

## 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:** October 31, 2022

## 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 the Aaa ('triple A') credit rating with a stable outlook as part of Moody's Investors Service (Moody's) latest Credit Opinion. Issued on October 5, 2022, this marks the 46<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 robust 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 2021 Financial Statements, 2021 Financial Information Return, 2022 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 October 5, 2022 by Moody's, is attached as **Appendix A** 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 2022 the 46<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 track record of solid operating outcomes and strong protection to bondholders stemming from a relatively low debt and interest burden as well as sizeable level of reserves."

## 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, inflation and other global factors." 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 and other broad global pressures. The application of multi-year budgeting signifies that the City is looking beyond a short-term horizon 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." Moody's also stated that the experience through the pandemic highlights the flexibility the multi-year budget model provides to immediate shocks, as well as providing visibility to long term planning needs.

New to the 2022 credit rating report, Moody's has now started to explicitly report its Environmental, Social and Governance (ESG) Credit Impact Score (CIS). These evaluations have been considered previously in assigning the City's credit rating but now have been separated and reported distinctly. It is important to note that this ESG score is not an evaluation of the City's performance or activities as it relates to ESG but rather a reflection of how ESG factors within the City of London impact credit risk and therefore the credit rating of the City. The CIS is based on a scale from one to five:

CIS - 1; representing positive impact  
CIS – 2; representing neutral to low impact  
CIS – 3; representing moderately negative impact  
CIS – 4; representing highly negative impact  
CIS – 5; representing very highly negative impact

The City's overall ESG CIS is CIS – 2; neutral to low impact. The environmental profile received a score of two; the social profile received a score of two; and the government profile received a score of one, which “captures London's very strong institutional and governance framework” according to Moody's.

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

## **Conclusion**

The City's achievement of Moody's Aaa credit rating for 46 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 and other global pressures 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 Business Support**

**Recommended by:** **Anna Lisa Barbon, CPA, CGA, Deputy City Manager, Finance Supports**

**CREDIT OPINION**

5 October 2022

Update



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**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 to credit analysis

**Summary**

The credit profile of the [City of London](#) (Aaa stable) reflects the track record of solid operating outcomes and strong protection to bondholders stemming from a relatively low debt and interest burden as well as sizeable levels of reserves. Through an increased use of reserves and elimination of debt for repair and maintenance of infrastructure, London's net direct and indirect debt declined to a very low 19.4% of operating revenues in 2021. Concurrently, the city's holdings of cash and investments, including those to be used for financing capital projects in lieu of debt, measured 6.5x net debt and 1.4x operating expenses as of December 31, 2021. While debt is expected to increase across the next 3-4 years due to an increase in growth related capital projects, we do not see this as a change in the city's strong debt management policies.

**Exhibit 1**

Even with a forecasted increase, the city's debt will remain low and the city's reserves will continue to provide ample coverage of operating expenses



Sources: City of London financial statements and 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, inflation and other global factors

### 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.

### 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

#### London, City of

(Year Ending 12/31)	2016	2017	2018	2019	2020	2021	2022F
Net Direct and Indirect Debt/Operating Revenue (%)	30.4	27.8	26.0	25.2	23.1	19.4	20.5
Gross Operating Balance/Operating Revenue (%)	22.4	21.2	21.2	21.2	24.0	24.7	24.0
Cash Financing Surplus (Requirement)/Total Revenue	8.6	6.2	8.2	13.2	16.9	20.3	-
Interest Payments/Operating Revenue (%)	0.9	0.8	0.8	0.7	0.7	0.5	0.6
Debt Service/Total Revenue (%)	5.3	5.0	4.6	4.7	4.7	4.3	4.3
Capital Spending/Total Expenditures (%)	24.8	25.5	21.7	19.1	20.3	19.6	20.7
Self-Financing Ratio	1.4	1.3	1.5	1.8	2.0	2.3	-

Sources: City of London financial statements and 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 2021 the city's cash and investments were equal to 6.5x net debt and 1.4x annual operating expenses. To achieve these levels, the city has continued to follow prudent fiscal management and liquidity policies across multiple changes in the municipal council, which we expect to continue into the future.

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 19.4% in 2021. While Canadian municipalities can only issue debt for capital reasons, London's debt burden is nonetheless relatively low to domestic peers. 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 has also eliminated debt for lifecycle maintenance of capital, which limits debt issuance to new and/or growth related needs.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.



The low debt burden also translates into a relatively low interest expense. In 2021, interest expense consumed only 0.5% 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 even as interest rates rise.

