FORM GEN. 160

# CITY OF LOS ANGELES

INTER-DEPARTMENTAL CORRESPONDENCE

0220-05291-0800

Date: April 24, 2020

To: The Mayor
The City Council

From: Richard H. Llewellyn, Jr., City Administrative Officer

Subject: **CREDIT RATING AGENCY UPDATES**

As you know, the coronavirus pandemic has created substantial economic challenges for the City of Los Angeles. Despite these challenges, I am pleased to report that the City has maintained its strong financial credit ratings. Over the past few weeks, Fitch Rating (Fitch), Kroll Bond Rating Agency (Kroll), Moody's Investors Service (Moody's), and S&P Global (S&P) have reviewed and affirmed our credit ratings at their current strong levels. We believe that these ratings are a reflection of the diverse and ultimately resilient Los Angeles economy as well as the City's ability, under Mayor/Council leadership, to address fiscal challenges.

The General Obligation (GO) bond rating is considered the City's general credit rating and is used to determine the ratings on all other debt issued by the City. On March 30, 2020, Fitch released its annual surveillance report affirming the City's current GO bond rating of AA with a stable outlook (see Attachment 1 for the City's ratings and Attachment 2 for the rating report). Fitch also affirmed the other debt programs: MICLA, Judgment Obligation, and Solid Waste.

Fitch states that the GO rating "reflects strong operating performance, resulting from years of revenue growth largely outpacing managed expenditure growth." Fitch's ratings are forward looking and expect the underlying strength and diversity of the City's economy to withstand the current economic downturn and Covid-19. Although Fitch indicates that this downturn exposes economically sensitive revenue sources, it believes that expenditure flexibility combined with continued proactive budget management can offset these pressures. Fitch states that the City's long-term liability burden is moderate, and demonstrates the highest level of gap-closing capacity typically achieving positive results despite expected revenue volatility.

Fitch affirms the rating with a stable outlook as the effects of Covid-19 are beginning to be felt. Fitch believes that the difficult decisions made by the Mayor and the City Council over the last few years as well as the Mayor's current Belt-Tightening Policies have demonstrated the City's ability to control expenditures. In each of its four rating drivers, Fitch praises these efforts, such as bi-weekly revenue monitoring, increased expenditures due to Covid-19 while implementing a hiring and expenditure freeze, future General Fund debt to remain low over the next few years, and growing fund balances and reserves. These measures all result in strong liquidity.

Fitch does warn that rating downgrades may occur "if the City fails to exercise sound budget management and spending outpaces revenue constraining liquidity and reserves though this economic cycle."

For Solid Waste, the strong rating is based on the resilience of the solid waste revenue fee, low debt burden, lack of sensitivity of economic downturns, no taxpayer concentration, and the City's willingness to increase the fee when necessary.

On April 2, 2020, S&P released a report entitled *COVID-19: A Closer Look at How it Affects 10 Mayor U.S. Cities*, including an analysis of the City of Los Angeles. In addition, S&P placed the U.S. public finance sector on negative watch indicating that it expects to downgrade more issuers than upgrade them. The City, however, maintained its current S&P rating of AA with a stable outlook.

S&P's analysis speaks to the City's very large liquidity position and the availability of cash across all funds. Although the City is expecting a decrease in sales and transit occupancy taxes, the Mayor's Belt-Tightening Policies impose a hiring and spending freeze to offset these decreases. S&P believes that "the City's broad revenue base, anchored by property tax, should help insulate the City from the worst of the downturn." S&P expressed concerns on the City's ability to sell its tax and revenue anticipation notes (TRAN) due to the bond market's instability. Our Office is monitoring the market and evaluating alternatives.

On April 13, Kroll released its report entitled, *City of Los Angele SurveillanceReport,* affirming the GO bond rating at AA+ with a stable outlook.

