MOODY'S INVESTORS SERVICE

CREDIT OPINION
26 May 2021

Update

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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.

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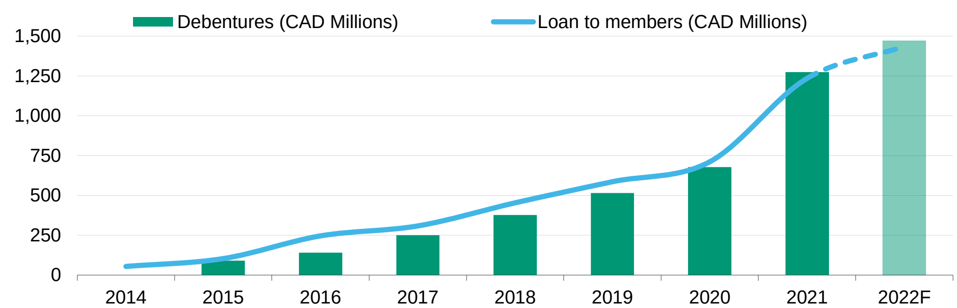
First Nations Finance Authority (Canada)

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 geographic diversification. FNFA's stringent monitoring process ensures that the credit quality of borrowing members will remain strong despite coronavirus pandemic-related uncertainties. Very high levels of intercepted revenues, which gives FNFA priority over cash flows, ensures strong interest and debt service coverage ratios. FNFA's governance and management structure provide significant debenture holder security, including robust structural mechanisms. 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 a relatively short history of borrowing and operations with nevertheless very fast growth, and low interest rates which could pressure investment returns.

Exhibit 1
FNFA continues to see very strong loan growth
Year ending March 31



Source: FNFA, Moody's Investors Service

Credit strengths

» Stringent monitoring of pool participants' credit quality support loan portfolio quality

» Robust structural credit protection mechanisms support high cash flow coverage even in the face of the coronavirus pandemic

» Continued growth in borrowing members and improving loan diversification

Credit challenges

» Persistent low interest rates pressure investment returns

» Short history of operations and borrowing amid rapid loan growth

Rating outlook

The outlook is stable, reflecting our expectations of FNFA's continued stable institutional framework, and continued solid operating performance.

Factors that could lead to an upgrade

A material improvement in the credit quality and default tolerance of the pool participants, together with improving diversity of the borrower member pool could lead to upward pressure on the rating. Additional improvements in liquidity above our current expectations 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 (leading to increased geographic or single name concentration) could put downward pressure on the rating. A material weakening in liquidity and reserves, or indications of lower extraordinary 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 March 31

(Year Ending 3/31)	2015	2016	2017	2018	2019	2020
Total Direct Debt (C$000)	107,736	249,840	315,978	469,663	619,470	752,803
Loans Outstanding to Clients (C$000)	103,367	246,022	308,569	453,504	585,977	711,000
Total Cash and Investments (C$000)	19,820	33,008	59,319	88,475	115,119	156,980
Interest Income as % of Revenues	56.4	69.8	71.5	74.5	76.4	75.2
Net interest margin (%)	0.16	0.21	-0.03	0.03	0.17	0.16
Operating Margin as % of Revenues	-2.6	6.8	7.2	9.9	11.3	13.8
Cash and Investments as % of Net Debt	21.4	14.7	22.1	22.3	22.0	25.3

Source: FNFA financial statements, Moody's Investors Service

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. The methodologies used in assessing the ratings were the Public Sector Pool Programs and Financings Methodology (April 2020) and the Government-Related Issuers Methodology (February 2020).

Baseline credit assessment

Stringent monitoring of pool participants' credit quality support 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 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.

FNFA is one of three First Nation-led national institutions legislated under the First Nations Fiscal Management Act by the Government of Canada. 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. This multi-step membership process aids in maintaining the credit quality of borrowing members and by extension, the loan portfolio.

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 even in the face of the coronavirus pandemic

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 debt coverage ratios (DCR); anything in excess of that needed for the borrowing is then diverted back to the First Nation.

Intercepted revenues provided 2.0x debt service coverage and 4.1x interest coverage in 2020, which we consider to be high levels. These high levels of coverage ratios also reflect the stability of the borrowers' revenue bases despite the pandemic, and improvements in FNFA's due diligence and loan monitoring. These DCRs 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.

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.

The DRF continues to grow in proportion with the loan portfolio growth, reaching an estimated CAD68.5 million at March 31, 2021, with continued increases projected as the aggregate loan amount increases. The DRF provides liquidity in the event of non-payment by a borrowing member. Assets in the DRF are invested mostly in liquid securities. 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, a joint and several obligation of borrowing members requires them to replenish the DRF without limit. As debt coverage ratios are set above required debt service payments, this allows FNFA to replenish the DRF directly from the SRTA.

