

TO:	CHAIR AND MEMBERS CORPORATE SERVICES COMMITTEE MEETING ON SEPTEMBER 20, 2016
FROM:	MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER
SUBJECT:	CITY OF LONDON'S CREDIT RATING

RECOMMENDATION

It is recommended that this report **BE RECEIVED** for information.

BACKGROUND

Moody's Investors Service (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. Each year Moody's reviews the credit worthiness of the City of London (the "City") and then assigns the City a credit rating for the year.

The rating process involves a review of the City's 2015 financial statements, 2016-2019 approved multi-year budget and forecasts. Moody's also utilizes independent research from a variety of sources such as Statistics Canada, comparisons with other municipalities, and local media. Along with reviewing and analyzing documents, Moody's arranges a site visit to the city and interviews with senior management and the Mayor.

The published credit opinion of the City from Moody's is attached 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 2016 the 40th consecutive year of the Aaa rating and reaffirming that the City's debt has the highest rating possible. The Aaa rating was integral in securing buyers for the City's debentures on March 7, 2016 at favourable interest rates (\$27 million at an all-in-rate of 2.30% over a ten-year term).

Moody's comments regarding the national peer comparison are as follows:

"The City of London is rated at the high end of Canadian Municipalities, whose rating span a narrow range of Aaa-Aa3. Compared with other Canadian Municipalities, London maintains 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."

The Moody's Credit Opinion Report also summarizes the City's credit strengths and challenges. The City's credit strengths include;

1. High levels of cash and investments providing strong liquidity;
2. Low debt levels supported by conservative debt management practices;
3. Mature, supportive, institutional framework governing municipalities in Ontario; and
4. Prudent fiscal plan with track record of generating positive outcomes.

Along with the noted strengths, the generation of internal financing for capital expenditures (i.e. pay-as-you financing) is highlighted as a credit positive. While the City continues to maintain its strong fiscal performance there is some pressure resulting from labour negotiations.

Moody's indicates that the outlook for the City's Aaa debt rating is stable reflecting their expectation that liquidity will remain strong, debt will remain stable and the City will continue to post positive operating results.

There are circumstances that could apply downward pressure on the City's credit rating which are as follows;

1. A sustained loss of fiscal discipline leading to a material increase in debt; and
2. A substantial reduction in accessible financial reserves.

A downgrade or negative outlook from Moody's would cause investors to lose confidence in the quality of the City's debt and financial management affecting the City's ability to raise future financing.

The City's achievement of being Aaa rated for 40 consecutive years is a testament to the success of the City's prudent, conservative approach to fiscal planning.

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Attach. City of London's Credit Opinion Report by Moody's Investors Service

Cc: Anna Lisa Barbon, Director, Financial Services
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CREDIT OPINION

9 September 2016

Update

Rate this Research >>

RATINGS

London, City of

Domicile	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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London, City of

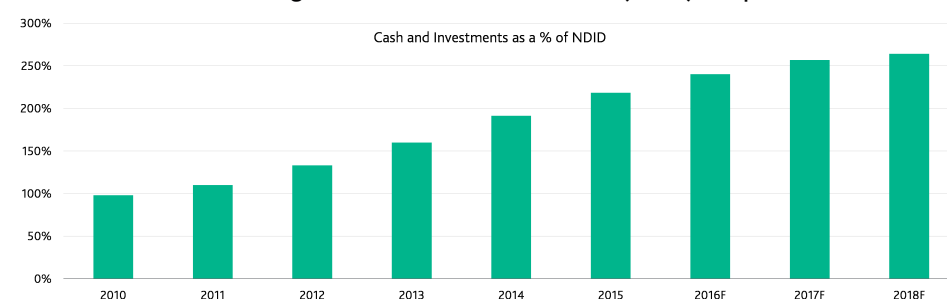
Update to Discussion of Key Credit Factors

Summary Rating Rationale

The City of London's Aaa debt rating is supported by its sizeable levels of reserves and prudent, conservative approach to fiscal planning. London's cash and investments, which measured 217.6% of net direct and indirect debt at December 31, 2015, 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.

Exhibit 1

Cash and investment coverage of net direct and indirect debt (NDID) is expected to stabilize



Source: Moody's Investors Service, City of London Financial Statements, City of London Budgets

National Peer Comparisons

The City of London is rated at the high end of Canadian Municipalities, whose ratings span a narrow range of Aaa-Aa3. Compared with other Canadian municipalities, London maintains 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

- » 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
- » Prudent fiscal plan with track record of generating positive fiscal outcomes

Credit Challenges

- » Pressures stemming from labour could return

Rating Outlook

The outlook for London's Aaa debt rating is stable, reflecting our expectation that liquidity will remain strong, debt will remain stable and the city will continue to post positive operating results.

Factors that Could Lead to a Downgrade

- » A sustained loss of fiscal discipline leading to a material increase in debt
- » Substantial reduction in accessible financial reserves

Key Indicators

Exhibit 2

London, City of

(Year Ending 12/31)	2011	2012	2013	2014	2015
Net Direct and Indirect Debt/Total Revenue (%)	38.2	38.3	35.7	33.8	31.5
Gross Operating Balance/Operating Revenue (%)	14.3	16.2	19.1	16.0	18.1
Cash Financing Surplus (Requirement)/Total Revenue (%)	3.6	8.2	8.2	3.0	7.4
Interest Payments/Operating Revenue (%)	1.2	1.2	1.1	1.1	1.0
Debt Service/Total Revenue (%)	9.4	7.5	5.4	5.2	5.2
Capital Spending/Total Expenditures (%)	20.5	17.2	17.9	20.0	19.8
Self-Financing Ratio	1.2	1.5	1.5	1.2	1.4

Source: Moody's Investors Service, City of London Financial Statements

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, stable) in the event London faced acute liquidity stress.

