

MOODY'S

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Credit Opinion: London, City of

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Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Bonds -Dom Curr	Aaa

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Key Indicators

London, City of (Year Ending 12/31)	2009	2010	2011	2012	2013
Net Direct and Indirect Debt/Total Revenue (%)	32.7	30.2	38.2	38.3	35.7
Gross Operating Balance/Operating Revenue (%)	17.0	18.9	14.3	16.2	19.1
Cash Financing Surplus (Requirement)/Total Revenue (%)	-0.8	-1.3	3.6	8.2	8.2
Interest Payments/Operating Revenue (%)	1.6	1.4	1.2	1.2	1.1
Debt Service/Total Revenue (%)	6.2	4.8	9.4	7.5	5.4
Capital Spending/Total Expenditures (%)	25.9	34.5	20.5	17.2	17.9
Self-Financing Ratio	1.0	1.0	1.2	1.5	1.5

Opinion

SUMMARY RATING RATIONALE

The City of London's Aaa debt rating is supported by sizeable levels of reserves and a prudent, conservative approach to fiscal planning. London's cash and investments, which represented 159.9% of net direct and indirect debt at December 31, 2013, provide considerable liquidity and a measure of safety for debenture holders. The rating also reflects the city's strong track record of achieving positive operating results and the generation of internal financing for capital expenditures.

National Peer Comparisons

The City of London is rated at the high end of Canadian municipalities, whose rating remain in a narrow range of Aaa-Aa2. When compared with other Canadian municipalities, London exhibits a lower debt burden, while the city's liquidity, as measured by the level of net cash and investments relative to debt and revenue, is considered healthy and in line with national peers of a similar rating. The institutional framework governing municipalities in Ontario is mature and well developed, similar to that of other Canadian provinces where Moody's rates municipalities.

Credit Strengths

Credit strengths for the City of London include:

- High levels of cash and investments providing liquidity
- Mature, supportive, institutional framework governing municipalities in Ontario
- Modest debt levels supported by conservative policies and strong capital planning
- Prudent fiscal plan generating positive operating outcomes

Credit Challenges

Credit challenges for the City of London include:

- Operating pressures are building

Rating Outlook

The outlook for London's Aaa debt rating is stable.

What Could Change the Rating - Down

Given the history of prudent expenditure and debt management, relative stability of the local economy and high fund balances, it is unlikely that conditions could deteriorate by a large enough margin, in the near term, to cause a downgrade of London's rating. Nonetheless, a sustained loss of discipline, leading to a significant increase in debt or a substantial reduction in the level of reserves, would apply downward pressure on the rating.

DETAILED RATING 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 (Aa2, negative) in the event London faced acute liquidity stress.

Baseline Credit Assessment

The City of London's BCA of aaa reflects the following factors:

HIGH LEVELS OF CASH AND INVESTMENTS PROVIDING STRONG LIQUIDITY

London's credit rating is supported by a strong liquidity position which provides a considerable measure of safety for bondholders. Holdings of cash and investments have increased since 2010, reaching CAD621.7 million as of December 31, 2013. This level represented 160% of net direct and indirect debt and roughly 80% of operating expenditures. The city's holdings of cash and investments have increased substantially over the past decade, rising to their current level from 46.5% of net debt and indirect debt in 2004.

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 over-concentration of investments to specific sectors or issuers, limiting investments to only highly rated securities and ensuring a variety of maturities. The presence and adherence to these policies offer reassurance that the city's investment management provides security to liquidity, which along with the level of liquidity, is a strong credit positive.

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. 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.

MODEST DEBT LEVELS SUPPORTED BY CONSERVATIVE POLICIES AND STRONG CAPITAL PLANNING

The city's debt burden, measured by the ratio of net debt as a percentage of total revenues, has declined from

54.8% in 2004 and remained relatively stable in recent years. Registering 35.7% of revenues in 2013, the city's debt burden reflects the tight controls placed on debt issuance, notably through a self-imposed "debt cap" limiting the amount of debt issued for capital projects, as well as an increased reliance on pay-as-you-go financing. Debt issuance is also limited through the use of a policy that applies year-end debt service savings and 50% of unallocated assessment growth towards financing needs that would have come from authorized, but unissued, debt.

