TO:	**CHAIR AND MEMBERS CORPORATE SERVICES COMMITTEE MEETING ON SEPTEMBER 26, 2017**
FROM:	**ANNA LISA BARBON MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER**
SUBJECT:	**CITY OF LONDON'S CREDIT RATING**

RECOMMENDATION

That, on the recommendation of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer, 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.

PREVIOUS REPORTS PERTINENT TO THIS MATTER

Corporate Services Committee, September 20, 2016, Agenda Item 3 - City of London's Credit Rating (2016)
http://sire.london.ca/mtgviewer.aspx?meetid=1292&doctype=AGENDA

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 120 sovereign nations, approximately 11,000 corporate issuers, 21,000 public finance issuers, and 72,000 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 2016 financial statements, 2016-2019 approved multi-year budget, 2017 annual budget update, 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 or Deputy Mayor.

The credit opinion of the City published September 7, 2017 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 2017 the 41st 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, 2017 at favourable interest rates ($41 million at an average all-in-rate of 2.48% 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 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."

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 fiscal outcomes.

Along with the noted strengths, the generation of internal financing for capital expenditures (i.e. pay-as-you financing), presence and adherence to fiscal policies, application of the multi-year budget, strict controls over debt issuance, and conservative debt management and investment policies are highlighted as credit positives. While the City continues to maintain its strong fiscal performance, one challenge that Moody's notes is that there is a relatively small pressure from the use of one-time measures to balance the budget.

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 41 consecutive years is a testament to the success of the City's prudent, conservative approach to fiscal planning.

PREPARED BY:	**REVIEWED BY:**
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CONCURRED BY:	**RECOMMENDED BY:**
LARRY PALARCHIO, DIRECTOR, FINANCIAL PLANNING & POLICY	**ANNA LISA BARBON, MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER**

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

Cc: Ian Collins, Director, Financial Services
Sharon Swance, Manager, Accounting

MOODY'S
INVESTORS SERVICE

CREDIT OPINION
7 September 2017

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

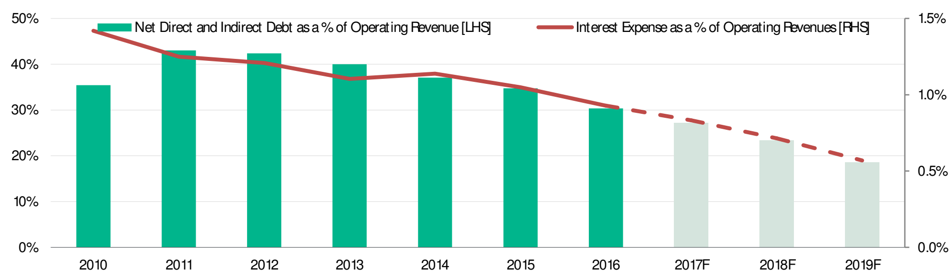
Update to Discussion of Key Credit Factors

Summary Rating Rationale

The City of London's Aaa debt rating is supported by the correlated combination of a relatively low debt burden and sizeable levels of reserves relative to the debt burden. Through an increased use of reserves and decreased reliance on debt issuance to fund capital projects than in the past, London's net direct and indirect debt relative to operating revenue has recently fallen from 42.4% in 2012 to 30.4% in 2016. Concurrently, the city's holdings of cash and investments, including those to be used for financing capital projects in lieu of debt, has increased to 259.1% of net debt as of December 31, 2016. This provides 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

London's efforts to rely less on debt will lead to a reduced debt burden and interest expense across the medium term