Kroll's rating and outlook reflect its view that "the City is relatively well positioned to weather the near to medium term challenges brought by the global Covid-19 pandemic." As reflected in Kroll's credit rating criteria, the City's experienced management and leadership team, established financial management practices, manageable debt burden, stable reserves, and strong liquidity, with as substantial and diverse tax base, provide the framework to manage the financial downturn. The combination of all these provides enough flexibility to manage unexpected expenditures and adverse economic conditions due to Covid-19. Kroll cites Mayor Garcetti's implementation of a "belt-tightening order" to manage the unknown impact of the pandemic.

Although Kroll's report extensively details the City's strong financial condition and liquidity, there are credit challenges noted in the report. Kroll is concerned with the severity of the economic downtown and its effect on economically sensitive revenues, pension costs due to lower investment returns, and the cost of the new labor agreements. The results of these could affect the City's ratings.

On April 17, 2020, Moody's released a report entitled, *Moody's revises City of Los Angeles, CA's outlook to stable from positive, affirms outstanding Aa2 GO.* Although Moody's had expected the City's continued revenue growth and increasing reserves over its 18 to 24 month outlook, Moody's concluded that this is no longer possible in the current economic environment. Moody's thus revised the revenue growth; 2) material decrease in both City's outlook from positive to stable.

Moody's does expect the City to manage this downturn as it has prior economic downturns. Thus, the City's Aa2 (AA equivalent) GO rating and the MICLA Aa3 (AA- equivalent) rating are affirmed. Moody's states that the following factors could lead to an upgrade: 1) a rapid return to recent rates ondirect debt, and unfunded pension and OPEB liabilities; and, 3) continued building of available reserves. In contract, Moody's notes the following factors that could lead to a downgrade: 1) prolonged deterioration of the tax base and economy; 2) weakened financial position through deficit spending or significant increases in fixed costs; and 3) material increases in unfounded pension and OPEB liabilities

The four credit rating agencies expect the City's strong management team and conservative policies to enable the City to manage through the Covid-19 downturn.

*RJL:NRB:09200189*

Attachments

City of Los Angeles Debt Rating
Fitch Affirms Los Angeles, CA's IDR at "AA"; Outlook Stable
Kroll Bond Rating Agency, City of Los Angeles Surveillance Report
S&P Global Ratings-COVID-19: A Closer Look at How it Affects 10 Mayor U.S. Cities
Moody's revises City of Los Angeles, CA's outlook to stable from positive, affirms outstanding Aa2 GO

# Attachment 1

## City of Los Angeles
## Debt Ratings
**(As of April 13, 2020)**

## CITY OF LOS ANGELES
## DEBT RATINGS[1]
**AS OF APRIL 13, 2020**

| Program | Moody's Investors Service | S&P Global Ratings | Fitch Ratings | Kroll Bond Rating Agency |
|---|---|---|---|---|
| General Obligation Bonds | Aa2 | AA | AA | AA+ |
| Judgment Obligation Bonds | A1 | AA | AA- | n/a |
| MICLA Lease-Revenue Obligations (Real Property)[2] | Aa3 | AA- | AA- | AA |
| MICLA Lease-Revenue Obligations (Capital Equipment) | Aa3 | AA- | AA- | AA |
| Tax and Revenue Anticipation Notes | MIG 1 | SP-1+ | n/a | n/a |
| Solid Waste Resources Revenue Bonds | Aa2 | A+ | AA | AA |
| Wastewater System Revenue Bonds | Aa2 | AA+ | AA+ | AA+ |
| Wastewater System Subordinate Revenue Bonds | Aa3 | AA | AA | AA |

[1] These ratings represent the underlying ratings of the City's obligations. The "investment grade" rating scale of the four major rating agencies are as follows:

| Moody's | Standard & Poor's | Fitch | Kroll |
|---|---|---|---|
| Aaa | AAA | AAA | AAA |
| Aa1 | AA+ | AA+ | AA+ |
| Aa2 | AA | AA | AA |
| Aa3 | AA- | AA- | AA- |
| A1 | A+ | A+ | A+ |
| A2 | A | A | A |
| A3 | A- | A- | A- |
| Baa1 | BBB+ | BBB+ | BBB+ |
| Baa2 | BBB | BBB | BBB |
| Baa3 | BBB- | BBB- | BBB- |

For more information on the rating agencies and their ratings, please see their respective web sites: www.moodys.com; www.standardandpoors.com; www.fitchratings.com and www.krollbondratings.com.

