Report to Corporate Services Committee

To: Chair and Members
Corporate Services Committee

From: Anna Lisa Barbon, CPA, CGA, Deputy City Manager, Finance Supports

Subject: City of London's Credit Rating

Date: October 3, 2023

Recommendation

That, on the recommendation of the Deputy City Manager, Finance Supports, the City of London's Credit Rating Report, providing a summary of Moody's Investors Service Credit Opinion of the City of London, **BE RECEIVED** for information.

Executive Summary

The City of London has achieved the Aaa ('triple A') credit rating with a stable outlook as part of Moody's Investors Service (Moody's) latest Credit Opinion. Issued on September 11, 2023, this marks the 47th consecutive year of such a rating and represents the highest credit rating issued by Moody's.

Linkage to the Corporate Strategic Plan

Council's 2023-2027 Strategic Plan for the City of London identifies 'Londoners experience good stewardship, exceptional and valued service' as an outcome of the strategic area of focus "Well Run City". Maintaining London's finances in a transparent, sustainable and well-planned manner by adhering to robust financial policies and practices has helped the City maintain positive operating results, stable debt levels, and strong liquidity, reflected in the credit rating assigned by Moody's and links to the strategy of 'Review, update and implement the City's strategic financial principles, policies and practices'.

Analysis

1.0 Background Information

Moody's is a leading provider of credit ratings, research, and risk analysis. The firm's ratings and analysis track debt covering more than 130 countries, 11,000 corporate issuers, 21,000 public finance issuers and 76,000 structured finance obligations. Typically, Moody's reviews the credit worthiness of the City of London annually and then assigns the City a credit rating.

The rating process involved a review of the City's 2022 Financial Statements, 2022 Financial Information Return, 2023 Annual Budget Update and recent relevant reports to Council (e.g. Budget Monitoring Reports). Moody's also utilizes independent research from a variety of sources such as Statistics Canada, comparisons with other municipalities, and news from local media. Along with reviewing and analyzing documents, Moody's arranges a meeting with the City including members of Civic Administration and the Mayor or Deputy Mayor.

The Credit Opinion for the City of London, published September 11, 2023 by Moody's, is attached as **Appendix A** to this report. Consistent with prior years, the City has maintained its Aaa credit rating with a stable outlook. The City has held the Aaa rating since 1977, making 2023 the 47th consecutive year of the Aaa rating and reaffirming that the City's debt has the highest rating possible. The Aaa rating is integral in securing buyers for the City's debentures. Moody's stable outlook "reflects the long track record of solid operating outcomes, which are built on the City's prudent management and long-term planning approach and strong protection to bondholders stemming from a relatively low debt and interest burden as well as sizeable level of reserves."

2.0 Discussion and Considerations

The Moody's Credit Opinion summarizes the City's credit strengths and challenges. The credit strengths of the City support the rating outlook of Aaa while the challenges are factors that could impact the rating in the future.

The City's credit strengths include:

- High levels of cash and investments providing strong liquidity;
- Low debt levels supported by conservative debt management practices;
- Mature, supportive, institutional framework governing municipalities in Ontario; and,
- Track record of generating positive fiscal outcomes highlights robustness of fiscal planning.

Moody's comments regarding the City's track record of generating positive fiscal outcomes are as follows:

*"…*the City of London displays strong governance and management practices, such as the application of multi-year budgets, which helps to promote stable operations. London's history of posting positive operating results, application of strict controls on debt issuance, and conservative debt and investment policies which limit their exposure to market related risks and help ensure relatively smooth debt servicing costs all act as evidence of the city's strong management and governance*."*

The comments provided by Moody's in their review of the City of London's credit rating further supports the strategy prioritized by Council to ensure Londoners experience good stewardship, exceptional and valued service by ensuring London's finances are maintained in a transparent, sustainable and well planned manner. The application of multi-year budgeting signifies that the City is looking beyond a short-term horizon when planning its finances. The City's Multi-Year Budget provides alignment of longer-term goals with longer-term funding plans, improved accountability and transparency over spending changes. Taking a long-term view with respect to financial matters has led to fiscally responsible decisions, as reflected in the City's credit rating. According to Moody's, "the multi-year budget approach proved beneficial during the pandemic given the city's plans were already well developed which made the process to find mitigating measures relatively easier than for other municipalities that still needed to "build" their budget."