Baseline Credit Assessment

HIGH LEVELS OF CASH AND INVESTMENTS PROVIDING STRONG LIQUIDITY

London's credit rating is supported by a strong liquidity position which provides a significant measure of safety for bondholders. The city's cash and investments measured CAD795.3 million as of December 31, 2015 compared to CAD717.8 million in 2014. The city's cash and investments represented 218.5% of net direct and indirect debt in 2015, and approximately 93% of operating expenses. Over the past decade the city's cash and investment holdings have increased substantially, rising to their current level from 47% of net direct and indirect debt in 2005, highlighting the prudent fiscal management and liquidity strength that London possesses.

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

The city of London's net direct and indirect debt expressed as a percentage of total revenues measured 31.5% in 2015, a figure that has fallen significantly since 2011. This trend has been declining over the past several years, propelled by the conservative debt policies that

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the city employs such as the 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 issuance is also limited through the use of multiple policies; the city applies all year-end debt service savings and 50% of unallocated assessment growth as well as 50% of any operating surplus that it generates towards financing needs that would have come from authorized, but unissued, debt. In 2015, interest expense consumed only 1% of operating revenues, unchanged from 2014, and the city's debt service costs as a percentage of revenue are expected to remain low in the intermediate term.

London's current 2016-2019 tax and rate-supported capital plan calls for expenditures of nearly CAD872 million. Of this, CAD246.6 million (28% of the total amount) will require debt financing. In 2016, capital financing from reserves should reach CAD60.5 million, compared to CAD62.5 million in 2015, and is expected to remain relatively stable during the current planning cycle through 2019. In the 2016-19 capital plan, 58% of spending will be in the non-taxpayer supported category, much of which is expected to be covered through development charges and government grants. If the current capital plan comes to fruition, we anticipate that the city's debt burden will stabilize around its current level, supporting the Aaa rating.

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.

PRUDENT FISCAL PLAN WITH TRACK RECORD OF GENERATING POSITIVE FISCAL OUTCOMES

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 recent 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.

In 2015 the city posted a consolidated surplus of CAD144.8 million, equivalent to 12.5% of total revenues, continuing the trend of positive fiscal outcomes seen in recent years. Operating revenue increased by 3.5% in 2015, in line with historical levels, however operating expenses grew by only 0.8% in 2015 compared to 8.2% growth in 2014.

In 2016 the city moved away from annual budgets, instead opting to pass a 4-year operating budget that spans the 2016 - 2019 period. Through this process, annual departmental expenditures for the next 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 approved rates as part of the annual budget review process, however barring this the approved property tax increases should average 2.8% annually for the budget cycle.

While the move to four year operating budgets highlights the city's commitment to long term planning, this new process could create challenges as council attempts to cope with unforeseen expenditure pressures that may arise throughout the budgeting cycle. We will monitor this process closely to ensure the city is able to adhere to expenditure growth in line with the approved average 2.8% property tax increases.

PRESSURES STEMMING FROM LABOUR COULD RETURN

London's operating expenditures grew by just 0.8% in 2015, assisted by a three month long strike with its indoor workers which contributed to a 2.1% decline in the city's salaries, wages and fringe benefits expenditures relative to 2014 levels. The strike, despite its positive impact on the city's bottom line in 2015, highlights the pressures resulting from labour negotiations which remain a concern for the city.

The city agreed to four year contracts with its CUPE Local 101 and 107 units and two year agreements with its two healthcare unions in 2015, each settling for affordable annual wage increases that ranged from 0% (plus lump sum payments) to 1.5%. London also agreed to a contract with its Police Services Union in 2015. While the base salary increase for police services (1.95% in 2015 and 0.95% annually from 2016 - 2018) are affordable for the city, the inclusion of a market value adjustment, which will compensate police if other jurisdictions offer higher wages, at the end of the contract in 2018 means that the total increase in compensation could be much higher.

Despite the certainty that the city has achieved by settling with multiple unions and Police Services, the London Professional Fire Fighters Association have been without a contract since 2010 and is currently in the process of arbitration, which is expected to continue into 2017.

Considering the operating budget has outlined property tax increases for the next 3 years, any compensation settlements that come in above forecasted levels could test the new budget model. In the event the Fire Fighters Association were awarded rate increases above inflation, or the market value adjustment for Police Services comes in higher than the city expects, it may force the city to seek savings in other departments or increase property taxes above the 2.8% average it has planned for in the 4 year budget.

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.

Rating Methodology and Scorecard Factors

Exhibit 3

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	95.30	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	17.64	12.5%	1.75	30%	0.53
Interest payments / operating revenues (%)	3	1.04	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	34.80	25%			
Short-term direct debt / total direct debt (%)	3	13.30	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						1.79(2)
Systemic Risk Assessment						Aaa
Suggested BCA						aa1

Source: Moody's Investors Service, City of London Financial Statements

Ratings

Exhibit 4

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

Source: Moody's Investors Service

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REPORT NUMBER 1038788