[2] Moody's Investors Service rates MICLA Lease Revenue Refunding Bonds, Series 2018-C (Real Property - Taxable) (Dolby Theater) at A1.

## Attachment 2

### Fitch Affirms Los Angeles, CA's IDR at "AA"; Outlook Stable

FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms Los Angeles, CA's IDR at 'AA'; Outlook Stable

Mon 30 Mar, 2020 - 4:42 PM ET

Fitch Ratings - San Francisco - 30 Mar 2020: Fitch Ratings has affirmed the following Los Angeles, CA ratings:

--Issuer Default Rating (IDR) at 'AA';

--$381 million outstanding general obligation bonds, series 2011-A, 2011-B, 2012-A, 2017-A, and 2017-B at 'AA';

--$6 million outstanding judgment obligation bonds, series 2010-A at 'AA-';

--$1.1 billion outstanding Municipal Improvement Corporation of Los Angeles (MICLA) lease revenue bonds, series 2010-A, 2010-B, 2010-C, 2012-A, 2012-B, 2012-C, 2014-A, 2014-B, 2015-A, 2016-A, and 2016-B at 'AA-';

--$72 million solid waste resources revenue bonds, series 2009-A, 2013-A, and 2013-B at 'AA'.

The Rating Outlook is Stable.

## SECURITY

GO bonds are payable from ad valorem property taxes levied without limitation on rate or amount upon taxable properties within the city.

Judgment obligation bonds are payable from any legally available funds based on the city's absolute and unconditional obligation to pay principal and interest to refund an obligation imposed by law.

MICLA lease revenue bonds are payable solely from the city's lease rental payments for use and occupancy of various facilities and capital equipment. The city covenants to budget and appropriate sufficient annual debt and interest payments from any available source of funds, subject to abatement.

Solid waste resources revenue bonds are payable from a first lien on pledged solid waste resources fee revenues, including penalties and interest, net of administrative charges made by the Los Angeles Department of Water and Power (LADWP).

## IDR ANALYTICAL CONCLUSION

The 'AA' IDR reflects the city's strong operating performance, resulting from some years of solid revenue growth largely outpacing managed expenditure growth. The city also benefits from a moderate debt burden and the highest level of gap-closing capacity. As with many major cities, Los Angeles faces ongoing challenges arising from a strong labor environment, increasing pension system and other post-employment benefit (OPEB) employer contributions, and public demand for service enhancements. These challenges will likely be exacerbated by an economic downturn. The 'AA-' rating for the city's judgment obligation bonds and the MICLA lease revenue bonds indicates the slightly higher repayment optionality.

## DEDICATED TAX ANALYTICAL CONCLUSION

The 'AA' solid waste resources revenue bond rating is based on strong solid waste resources fee revenue resilience and debt service cushion, lack of sensitivity to economic downturns, no ratepayer concentration, and the city's willingness to

implement fee increases when necessary. Since the flat solid waste resources fee is not ad valorem-based or volumetrically determined, fee revenues could only decline if land use shifts from residential to commercial/industrial uses, or the number of residences serviced by the city decreases. Fitch considers it unlikely that this would occur on a scale sufficient to materially affect fee revenues and assumes the city would adjust the fee to a rate that fully recovers the system's costs. Since Fitch does not assume that the solid waste resources fee would be considered a special revenue in the unlikely event the city declared bankruptcy, the solid waste resources revenue bond rating is capped at the city's IDR of 'AA'.