The City's credit challenges outlined by Moody's include the potential for "near-term fiscal pressures stemming from cost escalation and provincial changes." Moody's further states that "While the low debt levels of the city will limit budgetary pressure caused by higher interest rates, interest expense will rise as well pushing the "all-in" cost of capital projects up."

Moody's also comments that "legislative changes restricting local governments' ability to impose development charges on certain projects" poses additional pressure with no formal process implemented to date to provide additional funding to municipalities to offset the lost revenue.

Consistent with previous years, Moody's notes that a sustained loss of fiscal discipline leading to a material increase in debt or a substantial reduction in accessible financial reserves could place downward pressure on the City's credit rating. A credit rating downgrade or change in outlook to negative by Moody's may cause investors to lose confidence in the City's financial management practices and/or the corresponding quality of the City's debt, potentially affecting the City's ability to raise future financing. This would also increase interest rates at which the City issues debt, which would increase debt servicing costs for the City.

Moody's introduced an explicit reporting on Environmental, Social and Governance (ESG) Credit Impact Score (CIS) in 2022. It is important to note that this ESG score is not an evaluation of the City's performance or activities as it relates to ESG but rather a reflection of how ESG factors within the City of London impact credit risk and therefore the credit rating of the City. The CIS is based on a scale from one to five:

CIS - 1; representing positive impact
CIS – 2; representing neutral to low impact
CIS – 3; representing moderately negative impact
CIS – 4; representing highly negative impact
CIS – 5; representing very highly negative impact

The City's overall ESG CIS is CIS – 2; neutral to low impact. The environmental profile received a score of two; the social profile received a score of two; and the government profile received a score of one, which "captures London's very strong institutional and governance framework" according to Moody's.

3.0 Financial Impact/Considerations

The Moody's Credit Opinion does not have a direct financial impact but affects the rates at which the City is able to issue debt, which in turn affects the City's debt servicing costs. The Aaa rating allows the City to issue debt at favourable rates as debentures rated Aaa are perceived to have less risk of default.

Conclusion

The City's achievement of Moody's Aaa credit rating for 47 consecutive years is a testament to the success of the City's prudent, conservative approach to fiscal planning and related policies. Maintaining this top credit rating through a year with continued impacts from high inflation and persistent global pressures is also a testament to the flexibility and adaptability of the City's financial policies and processes. These prudent financial policies and practices will position the City well as the City embarks on the 2024-2027 Multi-Year Budget in support of the 2023-2027 Strategic Plan.

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Submitted by:	**Kyle Murray, CPA, CA, Director, Financial Planning and Business Support**
Recommended by:	**Anna Lisa Barbon, CPA, CGA, Deputy City Manager, Finance Supports**

Appendix "A"

SUB-SOVEREIGN

MOODY'S
INVESTORS SERVICE

CREDIT OPINION
11 September 2023

Update

Send Your Feedback

RATINGS

London, City of

Domicile	London, Ontario, Canada
Long Term Rating	Aaa
Type	Senior Unsecured - 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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City of London (Canada)

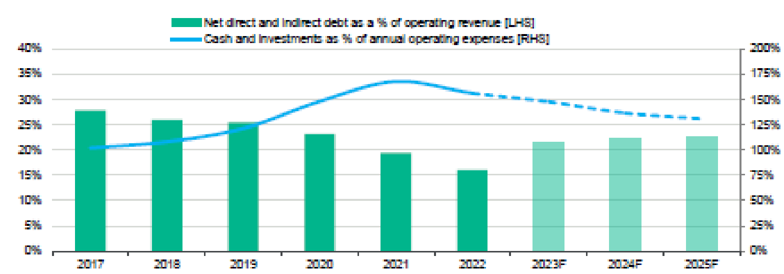
Update to credit analysis

Summary

The credit profile of the City of London (Aaa stable) reflects the long track record of solid operating outcomes, which are built on the city's prudent management and long-term planning approach. The credit profile also reflects the strong protection to bondholders stemming from relatively low debt and interest burdens. The city also holds sizeable levels of reserves which protect against unforeseen pressures. While debt is expected to increase across the next 3-4 years due to an increase in growth related capital projects, we do not see this as a change in the city's strong debt management policies.

