating balances may weaken unexpectedly.
over the forecast horizon (through fiscal 2028) because of lower-than-expected revenues, above-expectation expenditures, or an unanticipated rise in liabilities or debt-service requirements.

**Revenue Robustness: 'Midrange'**

Alberta’s revenue base is comparatively less diverse than other Canadian provinces and highly sensitive to its cyclical energy sector, supporting the 'Midrange' assessment. A range of taxes and fees is levied both on general activity and on natural resources, but there is no general sales tax, a major revenue source among provincial peers. Non-renewable resources provided CAD25.2 billion in fiscal 2023, one-third of the total, as adjusted by Fitch, but are highly volatile. Growth prospects remain solid, given above-average population gains and gradual economic diversification.

**Revenue Adjustability: 'Stronger'**

All Canadian provinces have a constitutionally unlimited power to raise revenues, supporting the 'Stronger' assessment. Alberta has no broad-based sales tax and comparisons of provincial tax burdens suggests ample room to raise additional revenues, providing flexibility to increase revenue despite political reluctance to do so. A robust and stable system of federal transfers diversifies revenues and provided CAD11.4 billion in fiscal 2023, 14% of the total; major transfers are unconditional. Provincial forecasting is typically conservative and transparent, with benchmarking to federal and private forecasters.

**Expenditure Sustainability: 'Midrange'**

Provinces deliver most public services under Canada’s system of federalism, from relatively stable categories such as education to fast-growing healthcare and more countercyclical social services spending, along with most capital outlays. Alberta’s 'Midrange' assessment, consistent with other provinces, reflects this broad spending mandate and Fitch’s expectation that, faced with an economic downturn, provinces will maintain or increase spending, elevating the risk of deficits over time; this was particularly true in Alberta over the last decade as it contended with oil-price driven volatility in 2015 and 2020, triggering sizable deficits.

**Expenditure Adjustability: 'Stronger'**
High service levels, either delivered directly or via transfers to other entities support a solid ability to modify spending support Alberta's 'Stronger' assessment. Staff costs are 35% of total expenditure, and transfer spending another 23%. Alberta has actively managed spending in recent years to curtail growth and bring per capita spending to an average of the three largest provinces; this has been pursued via efficiencies and collective labor agreements. Despite successes, it remains subject to the spending pressures common to provinces, especially healthcare, and provinces tend to maintain or raise spending during recessionary periods. A new fiscal framework limits future spending growth to population and inflation and requires annual contingencies. Capital spending is almost 9% of total expenditure and provides additional flexibility.

**Liabilities & Liquidity Robustness: 'Stronger'**

The 'Stronger' assessment reflects unlimited provincial borrowing powers and Alberta's comprehensive approach to managing debt and liquidity through access to financial markets, largely in Canada but also internationally. Treasury management is sophisticated, with financing needs driven by operations, net capex, and bullet maturities. Most borrowing is long term, with maturities averaging 11.7 years, with interest rate and foreign currency risks hedged, and risks from bullet maturities mitigated by large liquid balances and the diversity of refinancing options.

**Liabilities & Liquidity Flexibility: 'Stronger'**

As with all provinces, Alberta has extensive power under Canada's federal framework to manage its own internal liquid resources or mobilize external resources as needed, supporting the 'Stronger' assessment. Although the province does not establish sinking funds, it holds sizable liquid or near-liquid balances totalling CAD28.8 billion in fiscal 2023, including CAD9.8 billion in cash and equivalents and CAD19 billion in the Alberta Heritage Savings Trust (AHST) accumulated surplus, which Fitch views as being available to support liquidity if required. Liquidity is supported by diverse borrowing programs including a USD12 billion CP program and unlimited domestic note and T-bill programs; CAD2.4 billion in domestic notes and T-bills was outstanding at the end of fiscal 2023.

**Debt Sustainability: 'a category'**

Fitch assesses Alberta's debt sustainability at the high end of the 'a' category. Under the rating case, which relies on the 'low scenario' economic and revenue stress in Budget 2023 but incorporates additional stresses of operating expenditure, capex and borrowing rates, the economic liability burden (ELB) metric (net adjusted debt plus a proportion of central
government debt/GDP) is 66.3% in fiscal 2028, at the low end of the 'aa' category. This is also above the 53% level in the base case, which approximates the province's baseline scenario.

Secondary metrics include the payback ratio and fiscal debt burden, both in the 'a' category, while synthetic debt service coverage is in the 'bbb' category. The ultimate assessment, at the high end of the 'a' category, overrides the higher outcome given weaker secondary metrics and likelihood of near-term economic weakness. However, absent a more severe downturn, the Positive Outlook reflects the likelihood that the ELB will remain solidly within the 'aa' category, which would warrant the higher debt sustainability assessment.