The CEF has grown to CAD45.5 million at March 31, 2021 following multiple direct contributions by the Government of Canada, and evidencing the federal government's strong support of FNFA. The CEF could be used to temporarily offset shortfalls in the DRF, which provides additional protection to bondholders. 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.

FNFA also has access to CAD220 million syndicated revolving credit facility syndicated across several Canadian chartered banks for financing loans to borrowing members.

Continued growth in borrowing members and improving loan diversification

FNFA anticipates continued strong First Nations interest to borrow through FNFA, leading to a continued rise in its borrowing base. Participating borrowing members reached 74 by March 2021, up from 13 in the original 2014 debenture issuance. FNFA now has over 320 scheduled and pending members, representing half of all the First Nations across Canada.

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. FNFA now has scheduled or approved members across all ten Canadian provinces and the Northwest Territories, with particularly strong growth expected in Ontario, Saskatchewan and Manitoba. Despite this significant growth, the quality of borrowing members remains strong which supports FNFA's high credit quality.

For example, FNFA's loan portfolio had a 65% concentration to British Columbia borrows in 2014. Over the last seven years, borrower concentration has significantly improved, with no province or territory representing more than 20% of borrowers.

Persistent low interest rates pressure investment returns

FNFA earns investment returns on its various funds, with investment income growing in size and relative importance over the last six years (9.6% of total revenue in 2020). However, lower for longer interest rates, which benefit its debt issuances, could lead to lower for longer investment returns as well, especially given that a significant component of its investment portfolio is invested in cash and cash equivalent securities.

Investment returns will also be modestly impacted in 2021 from coronavirus-related market stresses that may weigh on asset price appreciation and dividend income, following some stresses in the market in 2020. Nevertheless, FNFA's conservative debt and investment management policies which limit investments to highly rated securities, which limits its exposure to market-related risks. Its Act restricts the spectrum of allowed investments to fixed-income securities issued or guaranteed by Canadian governments or Canadian chartered banks or savings institutions. Equity investments are not allowed.

Short history of operations and borrowing amid rapid loan growth

FNFA has a limited track record of operations as a specialized lender. FNFA only issued its first debenture in 2014, a relatively short borrowing history for a pooled borrower. Its first bullet debenture will not mature until 2024.

Further, FNFA remains reliant on federal operating support, although at a diminishing rate. FNFA receives a portion of its revenues through federal grants and contributions from Indigenous Services Canada (ISC). Although federal transfers and ISC contributions have declined steadily year over year from 61.1% of total revenues in 2013-14 to 13.6% of revenues in 2019-20, they are still an important source of revenue to FNFA.

FNFA targets continued strong growth of its loan portfolio over the next several years. At the same time, loans to members grew to CAD1,235 million at 31 March 2021, a remarkable rate of growth which is 12 times its loan portfolio value of CAD103 million in 2015. The material growth between 2019-20 and 2020-21 includes nearly CAD350 million in new loans, of which a significant portion was allocated to the Mi'kmaq First Nations Coalition (the Membertou and Miawpukek First Nations) for the purchase of offshore fishing licenses relating to purchase of Clearwater Seafoods, a Canadian seafood company. We expect that the loan portfolio will continue to grow between CAD150-200 million annually to support strong demand for capital from first nations. This level of growth has put some pressure on FNFA's due diligence process, including its capacity to review and analyse a large number of documents and agreements. As a result, FNFA strengthened its monitoring procedures during the pandemic, and hired more staff in 2020 to improve the effectiveness of its member outreach and monitoring, improve document processing efficiency, and enhance business analysis.

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:

The exposure to environmental risks is low, consistent with our assessment of financing entities. FNFA does not own land that is subject to environmental risks, and environmental exposure is only indirect through borrowing members' operations.

The exposure to social risks is low. Social issues facing first nations such as poorer health, inadequate housing, lower income levels and higher unemployment rates compared to non-indigenous people in Canada do not directly impact FNFA's loan portfolio. We regard the coronavirus outbreak as a social risk given the implications for public health, however the credit impact from the pandemic is low as the majority of related expenses are the responsibility of provincial governments and not First Nations.

Governance risks are material and overall governance risk is moderate. The institutional framework is strong with a stringent member onboarding process and strict guidelines on lending and monitoring borrowers' credit quality. The constantly changing borrower pool landscape presents some governance challenges, including administration capacity constraints evaluating a high volume of member applications while needing to monitor member credit quality.

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'.

Ratings

Exhibit 3

Category	Moody's Rating
FIRST NATIONS FINANCE AUTHORITY	
Outlook	Stable
Issuer Rating -Dom Curr	Aa3
Senior Unsecured -Dom Curr	Aa3

Source: Moody's Investors Service

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