**(SEE BELOW FOR DEDICATED TAX ANALYSIS)**

## ECONOMIC SUMMARY

Sector-Wide Coronavirus Implications

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. As severe limitations on economic activity have only begun within the last week or so, most local governments' fiscal and economic data do not reflect any credit impairment. However, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

Economic Resource Base Details

Los Angeles is the commercial and cultural center of a very large, diverse economy that has been benefitting from population, employment, and property market growth. The city's wealth characteristics remain somewhat mixed, as would be expected for such a large urban area. Nevertheless, Fitch expects the underlying strength and diversity of Los Angeles' economy will support the city in its recovery from the current economic downturn.

## IDR KEY RATING DRIVERS

### Revenue Framework: 'aa'

Historically, revenue growth has been below national GDP growth but above inflation, reflecting the city's ability to capture revenues from across its wide range of economic activity. Although property taxes remain the largest and most stable of the city's general fund revenues, the city is also exposed to a number of economically sensitive revenue sources. While the city's independent ability to raise revenues is limited by the state constitution, it is still satisfactory since fees, charges, and other locally-controlled revenues are a sizeable portion of the city's revenue stream.

### Expenditure Framework: 'a'

Over time, expenditure growth is expected to be roughly in line with, to marginally above, the city's strong revenue growth given rising employee remuneration costs and public demand for service enhancements. This will require continued proactive budget management, particularly during a significant economic downturn. Expenditure flexibility is adequate. While there is labor contract flexibility, the labor environment can be contentious.

### Long-Term Liability Burden: 'aa'

The long-term liability burden is moderate relative to personal income.

### Operating Performance: 'aaa'

The city demonstrates the highest level of gap-closing capacity relative to expected revenue volatility. Reserves in combination with the city's midrange inherent budget flexibility mean it is well positioned to address an economic downturn. The city has made consistent efforts to retain financial flexibility and in recent years has typically achieved positive operations.

## RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

--Balanced Spending and Revenues: Decreasing expenditure pressure and/or natural revenue growth above GDP.

--Greater Spending Flexibility: An improvement in Fitch's assessment of the city's expenditure flexibility, due to declines in fixed debt service and retiree benefit costs, and/or sustained cooperation between labor and management to contain rising costs.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

--Constrained Liquidity and Reserves: Failure to exercise sound budget management and maintain the highest level of gap-closing capacity through the economic cycle.

--Escalation of Spending Pressures: Evidence that spending growth will consistently outpace the natural pace of revenue growth through increases in carrying costs, service provision costs, or employee remuneration, or expectations that the natural pace of revenue growth will go below CPI.

## BEST/WORST CASE RATING SCENARIO

Ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings https://www.fitchratings.com/site/re/10111579.

## CURRENT DEVELOPMENTS

The city is already experiencing impacts of the spread of, and efforts to mitigate the spread of, the coronavirus. Given federal travel restrictions and the state's "shelter-in-place" requirements, tourism has declined sharply, conventions, large meetings, and sporting events have been cancelled, non-essential businesses are closed or operating with remote workforces, and all Los Angeles Unified School District schools are closed through May 1, 2020.

Fitch expects the city's current fiscal 2020 budget to be significantly impacted by the current public health crisis due to near-term revenue impacts and increased expenditures on containment measures. The city is expecting immediate revenue declines in its transient occupancy, business, and parking tax revenues (collectively 17% of the fiscal 2020 adopted budget's general fund revenues), as well as investment-based revenues. Other economically sensitive revenue streams, for example licenses, fees, and fines (19% of the fiscal 2020 adopted budget's general fund revenues) are also likely to experience declines if the economic downturn is prolonged. In response, the city is instituting a hiring freeze, reducing its contractual services, requiring departments to repay reserve fund loans by the end of the fiscal year, and sweeping funds for surplus moneys. The city has instituted bi-weekly revenue monitoring to keep a close watch on revenue declines as they unfold. The mayor's proposed fiscal 2021 budget, due to be released on April 20, 2020, will include revised revenue expectations.