Exhibit 1

Even with a forecasted increase, the city's debt will remain low and the city's reserves will continue to provide ample coverage of operating expenses



Sources: City of London financial statements and Moody's Investors Service

Credit strengths

» High levels of cash and investments provide strong liquidity

» Low debt levels supported by conservative debt management practices

» Mature, supportive, institutional framework governing municipalities in Ontario

» Track record of generating positive fiscal outcomes highlights robustness of fiscal planning

Credit challenges

» Near-term fiscal pressures stemming from cost escalation and provincial changes

Rating outlook

The outlook for London's Aaa debt rating is stable, reflecting our expectation that the city's fiscal management will continue to ensure that operations remain well maintained, liquidity remains strong and debt will continue to remain within our forecasts across the next 3 years.

Factors that could lead to a downgrade

Downward pressure could arise if the city were to experience a sustained loss of fiscal discipline leading to a material increase in debt or substantial reduction in accessible financial reserves.

Key indicators

London, City of

(Year Ending 12/31)	2019	2020	2021	2022	2023F	2024F
Net Direct and Indirect Debt/Operating Revenue (%)	25.4	23.1	19.4	16.1	21.6	22.2
Gross Operating Balance/Operating Revenue (%)	21.2	24.0	24.7	24.1	22.1	20.1
Cash Financing Surplus (Requirement)/Total Revenue	13.2	16.9	20.3	9.1	13.5	13.2
Interest Payments/Operating Revenue (%)	0.7	0.7	0.5	0.4	0.6	0.6
Debt Service/Total Revenue (%)	4.7	4.7	4.3	3.4	3.1	3.0
Capital Spending/Total Expenditures (%)	19.1	20.3	19.6	22.3	21.8	20.6
Self-Financing Ratio	1.8	2.0	2.3	1.5	1.8	1.8

Sources: City of London financial statements and Moody's Investors Service

Detailed credit considerations

The City of London's Aaa rating combines (1) a baseline credit assessment (BCA) of aaa, and (2) a high likelihood of extraordinary support coming from the Province of Ontario (Aa3 positive) in the event London faced acute liquidity stress.

Baseline credit assessment

High levels of cash and investments provide strong liquidity

London's credit profile is supported by a strong liquidity position which provides a significant measure of safety for bondholders. In 2022, the city's cash and investments were equal to 7.8x net debt and 1.4x annual operating expenses. To achieve these levels, the city has continued to follow prudent fiscal management and liquidity policies across multiple changes in the municipal council, which we expect to continue into the future.

London's investment policies ensure that the city minimizes credit risk and maintains liquidity of its investment portfolio. The city's policies outline various limits placed on investment decisions, such as limiting the concentration of investments in specific sectors or issuers, limiting investments to only highly rated securities and ensuring a variety of maturities. The presence and adherence to these policies offers reassurance that the city's investment management policies provide security to liquidity, which along with the level of liquidity, is a strong credit positive.

Low debt levels supported by conservative debt management practices

London's net direct and indirect debt expressed as a percentage of operating revenues measured 16.1% in 2022. While Canadian municipalities can only issue debt for capital reasons, which therefore helps limit indebtedness, London's debt burden is low even compared to domestic peers. Even though Canadian municipalities' revenue structure and high level of operating expense tend to not favour funding capital needs from operations, London has successfully oriented its budget process to minimize debt needs while still implementing necessary capital projects. The city's 2023-2032 capital plan totals CAD3.9 billion across tax-supported and rate-supported projects.

The low debt burden is propelled by the conservative debt policies that the city employs such as a self-imposed "debt cap" which limits the amount of debt that can be issued for capital projects as well as the move to a greater reliance on pay-as-you-go financing. Debt

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

issuance is also reduced through the use of multiple policies overseeing the use of excess funds at year end: the city applies all year-end debt service savings, 50% of unallocated assessment growth as well as 50% of any operating surplus that it generates towards financing needs that would have otherwise be funded from authorized debt issuance. The city has also eliminated debt for lifecycle maintenance of capital, which limits debt issuance to new and/or growth related needs.

The low debt burden also translates into a relatively low interest expense. In 2022, interest expense consumed only 0.4% of operating revenues. Given the efforts to minimize debt issuance, the city's debt service costs as a percentage of revenue are expected to remain low in the intermediate term even as interest rates rise.