The city's 2022-2031 capital plan totals CAD4.2 billion across tax-supported and rate-supported projects. Due in part to eliminating debt for lifecycle maintenance, which helped to promote a declining debt level, the capital plan's financing requirements will lead to an increase in the city's debt burden, although we expect it will begin to stabilise as early as 2024. The anticipated increase, however, is slight and will not 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. Municipalities are, however, subject to the powers and responsibilities imposed upon them by their respective provinces. 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.

Despite the multi-year approach, this budget model provided sufficient flexibility for London to adjust the fiscal plan in 2020 and 2021 in reaction to pressure generated by the coronavirus pandemic, on both revenue and spending. 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. The experience through the pandemic highlights the flexibility the multi-year budget model provides to immediate shocks, as well as providing visibility to long-term planning needs.

**Near-term fiscal pressures stemming from the ongoing coronavirus pandemic, inflation and other global factors**

As with all Canadian municipalities, London faces continued uncertainty on how the continuing pandemic may impact 2023 and beyond. Pandemic related pressures could continue to impact revenues (lower user fees for certain activities) and costs (continued health related measures). Absent extraordinary funding by the federal and provincial governments, the largest single source of financial pressure we expect with greater certainty is from the city's public transit network, which will continue to face lower ridership levels, and therefore lower fare revenue, but concurrently needs to continue to offer a relatively high level of service to ensure reliable service to those customers dependent on public transit for their mobility needs.

Other broad global pressures also arose in 2022 which will likely continue to lead to fiscal pressure in 2023. These include higher inflation and interest rates than what has been recorded over the past decade and higher energy costs. The city was protected in 2022 through multi-year collective agreements that limited the pressure from inflation on salaries and wages. However, as contracts expire, unions will seek to adjust wages to reflect the higher cost of living. Additionally, prices for materials and services purchased by the city

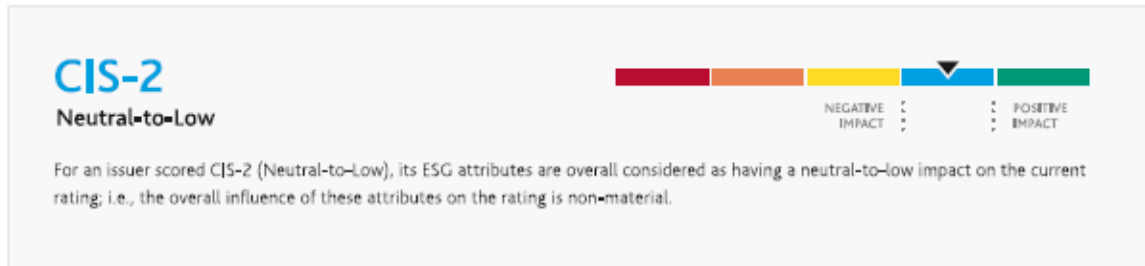
will also see increases as inflation is expected to remain above historical levels in 2023. While the low debt requirements of the city will limit budgetary pressure caused by higher interest rates, interest expense will rise as well.

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. While we consider London to have a high level of budget flexibility to absorb certain pressures, they do nonetheless impose risks to the city.

### ESG considerations

#### The City of London's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3  
ESG Credit Impact Score



Source: Moody's Investors Service

London's neutral-to-low (**CIS-2**) ESG Credit Impact Score reflects neutral-to-low exposure to environmental and social risk, along with very strong governance and policy effectiveness that mitigates the city's susceptibility to these risks.

Exhibit 4  
ESG Issuer Profile Scores



Source: Moody's Investors Service

#### Environmental

The E issuer profile score is neutral-to-low (**E-2**), reflecting neutral-to-low scores across all environmental risk categories. Neither the city's infrastructure nor economic base are subject to material risks stemming from environmental concerns and the city's relatively small geographic footprint further minimizes any exposure to environmental risks.

#### Social

The S issuer profile score is neutral-to-low (**S-2**). The city provides key public services such as public safety (police, fire and paramedic) and environmental (water and waste collection), but demand for these services do not face risks from social considerations given the stable population levels and predictable demographic trends which allows for long-term forecasting of such service requirements. London has a high level of education and overall strong levels of public health and safety. We regard the coronavirus pandemic as a social risk given the implications for public health, but the city benefits from significant provincial and federal pandemic-related support.

**Governance**

The positive G issuer profile score (**G-1**) captures London's very strong institutional and governance framework. 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.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

**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.



### 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 5

##### 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	100.83%	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	23.99%	12.5%			
Interest Burden [3]	1	0.60%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	19.40%	25%			
Debt Structure [5]	3	18.91%	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>Scorecard-Indicated BCA Outcome</b>						<b>aa1</b>
<b>Assigned BCA</b>						<b>aaa</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 2021.

### Ratings

#### Exhibit 6

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

Source: Moody's Investors Service

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