

TO:	CHAIR AND MEMBERS CORPORATE SERVICES COMMITTEE MEETING ON OCTOBER 8, 2019
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.

LINK TO 2019-2023 STRATEGIC PLAN

Council's 2019-2023 Strategic Plan for the City of London (the "City") identifies "Leading in Public Service" as a strategic areas of focus. Continuing to ensure the strength and sustainability of London's finances is a strategy to maintain London's finances in a well-planned manner to balance equity and affordability over the long term. The City's adherence to 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.

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 135 sovereign nations, approximately 4,800 non-financial corporate issuers, 4,100 financial institutions issuers, 17,600 public finance issuers, 9,600 structured finance transactions, and 1,000 infrastructure and project finance issuers. Typically, Moody's reviews the credit worthiness of the City of London annually and then assigns the City a credit rating.

The rating process involves a review of the City's 2018 Financial Statements, 2018 Financial Information Return, approved 2016-2019 Multi-Year Budget, 2019 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.

The credit opinion of the City published September 20, 2019 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 2019 the 43rd 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 April 2, 2019 at favourable interest rates (\$49.38 million at an average all-in-rate of 2.655% over a ten-year term). The stable outlook reflects Moody's expectation that liquidity will remain strong, debt will remain stable and the City will continue to post positive operating results.

The Moody's Credit Opinion Report 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.

Moody's comments regarding the City's prudent fiscal plan and track record of generating positive fiscal results are as follows:

"...the City of London displays strong governance and management practices, such as the application of multi-year budgets, which helps 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."

The comments provided by Moody's in their review of the City of London's credit rating further supports the strategy taken by Council to ensure the strength and sustainability of London's finances. The application of multi-year budgeting signifies that the City is looking beyond a short term focus 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.

While the City continues to maintain its strong fiscal performance, one credit challenge that Moody's mentions is the potential for the reductions in provincial funding to lead to near-term fiscal challenges. Moody's states that even though London is well positioned to accommodate these reductions, they do still impose a fiscal burden on the City, also noting that the full impact of the reductions to the City is not yet fully known. These challenges will be addressed through the 2020-2023 Multi-Year Budget process.

Moody's also states that a sustained loss of fiscal discipline leading to a material increase in debt and 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 would cause investors to lose confidence in the quality of the City's debt and financial management practices, 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.

CONCLUSION

The City's achievement of the Aaa credit rating for 43 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: Ian Collins, Director, Financial Services
Sharon Swance, Manager, Accounting

CREDIT OPINION

20 September 2019

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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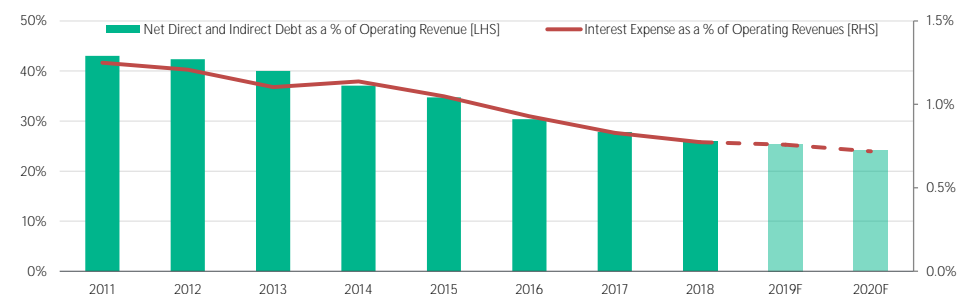
Update to credit analysis

Summary

The credit profile of the [City of London \(Aaa stable\)](#) reflects the strong protection to bondholders stemming from a relatively low debt burden, low interest expense and sizeable levels of reserves relative to outstanding debt. Through an increased use of reserves and decreased reliance on debt issuance to fund capital projects, London's net direct and indirect debt relative to operating revenue has steadily fallen from 42.4% in 2012 to 26.0% in 2018 with further declines anticipated. 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 nearly 3.3x net debt as of December 31, 2018. 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 continue low debt burden and interest expense across the medium term



Source: Moody's Investors Service, City of London financial statements and budget