London's current 2014-2018 tax and rate-supported capital plan calls for expenditures of nearly CAD600 million. Of this level, CAD129.3 million, 21.6%, will require debt financing, a share kept low by the increasing amount of funding that the city devotes to pay-as-you-go capital financing. In 2014, pay-as-you-go financing reached CAD27.1 million, compared to CAD18.5 million in 2013, and is expected to reach CAD33.8 million in 2018. If the current capital plan comes to fruition, we anticipate that the city's debt burden should improve, remaining consistent with the Aaa rating. Accordingly, debt service costs as a percentage of revenue are expected to remain low, ensuring that fiscal flexibility remains high. In 2013, interest expense consumed only 1.1% of operating revenues in 2013.

PRUDENT FISCAL PLANNING GENERATING POSITIVE OPERATING OUTCOMES

Similar to other highly rated municipalities in Ontario, the City of London displays strong governance and management characteristics that helps to promote stable operations. In addition to multi-year planning for operating and capital budgeting and a recent history of meeting fiscal targets and applying strict controls on debt issuance, management adheres to conservative debt and investment management policies, which limits the city's exposure to market-related risks and helps to ensure relatively smooth debt servicing costs.

In 2013, the City of London posted a consolidated surplus of CAD158.0 million, equal to 14.5% of total revenues, in line with the trend of recent years. Operating revenues rose by 3.8% from the previous year while the city was able to maintain operating expenses unchanged from 2012 to 2013, and 1.5% lower than 2011.

OPERATING PRESSURES ARE BUILDING

Although surpluses have been strong in recent years, the city is facing building pressure on expenditures. These pressures have been mitigated to date, somewhat, by savings via service efficiencies. As efficiencies are expected to be harder to find in the future, these offsets will likely decrease as certain pressures, notably costs for public security (fire and police) continue.

Although the city has means to offset expenditures pressure, through increases to own-source revenue such as property taxes and user fees, these means have practical limits. The efforts required to balance budgets in 2013 and 2014 highlight these limits. In the past few years budgets have been balanced through the use of speculative measures, such as increasing the expected revenue stemming from future assessment growth, or through the use of reserves and prior year surpluses.

Unless these expenditure pressures can be contained on a recurrent basis, pressures to raise property tax increases or user rates, likely beyond the acceptable rate of most taxpayers, will persist. In our opinion, this raises the risk that the city's planned approach of funding capital projects through pay-as-you-go may not proceed as planned, as these funds may be directed to operations, resulting in greater debt issuance for capital projects than currently planned.

Extraordinary Support Considerations

Moody's assigns a high likelihood of extraordinary support from the Province of Ontario (Aa2, stable), 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.

Output of the Baseline Credit Assessment Scorecard

In the case of London, the BCA matrix generates an estimated BCA of aa1, close to the BCA of aaa assigned by the rating committee.

The matrix-generated BCA of aa1 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).

The idiosyncratic risk scorecard and BCA matrix, which generates estimated baseline credit assessments from a

set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale ratings, please refer to Moody's Credit rating Methodology published in June 2014 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings."

The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of an entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), moderate (31% - 50%), strong (51% - 70%), high (71% - 90%) or very high (91% - 100%).

Rating Factors

London, City of

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	5	96.07	70%	3.8	20%	0.76
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	1	20%	0.20
Financial flexibility	1		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	1	16.04	12.5%	2.25	30%	0.68
Interest payments / operating revenues (%)	3	1.23	12.5%			

Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	3	42.40	25%			
Short-term direct debt / total direct debt (%)	3	11.30	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						1.94(2)
Systemic Risk Assessment						Aaa
Suggested BCA						aa1

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