

## 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:** August 30, 2021

## 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 an Aaa ('triple A') credit rating with a stable outlook as part of Moody's Investors Service (Moody's) latest Credit Opinion. Issued in July 2021, this marks the 45<sup>th</sup> consecutive year of such a rating and represents the highest credit rating issued by Moody's.

## Linkage to the Corporate Strategic Plan

Council's 2019 to 2023 Strategic Plan for the City of London (the "City") identifies "Leading in Public Service" as a strategic area 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.

## 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 2020 Financial Statements, 2020 Financial Information Return, 2021 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.

The Credit Opinion for the City of London, published July 23, 2021 by Moody's, is attached to this report. Consistent with prior years, the City has maintained its Aaa credit rating with a stable outlook, despite the financial challenges presented by the COVID-19 pandemic. The City has held the Aaa rating since 1977, making 2021 the 45<sup>th</sup> 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 strong protection to bondholders stemming from a relatively low debt burden, low interest expense and sizeable levels of reserves relative to outstanding debt. The rating also reflects the city's strong track record of achieving positive operating results and the generation of internal financing for capital expenditures."

## 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.

The City's credit challenges outlined by Moody's include the potential for "near-term fiscal pressures stemming from the ongoing coronavirus pandemic, ambitious council agenda and provincial changes [that] will impact operating balances." Moody's further states that "while we consider London to have a high level of budget flexibility to absorb certain pressures, they do nonetheless impose risks to the city."

Moody's also states 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 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 taken by Council to ensure the strength and sustainability of London's finances, particularly in light of the COVID-19 pandemic. 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. 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."

## 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 bonds/debentures rated Aaa are perceived to have less risk of default.

## **Conclusion**

The City's achievement of Moody's Aaa credit rating for 45 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 the coronavirus pandemic is also a testament to the flexibility and adaptability of the City's financial policies and processes.

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

## CREDIT OPINION

23 July 2021

Update

 Rate this Research

### 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)

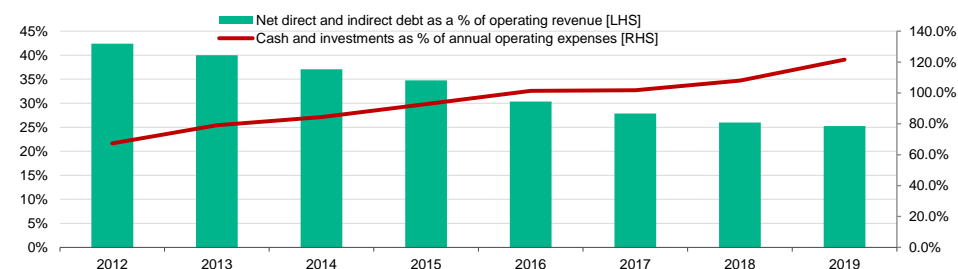
Update following rating affirmation

### 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 25.2% in 2019. 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 3.8x net debt and 1.2x operating expenses as of December 31, 2019. 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

**The city's low debt burden and high level of reserves provide ample flexibility should fiscal challenges arise**



Sources: City of London financial statements, 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 the ongoing coronavirus pandemic, ambitious council agenda and provincial funding changes will impact operating balances

## Rating outlook

The outlook for London's Aaa debt rating is stable, reflecting our expectation that liquidity will remain strong, debt will continue to remain at the current low levels. Federal and provincial funding received in 2020 will continue to support London's needs to offset lingering pressure from the coronavirus pandemic in 2021, while the city also maintains sufficient budget flexibility to mitigate further pressures should they arise.

## 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)	2015	2016	2017	2018	2019
Net Direct and Indirect Debt/Operating Revenue (%)	34.8	30.4	27.8	26.0	25.2
Gross Operating Balance/Operating Revenue (%)	18.1	22.4	21.2	21.2	21.2
Cash Financing Surplus (Requirement)/Total Revenue (%)	7.4	8.6	6.2	8.2	13.2
Interest Payments/Operating Revenue (%)	1.0	0.9	0.8	0.8	0.7
Debt Service/Total Revenue (%)	5.2	5.3	5.0	4.6	4.7
Capital Spending/Total Expenditures (%)	19.8	24.8	25.5	21.7	19.1
Self-Financing Ratio	1.4	1.4	1.3	1.5	1.8

Sources: City of London financial statements, 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 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 2019 the city's cash and investments were equal to 3.8x net debt and 1.2x annual operating expenses. These levels represent a transformational shift in the manner in which the city views its debt and reserves which has taken place consistently over a number of different municipal councils. These metrics have risen to their current levels from 0.47x net direct and indirect debt and only 0.3x operating expenses in 2005, highlighting the continued adherence to prudent fiscal management and liquidity strength that London possesses.

Shortly after the onset of the coronavirus pandemic in 2020, London focused on bolstering its levels of liquidity through an increased emphasis on short-term, highly liquid investments while still respecting its existing investment policy. The city continues to follow this approach in 2021.

The city's cash and reserve holdings will remain healthy even as the city moves forward with the construction of three of five budgeted rapid transit components and related transit supportive capital works totaling CAD375 million, of which the city is expected to fund CAD148 million from property tax supported sources and development charges. The remaining funding contributions 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

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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 25.2% in 2019. While Canadian municipalities can only issue debt for capital reasons, this is nonetheless a low level relative to domestic peers as Canadian municipalities' revenue structure and high level of operating expense tend to not favour funding capital needs from operations. 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 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 also has a target to eliminate debt for life cycle maintenance by 2022, a target which is expected to be achieved and remains unchanged even in the face of the coronavirus pandemic.