Mature, supportive institutional framework governing municipalities in Ontario

The institutional framework governing municipalities in Ontario is mature and highly developed. The division of roles and responsibilities between the province and municipalities is clearly articulated. Municipalities are, however, subject to the powers and responsibilities imposed upon them by their respective provinces. Historically, changes to the institutional framework have occurred at a measured, evolutionary pace, following discussions between both parties. Nevertheless, in certain cases, changes have occurred more rapidly.

London's creditworthiness benefits from the stability inherent in the provincial institutional framework. Provincial legislation dictates a high degree of oversight, including limits on debt servicing costs, while policy flexibility, on both the revenue and expenditure sides of the ledger, helps London to manage pressures as they arise.

Track record of generating positive fiscal outcomes highlights robustness of fiscal planning

Similar to other highly rated Ontario municipalities, the City of London displays strong governance and management practices, such as the application of multi-year budgets, which helps to promote stable operations. London's history of posting positive operating results, application of strict controls on debt issuance, and conservative debt and investment policies which limit their exposure to market related risks and help ensure relatively smooth debt servicing costs all act as evidence of the city's strong management and governance.

The city manages its plans using a four-year budget that is prepared during the first year of a new council and extends into the first year of the following council period. Through this process, annual departmental expenditures for the four years are determined in the initial budget year, and in theory only expenditures that are supported through additional assessment growth can be passed outside of the initial budget. City Council can still raise property taxes above the four-year planned approved rates as part of the annual budget review process.

Despite the multi-year approach, this budget model provides sufficient flexibility for London to adjust the fiscal plan in each year if necessary. This was evident during the peak of the pandemic when, in 2020 and 2021, the city was able to lower service levels where applicable and defer some new initiatives and capital projects to manage the fiscal pressure it faced. In our view, the multi-year budget approach proved beneficial during the pandemic given the city's plans were already well developed which made the process to find mitigating measures relatively easier than for other municipalities that still needed to "build" their budget.

Near-term fiscal pressures stemming from cost escalation and provincial changes

Broad global pressures that arose in 2022 and persisted through 2023 will continue to impact the city in the 2024. These include high inflation which has increased costs for most goods and service at a rapid pace, high energy costs and interest rates that represent a significant shift than those recorded over the previous decade. While the city benefits from multi-year collective agreements with the majority of its labour force, we anticipate that as contracts expire, unions will seek higher than previous wage adjustments to reflect the higher cost of living. Additionally, we expect prices for materials and services purchased by the city will remain elevated. While the low debt levels of the city will limit budgetary pressure caused by higher interest rates, interest expense will rise as well pushing the "all-in" cost of capital projects up.

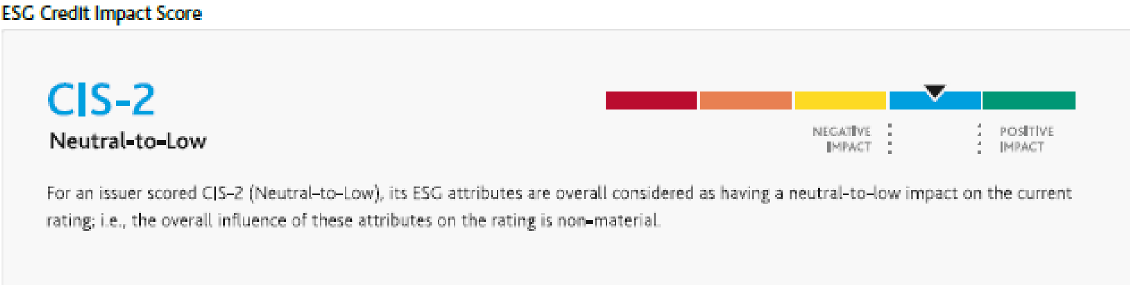
In addition to these operating pressures, in November 2022, the Province of Ontario made legislative changes restricting local governments' ability to impose development charges (which are fees applied to new housing projects to help fund the necessary infrastructure to service them) on certain projects. The provincial goal behind this change is to encourage multi-unit projects and affordable housing by lowering the costs for these units. While the province indicated it will provide additional funding to municipalities to offset the lost revenue, no formal process to do so has been implemented to date. As such, the changes currently curtail London's ability to generate future development charge revenues, impacting its revenue potential. The province's push to develop more housing quicker than the region previously planned will likely also lead to an accelerated plan for infrastructure projects on undeveloped lands.