Source: Moody's Investors Service, City of London 2016-19 Budget

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

- Use of one-time measures to balance budget

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)	2012	2013	2014	2015	2016
Net Direct and Indirect Debt/Operating Revenue (%)	42.4	40.0	37.1	34.8	30.4
Gross Operating Balance/Operating Revenue (%)	16.2	19.1	16.0	18.1	22.4
Cash Financing Surplus (Requirement)/Total Revenue (%)	8.2	8.2	3.0	7.4	8.6
Interest Payments/Operating Revenue (%)	1.2	1.1	1.1	1.0	0.9
Debt Service/Total Revenue (%)	7.5	5.4	5.2	5.2	5.3
Capital Spending/Total Expenditures (%)	17.2	17.9	20.0	19.8	24.8
Self-Financing Ratio	1.5	1.5	1.2	1.4	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 profile is supported by a strong liquidity position which provides a significant measure of safety for bondholders. The city's cash and investments measured CAD873.2 million as of December 31, 2016, an increase of 9.8% compared to the previous year. The level in 2016 equaled 259.1% of net direct and indirect debt and approximately 101.4% 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 and only 29.9% of operating expenses in 2005, highlighting the prudent fiscal management and liquidity strength that London possesses.

The city's cash and reserve holdings will remain healthy even as the city moves forward with the approval of a CAD500 million bus rapid transit infrastructure project, of which the city is expected to fund CAD130 million. The city's portion is expected to be funded from cash and development charges. The remaining funds are expected to come from both the Canadian and Ontario governments. Construction may begin as early as 2019.

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 operating revenues measured 30.4% in 2016. This measure has been declining over the past several years, propelled by the conservative debt policies that 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 overseeing the use of excess funds at year end; 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.

The low debt burden also translates into a relatively low interest expense. In 2016, interest expense consumed only 0.9% 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.

London's updated 2016-2019 property tax supported capital plan, which includes minor adjustments introduced in 2017, calls for expenditures of CAD903.6 million. Of this, CAD243.4 million (27% of the total amount) will require debt financing, a level that was relatively unchanged from the initial plan. In 2017, capital financing from reserves should reach CAD55.3 million in addition to CAD37.0 million raised from the capital levy (pay-as-you-go financing), representing 43% of capital spending planned for the year. The relative share of annual funding from these sources are expected to remain stable during the current planning cycle through 2019. In the 2016-19 capital plan, 57% 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, which forecasts average annual debt financing requirements of CAD26 million for the tax supported projects, we anticipate that the city's debt burden will continue to slowly fall over the medium-term. This is also aided by the city's target of eliminating debt for lifecycle maintenance by 2022.

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 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 process could create challenges as council attempts to cope with unforeseen expenditure pressures that may arise throughout the budgeting cycle. However, we note that Budget 2017 was approved largely in line with the 2016-19 plan forecasts, with only minimal amendments required. 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.

In 2016 the city posted a consolidated surplus of CAD166.9 million, equivalent to 14.1% of total revenues, continuing the trend of positive fiscal outcomes seen in recent years. Operating revenue increased 5.9% in 2016, above levels seen in recent years, however operating expenses grew by only 0.5%.

USE OF ONE-TIME MEASURES TO BALANCE BUDGET

Although the city has recorded strong results, and Budget 2017 was not materially different from the path set out in the 2016-19 four-year budget plan, new ongoing initiatives introduced in 2017 were funded by non-recurring one-time sources.

The pressure in 2017 is relatively small, roughly CAD1.3 million in a budget in excess of CAD860 million, however it does reflect council's view that property tax increases are elevated. In 2017 the property tax levy increase was 2.9%.

We noted London relied on this unsustainable approach to larger degrees in 2013 and 2014. The return of using unsustainable funding sources raises the possibility that other elements in the budget will be reduced, such as pay-as-you-go capital financing which would result in higher debt issuance. Additionally, the inability to find sustainable funding for such a relatively small amount also suggests the city could face pressure from rising expenditure costs, notably labour, within a context of maintaining affordable property tax increases.

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		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	20.26	12.5%	1.5	30%	0.45
Interest payments / operating revenues (%)	1	0.96	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	30.40	25%			
Short-term direct debt / total direct debt (%)	3	14.90	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						**1.71(2)**
Systemic Risk Assessment						**Aaa**
Suggested BCA						**aa1**

Source: Moody's Investors Service, City of London

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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Asia Pacific	852-3551-3077
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EMEA	44-20-7772-5454

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