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CREDIT OPINION
24 June 2022

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 following rating affirmation

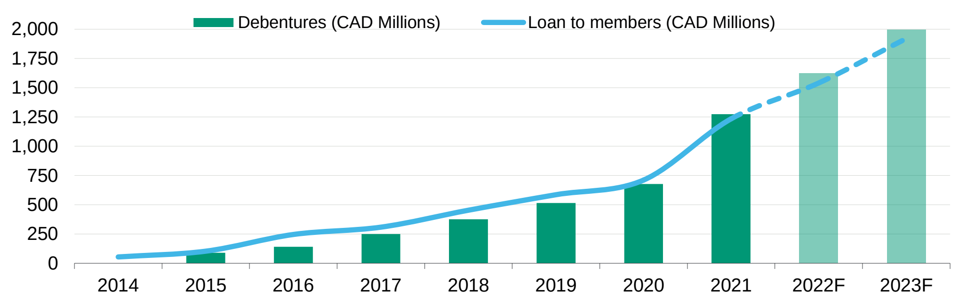
Summary

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 some volatility in investment returns, a short history of operations and risk monitoring constraints.

Exhibit 1

FNFA continues to see very strong loan growth which is funded through continued debenture issuances

Year ending March 31



Source: FNFA, Moody's Investors Service

Credit strengths

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

» Robust structural credit protection mechanisms support high cash flow coverage

» Additional liquidity backstops provide bondholder protection

» Significant member growth and diversity of pool composition

Credit challenges

» Short history of operations and risk monitoring constraints amid rapid loan growth

» Market volatility pressures investment returns

Rating outlook

The stable outlook on FNFA's rating reflects the stable institutional framework and governance structure, solid operating performance and our expectation of continued diversification of its borrowing members.

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. Evidence that continued growth of the member pool does not pose undue burden on FNFA's risk monitoring capability, which would support our strengthening opinion of FNFA's overall governance, could also lead to upward rating pressure. Additional improvements in liquidity above our current expectations could 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) 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)	2018	2019	2020	2021	2022F	2023F
Total Direct Debt (C$000)	469,663	619,470	752,803	1,303,239	2,026,000	2,396,000
Loans Outstanding to Clients (C$000)	453,504	585,977	711,000	1,234,793	1,540,542	1,920,641
Total Cash and Investments (C$000)	88,475	115,119	156,980	221,959	729,854	776,399
Interest Income as % of Revenues	74.5	76.4	75.2	83.6	80.7	88.2
Net interest margin (%)	0.03	0.17	0.16	0.15	0.24	0.21
Operating Margin as % of Revenues	9.9	11.3	13.8	7.4	14.2	4.4
Cash and Investments as % of Net Debt	22.3	22.0	25.3	19.9	41.9	38.0

Source: FNFA financial statements, Moody's Investors Service

Detailed rating considerations

On June 16, 2022, we affirmed FNFA's a1 Baseline Credit Assessment (BCA) and Aa3 ratings. The affirmation of the Aa3 issuer and debt ratings reflect the strong operating performance, robust credit protection mechanisms and level of diversification of the borrowing pool.

The credit profile of FNFA, as expressed in its Aa3 stable rating, combines a 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 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.

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 4x interest coverage (2.1x and 4.2x, respectively, at March 31, 2022). We consider these coverage levels to be high, which also reflect the stability of the borrowers' revenue bases despite the pandemic environment, and some improvements in FNFA's due diligence and loan monitoring.

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 liquidity 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.

The DRF continues to grow in proportion with the loan portfolio growth, reaching an estimated CAD87 million at March 31, 2022, 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 CAD53 million at March 31, 2022 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.

During the 2021-22 fiscal year, FNFA also received CAD32.5 million for a contingency fund from the federal government, in order to provide 0% loans to FNFA's members in case their revenue streams become adversely impacted due to future federal policies. Borrowing under the contingency fund is not subject to members' joint and several obligations.

In September 2021, FNFA also launched a CAD400 million commercial paper (CP) program for financing loans to borrowing members. The CP program is backstopped by a CAD400 million syndicated revolving credit facility syndicated across several Canadian chartered banks. Overall borrowing under the CP program and the credit facility is limited to CAD400 million.

Significant member growth and diversity of pool composition

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 80 in March 2022 from only 13 borrowers of its 2014 debenture issuance. FNFA now has 325 scheduled and pending members, representing approximately 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, removing some of the geographic concentration risk of the agency's lending portfolio. For example, FNFA's loan portfolio had a 65% concentration to British Columbia borrowers in 2014. Over the last seven years, borrower concentration has significantly improved, with no province or territory representing more than 25% of borrowers. However, the loan concentration to the top five borrowers, which stood at 38% in April 2022, creates some concentration risk.

Short history of operations and risk monitoring constraints amid rapid loan growth

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

At the same time, FNFA targets continued strong growth of its loan portfolio over the next several years which creates some governance challenges. FNFA now has scheduled or approved members across all ten Canadian provinces and the Northwest Territories, with 144 members at March 31, 2022 (of which 80 are borrowing) and 325 scheduled members. Concurrently, loans to members grew to an estimated CAD1,541 million at 31 March 2022 with further growth projected to CAD1,921 million at March 31, 2023, a remarkable rate of growth. The material growth also includes recent equity participation loans, including CAD250 million in new loans in 2020-21 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. As a result, we expect that FNFA will see larger disbursements to borrowing members relative to its past borrowing practice.

However, despite the robustness of the onboarding process, in our view this level of growth has put some pressure on FNFA's due diligence and its risk monitoring capability, including its capacity to review and prudently analyze the fiscal health of current and pending members including a large number of documents and agreements.

As a result of the anticipated loan growth, FNFA recently strengthened its monitoring procedures during the pandemic, and hired more staff to improve its outreach, monitoring and processing efficiency, and enhance business analysis.

Market volatility pressures 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 2020-21). However, market volatility - related both to the pandemic and to macroeconomic events that results in market destabilizations - could pressure investment returns. For example, investment returns dropped 57% year-over-year in 2020-21 due to market stresses.

In our view, investment returns could continue to be adversely impacted by heightened global macroeconomic volatility that could weigh on asset price appreciation and dividend income. 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.

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'.

Rating methodology and scorecard factors

The assigned BCA of a1 is one notch weaker than the scorecard-indicated BCA of aa3. For details about our rating approach, please refer to the Public Sector Pool Programs and Financings Methodology (April 2020) and Government-Related Issuers Methodology (February 2020).

Exhibit 3

First Nations Finance Authority - 2021 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%	Aa	Aa
Factor 2: Diversity of Portfolio (20%)			
Number of Borrowers	10%	80	Aa
Percentage of Loan Principal to Borrowers that Represent Less than 1% of the Pool	5%	20.14%	Aa
Percentage of Loan Principal to the Top 5 Borrowers	5%	37.94%	Aa
Factor 3: Debt Structure (30%)			
Cash Flows	20%	Aa	Aa
Counterparties	10%	A	A
Notching Factors			
Unusually Strong or Weak Management		-1	
Concentration of Pool Participants in a Volatile Sector		0	
Total Notching Adjustments		-1	
Scorecard-Indicated BCA Outcome			aa3

Financial year-end 31 December 2021

Source: Moody's Investors Service

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 Investors Service

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