Additional provincial changes include the assignment of 'strong mayor' powers to London along with many other large municipalities in Ontario. Under the 'strong mayor' system, the mayor can assume the responsibility of preparing the budget, appoint chairs to committees and boards and have a veto on certain motions brought to council. The latter however is subject to the veto being to support motions in-line with provincial priorities. Although granting these powers does not meaningfully change the governance of the city, the linkage of the veto to provincial priorities increases the risk of indirect intervention by the province in municipal affairs.

ESG considerations

City of London's ESG Credit Impact Score is Neutral-to-Low CIS-2

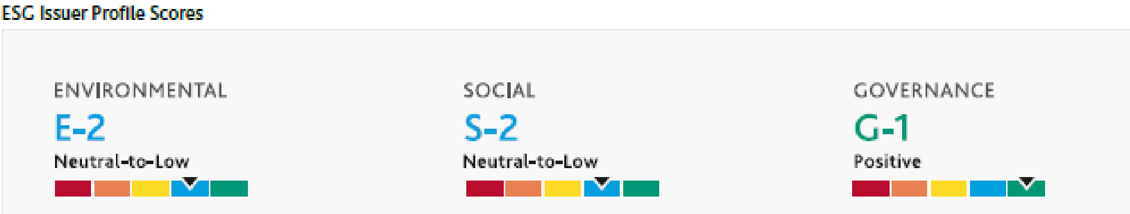
Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

London's **CIS-2** ESG Credit Impact Score reflects the low exposure to environmental and social risk considerations, any presence of which is further mitigated by the very strong governance and policy effectiveness of the city.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

The E issuer profile score (IPS) is **E-2**, reflecting that neither the city's infrastructure nor economic base are subject to material risks stemming from environmental concerns. The city's relatively small geographic footprint and high regulations on water management and waste further minimizes any exposure to environmental risks.

Social

The **S-2** IPS captures the city's role in providing key public services such as public safety (police, fire and paramedic) and environmental (water and waste collection), but demand for these services do not face risks from social considerations given the stable population levels and predictable demographic trends which allows for long-term forecasting of such service requirements. London has a high level of education and overall strong levels of public health and safety.

Governance

The positive **G-1** IPS captures London's very strong institutional and governance framework. The city utilizes prudent financing planning, including the establishment of a 4-year budget plan, and makes use of forward looking assumptions which provides the city with the ability to identify potential pressures and allows for sufficient time to adjust plans accordingly to mitigate any credit implications. The city provides transparent, timely financial reports and adheres to strict policies on debt and investment management.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Extraordinary support considerations

Moody's assigns a high likelihood of extraordinary support from the Province of Ontario (Aa3 positive), reflecting Moody's assessment of the incentive provided to the provincial government of minimizing the risk of potential disruptions to capital markets if London, or any other Ontario municipality, were to default.

Rating methodology and scorecard factors

In the case of London, the BCA of aaa assigned by the rating committee is close to the suggested outcome of aa1. The suggested outcome reflects (1) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a systemic risk score of Aaa, as reflected in the sovereign bond rating (Aaa stable).

For details of our rating approach, please refer to the methodology Regional and Local Governments, 16 January 2018

Exhibit 5

London, City of

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**3.80**	**20%**	**0.76**
Economic Strength [1]	5	102.95%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**1**	**20%**	**0.20**
Legislative Background	1		50%			
Financial Flexibility	1		50%			
Factor 3: Financial Position				**1.50**	**30%**	**0.45**
Operating Margin [2]	1	24.25%	12.5%			
Interest Burden [3]	1	0.50%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	16.07%	25%			
Debt Structure [5]	3	19.53%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**1.71 (2)**
Systemic Risk Assessment						**Aaa**
Suggested BCA						**aa1**
Assigned BCA						**aaa**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance by function/operating revenues
[3] (Adjusted) interest expenses/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2022.

Ratings

Exhibit 6

Category	Moody's Rating
LONDON, CITY OF	
Outlook	Stable
Senior Unsecured -Dom Curr	Aaa

Source: Moody's Investors Service

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