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

Credit challenges

- » Reductions in provincial funding will lead to near-term fiscal challenges

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

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

Exhibit 2

London, City of

(Year Ending 12/31)	2014	2015	2016	2017	2018
Net Direct and Indirect Debt/Operating Revenue (%)	37.1	34.8	30.4	27.8	26.0
Gross Operating Balance/Operating Revenue (%)	16.0	18.1	22.4	21.2	21.2
Cash Financing Surplus (Requirement)/Total Revenue (%)	3.0	7.4	8.6	6.2	8.2
Interest Payments/Operating Revenue (%)	1.1	1.0	0.9	0.8	0.8
Debt Service/Total Revenue (%)	5.2	5.2	5.3	5.0	4.6
Capital Spending/Total Expenditures (%)	20.0	19.8	24.8	25.5	21.7
Self-Financing Ratio	1.2	1.4	1.4	1.3	1.5

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

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 \(Aa3 stable\)](#) 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 2018 the city's cash and investments increased 12.6% from 2017 levels and measured nearly 3.3x net debt and nearly 1.1x annual operating expenses. Over the past decade the city's cash and investment holdings have increased substantially, rising to their current level from 0.47x net direct and indirect debt and only 0.3x 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 CAD375 million bus rapid transit infrastructure project and related transit supportive capital works, scaled back slightly from previous plans, of which the city is expected to fund CAD148 million from cash and development charges. The remaining funds have been approved by both the Canadian and Ontario governments.

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 26.0% in 2018, a low level for a Canadian municipality. This measure has been declining over the past several years, 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 issuance is also reduced through the use of multiple policies overseeing

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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 also has a target to eliminate debt for lifecycle maintenance by 2022.

The low debt burden also translates into a relatively low interest expense. In 2018, interest expense consumed only 0.8% 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.

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 budget that spanned 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. This approach successfully allowed the city to maintain strong operating outcomes, posting gross operating balances averaging 21.6% of operating revenues over the years 2016-2018. The city plans to repeat this process with the current council, elected in the fall of 2019, for the 2020-2023 period.

Reductions in provincial funding will lead to near-term fiscal challenges

Facing material deficits and seeking means to reduce its spending, the Province of Ontario announced in its 2019/20 Budget that it would reduce transfers to municipalities for a variety of programs. While London is well positioned to accommodate these reductions, they do nonetheless impose a fiscal burden on the city. Furthermore, with key details on the reductions still not available, the full impact to the city is not yet fully known.

Ontario's changes primarily relate to cost-sharing arrangements between the province and municipalities. These changes will either directly reduce funds for municipalities or will require municipalities to increase their share of funding commitments for programs which have mandated service levels. In some cases, such as the regionalization of ambulance services, London may find that its ability to control costs are reduced as it will share service delivery with a larger number of partners and therefore face increased considerations on services that are offered. Reductions to capital funds and the cancellation of a planned doubling of the provincial gas tax directed to municipalities are also among items that have been impacted from the provincial budget.

Furthermore, the province passed legislation that will reduce and/or delay the amount of funds municipalities can raise via development charges (fees that housing developers are mandated to pay to help fund growth related and community services). While some services will be eliminated from the list of eligible fees covered by development charges, these may be transferred to a new, although not yet detailed, community benefits by-law and dedicated funding source. Included in the changes are the timing of when development charges are payable. This will likely impact the timing and level of debt requirements for London in the short and medium-term, although the long-term impact should be broadly neutral.

Extraordinary support considerations

Moody's assigns a high likelihood of extraordinary support from the Province of Ontario (Aa3 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.

ESG considerations

How environmental, social and governance risks inform our credit analysis of the City of London

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 the City of London, we assess the materiality of ESG to the credit profile as follows:

Environmental considerations are not material to the credit profile. Neither the city's infrastructure nor economic base are subject to material risks stemming from environmental concerns. As such, both spending and revenue are not expected to be impacted by environmental changes at this time.

Social considerations are not material to the credit profile. The city provides key public services such as public safety (police, fire and paramedic) and environmental (water and waste collection), but these services do not face material social risks given the stable population levels and predictable demographic trends which allows for long-term forecasting of such service requirements.

Governance is considered quite important and London provides for strong governance characteristics. 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.

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

In the case of London, the BCA of aaa assigned by the rating committee is close to the scorecard-indicated outcome of aa1. The scorecard-indicated 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 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	99.80	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	21.37	12.5%	1.5	30%	0.45
Interest payments / operating revenues (%)	1	0.81	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	26.00	25%			
Short-term direct debt / total direct debt (%)	3	16.70	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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