https://www.moodys.com/research/Moodys-downgrades-the-Northwest-Territories-to-Aa2-outlook-stable--PR_462486

Rating Action:
Moody's downgrades the Northwest Territories to Aa2, outlook stable
09 Mar 2022

Toronto, March 09, 2022 -- Moody's Investors Service ("Moody's") has today downgraded the Northwest Territories' (NWT) long-term issuer and debt ratings to Aa2 from Aa1 and lowered the territory?s Baseline Credit Assessment (BCA) to a1 from aa3. The outlook has been revised to stable from negative.

Downgrades:

..Issuer: Northwest Territories

.... Issuer Rating (Foreign Currency), Downgraded to Aa2 from Aa1

.... Issuer Rating (Local Currency), Downgraded to Aa2 from Aa1

....Senior Unsecured Regular Bond/Debenture, Downgraded to Aa2 from Aa1

.... Baseline Credit Assessment, Downgraded to a1 from aa3

Outlook Actions:

..Issuer: Northwest Territories

....Outlook, Changed to Stable from Negative

RATINGS RATIONALE

The downgrade of NWT?s ratings to Aa2 reflects a rising debt burden and continued increase of short-term debt as a share of total debt. This coincides with a weakening of the territory?s overall fiscal and economic profile, with the coronavirus pandemic exposing the precariousness of the diamond mining and tourism sectors.

Moody?s estimates that debt will rise to 50-60% of revenue (from 37% in 2020-21) over the next three years to support capital expenses and rising infrastructure costs. Although the debt burden remains low relative to provincial peers, it exceeds Moody?s pre-coronavirus estimate of a band of 35-40%. Rising borrowing has already necessitated multiple increases in the federally-imposed debt ceiling since 2015 (most recently in 2020 to CAD1.8 billion from CAD 1.3 billion), and the territory now anticipates that debt levels could reach the debt ceiling over the next three years given a continued ramp-up in borrowing. In addition, short-term debt has increased materially to support NWT?s liquidity needs, despite Moody?s previous expectations that the government would be able to limit its rise. Short-term debt now accounts for approximately 50% of total direct debt, with Moody?s projection that it will remain at 50-55% over the next three years. This high reliance on short-term debt introduces increased refinancing risk, including risk that the interest burden will rise in the current environment of rising interest rates.

The territory projects that real GDP growth will contract 0.5% in 2022 and Moody?s estimates that GDP levels will not rebound to pre-pandemic levels for at least 2-3 years. The territorial economy remains narrow and concentrated in natural resources (diamonds), tourism, and public administration. While public administration remains a reliable anchor to the economy, diamond mining remains in a long-term decline and production levels and exports have been adversely impacted by weaker consumer demand and prolonged mine shutdowns during the pandemic. At the same time, tourism ? which has historically provided important support to the local economy - has stalled over the last two years due to the travel restrictions related to public health measures imposed by NWT, with Moody?s projection of continued weakness into 2022 and 2023 as tourism is expected to lag other sectors in recovering as pandemic measures ease.

These risks are mitigated by substantial and predictable federal transfers, which account for over 70% of total revenues and provide stability to the fiscal profile of NWT despite the weak economic growth conditions. Transfers from the federal government primarily relate to support for health and social care, which grow based on escalators set in federal legislation, and unconditional grants under the Territorial Formula Financing (TFF) program which account for approximately two-thirds of NWT's total revenue. The large share of revenues from predictable federal transfers, supplemented by significant federal COVID-related support, allowed NWT to post moderate operating surpluses even during the pandemic. In addition to operating grants, the federal government provides capital support to the territory given the elevated cost of infrastructure and other capital projects in the north.

Despite the projected rise in the debt burden, the territory maintains strong debt affordability. Moody?s projects that the interest expense will constitute 1.5% to 2.5% of revenue over the next three years, levels that are low compared to provincial peers. Moreover, the territory policies limit debt service to 5% of total annual revenues. The territory also maintains solid liquidity metrics from cash and investments, which cover an estimated 10% of expenses and 19% of net direct and indirect debt in 2021-22.

The territory?s Aa2 rating reflects a BCA of a1 along with an assumption of a high level of extraordinary support from the Government of Canada (Aaa stable).

RATIONALE FOR STABLE OUTLOOK

The stable outlook on NWT?s ratings reflects Moody's assumption that, despite continued fiscal and economic challenges, further downside risks from economic contraction have eased and the territory retains fiscal capacity to respond to further economic challenges. The projected rise in the debt burden is cushioned by solid liquidity and continued strong debt affordability.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

The ESG Credit Impact Score is neutral-to-low (CIS-2) reflecting neutral-to-low exposure to environmental risks, moderately negative exposure to social risks and neutral-to-low exposure to governance risks.

The E issuer profile score is neutral-to-low (E-2). Although the territory is susceptible to natural capital risk primarily from diamond extraction and severe weather that could result in mitigation expenses and economic losses, it manages these risks prudently and the amounts do not result in significant pressure on the territory's fiscal profile. The territory is also exposed to extreme weather including cold temperatures which limits economic activity, although it is a driver of tourism.

The S issuer profile score is moderately negative (S-3). The territory includes a large number of small and dispersed communities which make program delivery more expensive. Youth substance abuse and unemployment also put some strain on the territories' expenditures. Additionally, Moody?s views the pandemic as a social risk.

The G issuer profile score is neutral-to-low (G-2). The territory's strong governance attributes include the use of forward-looking plans and analysis, transparent disclosures and timely financial statements, and prudent liquidity management.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A significant rebound in economic conditions leading to a sustained improvement in the level of own-source revenues could lead to a rating upgrade. A sustained reversal in the rise of the debt burden and short-term debt to pre-pandemic levels, coupled with an improved liquidity position, would also contribute to upward rating pressure.

A deterioration in NWT's financial position, including recording consolidated deficits could result in a downgrade. A sustained increase in the debt burden or a rise in the share of short-term debt materially above Moody's currently projected levels, signaling weakness in debt management, could also result in downward rating pressure.

The principal methodology used in these ratings was Regional and Local Governments published in January 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1091595. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody?s key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody?s Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody?s Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody?s general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody?s affiliates outside the EU and is endorsed by Moody?s Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody?s office that issued the credit rating is available on www.moodys.com.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody?s affiliates outside the UK and is endorsed by Moody?s Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody?s office that issued the credit rating is available on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Adam Hardi, CFA
Vice President - Senior Analyst

Sub-Sovereign Group
Moody's Canada Inc.
70 York Street
Suite 1400
Toronto, ON M5J 1S9
Canada
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653
Alejandro Olivo
MD-Sovereign/Sub Sovereign
Sovereign/Sub-Sovereign Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454
Releasing Office:
Moody's Canada Inc.
70 York Street
Suite 1400
Toronto, ON M5J 1S9
Canada
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653