The low debt burden also translates into a relatively low interest expense. In 2019, interest expense consumed only 0.7% 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.

The city's 2020-2029 capital plan totals CAD4.2 billion across tax-supported and rate-supported projects. After taking into consideration of the city's conservative planning approach and debt avoidance policies mentioned previously, our estimate of average annual debt requirements are at levels that will likely stabilize the debt burden over the next 4-5 years, with the potential for slight upward pressure but not to the extent it will pressure the 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.

#### **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. This approach successfully allowed the city to maintain strong operating outcomes, posting gross operating balances averaging 21.5% of operating revenues over the 2016-2019 four-year budget plan.

Despite the multi-year approach, this budget model provided sufficient flexibility for London to adjust spending in 2020 to mitigate against revenue losses stemming from the reduced activity caused by the coronavirus pandemic. The city was able to lower service levels where applicable and defer some new initiatives and capital projects that were originally intended for 2020. In 2021, the budget was further adjusted to mitigate against forecasted pressure resulting in a balanced budget as per provincial requirements. 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 the ongoing coronavirus pandemic, ambitious council agenda and changes to provincial funding levels will impact operating balances**

As with all Canadian municipalities, London faces continued fiscal pressure from the continuation of the coronavirus pandemic in 2021 which can lead to depressed revenue, primarily from user fees and fines, and higher costs to accommodate the increased need for health and safety protection of workers and service delivery. Absent extraordinary funding by the federal and provincial governments, the largest single source of financial pressure is from the city's public transit network, which faces lower ridership levels, and therefore lower fare revenue, but concurrently needs to continue to offer a relatively high level of service to promote both social distancing and to ensure reliable service to those customers dependent on public transit for their mobility needs. Although London received funding in 2020 for transit that it can apply to offset revenue pressure in 2021, we anticipate that ridership levels will remain below pre-pandemic levels into 2022 and potentially 2023 and therefore continue to negatively impact transit related revenue.

Adding to the fiscal challenge facing the city, London's 2020-2023 budget includes a number of new initiatives. To help fund these initiatives, along with the need to offset funding changes introduced by the province, the property tax levy is expected to increase annually by an average 3.8% over the 2020-2023 budget plan. This is relatively high currently for Canadian municipalities which have in recent years tended to focus on keeping property tax levy increases at or below the level of inflation (2%). Certain projects and plans were deferred in 2021 which lowered the property tax levy increase to 3.4% from the originally planned 4.4%. The deferred projects are expected to now be introduced in 2022, for which the city forecasts a property tax levy increase of 3.9%. Once the new initiatives are implemented, they will result in a permanent addition to spending of the city and will need to be supported by ongoing revenue generation, which will further limit the ability of the city to lower tax rate increases in the future.

The Province of Ontario announced in its 2019/20 Budget that it would reduce transfers to municipalities for a variety of programs as the province faces material deficits and seeks to reduce its spending. The implementation of some changes were delayed given the province's intention to avoid further fiscal pressure to municipalities during the pandemic. However, municipalities now face uncertainty on the timing of implementation. Additionally, the additional fiscal pressure facing the province may lead to further funding changes should the province seek to reduce its spending. While we consider London to have a high level of budget flexibility to absorb certain pressures, they do nonetheless impose risks to the city.

### **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 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 risks are considered low to the credit profile of London. Neither the city's infrastructure nor economic base are subject to material risks stemming from environmental concerns. The relatively small geographic footprint, located in the middle of southwestern Ontario, minimizes exposure to environmental risk. As such, both spending and revenue are not expected to be impacted by environmental changes at this time.

Social risks are considered low. The city provides public safety (police and fire) and environmental services (water and waste collection which are tied to social factors, 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. London is Canada's 11th largest city, and benefits from strong educational attainment and access to health and safety given access to world-renowned health care institutions.

Governance is considered quite important and London provides for strong governance characteristics resulting in low risk. 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 Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
<b>Factor 1: Economic Fundamentals</b>				<b>3.80</b>	<b>20%</b>	<b>0.76</b>
Economic Strength [1]	5	99.85%	70%			
Economic Volatility	1		30%			
<b>Factor 2: Institutional Framework</b>				<b>1</b>	<b>20%</b>	<b>0.20</b>
Legislative Background	1		50%			
Financial Flexibility	1		50%			
<b>Factor 3: Financial Position</b>				<b>1.50</b>	<b>30%</b>	<b>0.45</b>
Operating Margin [2]	1	21.21%	12.5%			
Interest Burden [3]	1	0.75%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	25.24%	25%			
Debt Structure [5]	3	17.59%	25%			
<b>Factor 4: Governance and Management</b>				<b>1</b>	<b>30%</b>	<b>0.30</b>
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
<b>Idiosyncratic Risk Assessment</b>						<b>1.71 (2)</b>
<b>Systemic Risk Assessment</b>						<b>Aaa</b>
<b>Suggested BCA</b>						<b>aa1</b>

[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 2019.



## Ratings

Exhibit 4

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

Source: Moody's Investors Service

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