Alberta, like all provinces, can incur structural deficits and thus is designated as a 'Type A' entity under Fitch's International Local and Regional Government (LRG) Rating Criteria. This also makes the projected level of central government debt key to assessing debt sustainability. Federal debt outstanding as calculated by Fitch rose from CAD783 billion in fiscal 2020 to over CAD1.24 trillion in fiscal 2021, a result of pandemic response and economic stimulus. Over the past year, the rebound of economic activity has blunted a sharper upward rise in federal debt, although Fitch projects it to rise to CAD1.6 trillion by fiscal 2027.

**DERIVATION SUMMARY**

Fitch assesses Alberta's SCP at 'a+', based on the combination of a 'High Midrange' risk profile and debt sustainability metrics at the high end of the 'a' category. The IDR reflects an additional one-notch uplift from the SCP based on ad hoc federal actions to support provincial debt market access during episodes of market volatility.

**Short-Term Ratings**

The Short-Term IDR, at 'F1+', corresponds with the Long-Term IDR of 'AA-' under Fitch's International LRG Rating Criteria.

**KEY ASSUMPTIONS**

Risk Profile: 'High Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Stronger'

Expenditure Sustainability: 'Midrange'
Expenditure Adjustability: 'Stronger'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Stronger'

Debt sustainability: 'a'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): '1'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'N/A'

Rating Cap (LT LC IDR) 'N/A'

Rating Floor: 'N/A'

**Quantitative assumptions - Issuer Specific**

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on fiscal years 2019 to 2023 actual figures and fiscal years 2024 to 2028 projected ratios. The key assumptions for the scenario include:

--Scenario figures rely on Alberta's Budget 2023 and Fiscal Plan, and data from Fitch's sovereign rating group. The Fitch base case approximates Alberta's own base scenario, while Fitch's rating case incorporates economic and fiscal stresses approximating Alberta's low scenario. Nominal GDP falls 12% in 2023 before a steady recovery begins, although nominal GDP does not fully regain the level expected in the base case by 2026.

--Operating revenues decline by CAD14.5 billion in fiscal 2024, largely in non-tax resource revenues, with variances to the base case diminishing after fiscal 2026. There are no modifications made to federal transfers.

--Operating expenditure rises faster in the rating case than the base case, albeit by less than 1% each year, consistent with the expenditure sustainability key risk factor assumption that provinces will maintain or increase spending in the event of a recession.
--The cumulative impact of both revenue and expenditure variances are added to projected long-term borrowing,

--Capex is raised by about 10% annually vs. the base case, on the assumption that higher capex will be used to stimulate economic activity.

--The cost of borrowing is elevated about 10 bps above base case expectations through the forecast period.

**Liquidity and Debt Structure**

Debt calculated under the International LRG Rating Criteria differs from the comprehensive "net debt" calculation used in Canada. For Alberta, net adjusted debt calculation totals CAD59.2 billion in fiscal 2023. This figure includes direct debt of CAD76.4 billion (after netting self-supported borrowing) plus CAD11.5 billion in public private partnership debt, capital leases and pension liabilities, offset by CAD28.8 billion in cash, temporary investments and other investments, including the AHST accumulated surplus, which Fitch views as unrestricted and available to support provincial liquidity if needed.

**Issuer Profile**

One of the 10 Canadian provinces, Alberta is third largest by GDP and wealthiest by per capita GDP. The province is a growth leader within Canada, with the fastest population gains nationwide over time, although its prominent and volatile energy sector expose the broader economy and provincial finances to sharp cyclicalities.

**RATING SENSITIVITIES**

**Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

--A more severe energy sector downturn than assumed by Alberta in Budget 2023 under the low scenario, which results in higher fiscal stress, reverses recent progress in lowering debt and pushes the ELB to a level consistently higher than 70% of GDP.

--A national economic downturn in the near term that is more severe than Fitch's current forecast, which results in higher federal deficits, adds to the pro-rata share of federal debt attributable to Alberta, and pushes its economic liability burden over 70% of GDP.

**Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**
Economic and fiscal performance that exceeds Alberta's current, cautious near-term outlook, enabling it to sustain steady liquidity and further lower its debt burden over the rating case period, including reducing its ELB to less than 60% of GDP;

Stronger national economic performance than forecast by Fitch, supporting lower federal deficits, reducing the pro-rata share of federal debt attributed to Alberta and resulting in an ELB consistently below 60% of GDP.

**ESG CONSIDERATIONS**

Alberta has an ESG Relevance Score of '4' for Biodiversity and Natural Resource Management due to the exposure it has to the impact of natural resources management on the economy and governmental operations which, in combination with other factors, has a negative effect on the credit profile. All other ESG Relevance Scores, at 3, reflect their limited effects on the rating.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

**DISCUSSION NOTE**

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

**Best/Worst Case Rating Scenario**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories...
ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

### RATING ACTIONS

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APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021)
(including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

ENDORSEMENT STATUS

Alberta, Province of EU Endorsed, UK Endorsed

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