Fitch considers the city to be well positioned to absorb a temporary economic shock given the strength of its unrestricted general fund balance, adequate expenditure flexibility, and reliance on less economically sensitive property tax revenues to fund around a third of its general fund budget. However, a longer term recession could exacerbate general fund operating deficits the city is already projecting through fiscal 2024, thereby pressuring the city's reserves.

## ECONOMIC RESOURCE BASE

The city has been benefitting from economic expansion characterized by employment growth, business sector expansion, strong tourism trends, and numerous new construction projects, particularly downtown. Since minor recessionary losses in fiscal years 2010 and 2011, the city's assessed valuation grew strongly by 56% through fiscal 2020, with further new developments in the pipeline. Depending on its length and severity, the current economic downturn could have a significant adverse impact on the regional economy and, potentially, the city's tax

base. Nevertheless, given the underlying economy's strength and diversity, Fitch would expect the city to rebound over time.

## IDR CREDIT PROFILE

### REVENUE FRAMEWORK

A variety of taxes enables the city to translate its active economy into revenue, capitalizing on the city's size and economic diversity. In fiscal 2019, property taxes represented 37% of total general fund revenues, followed by business taxes, utility users' taxes, and sales taxes (at approximately 11% each), and other taxes (13%). Each of these major revenue streams saw continued growth in fiscal 2019 except for the utility users' tax (which is expected to continue declining due to changing consumer habits). The annual transfer from the power revenue fund, which has traditionally represented approximately 5% of annual general fund revenues, is expected to contribute around 4% annually going forward under a negotiated agreement.

General fund revenues (particularly property taxes) were relatively resilient during the Great Recession, with solid post-recessionary growth. Historically, the city's general fund revenues have trailed national GDP but exceeded inflation. While both the city's multiyear projections and the controller's Mar. 2, 2020 revenue forecast for fiscal years 2020 and 2021 assumed ongoing general fund revenue growth in a healthy regional economy, current global economic concerns are going to adversely affect the city's revenues.

The impact on transient occupancy, business, and sales tax revenues will be felt swiftly, and the city has curtailed imposition of certain parking fines, thereby also reducing that revenue stream. City-owned revenue generating facilities such as the convention center and the zoo are closed.

If the economic downturn is sustained and adversely affects property values, the impact on property tax revenues, which are the largest source of general fund revenues, will not be seen for some time, giving the city a chance to make the necessary budgetary adjustments. However, some residents' ability to make time April 2020 property tax payments might be impaired. Similarly, businesses that have

not already paid their 2020 business taxes might now delay doing so. City officials advise that documentary transfer tax revenues have not yet declined due to low interest rates.

The city has an internal team focused on revenues and will call upon county revenue staff and external advisors for input to reformulate the city's financial and economic assumptions. Bi-weekly revenue monitoring is underway. Each of the city's revenue streams will likely rebound in a different way, depending on pent-up demand during the recovery period and the size of residents' discretionary incomes.

While the city's independent legal revenue-raising capacity is constrained by a variety of voter-approved state propositions, it is still satisfactory since fees, charges, and other locally-controlled revenues are a sizeable portion of the city's revenue stream. However, the city historically has been reticent to increase its fees and charges.

## EXPENDITURE FRAMEWORK

The city has demonstrated its ability to control expenditures. Between fiscal years 2009 and 2019, general fund expenditures and transfers out grew by 24% compared to 31% growth in general fund revenues and transfers in, despite a majority of general fund expenditures going to public safety (approximately 61% of general fund expenditures in fiscal 2019). Fitch anticipates that the city's spending growth will be roughly in line with, to marginally above, the city's revenue growth given rising employee salary and benefit costs and public demand for service enhancements. City officials expect that holding current vacancies open and maintaining the recently imposed hiring freeze and departmental expenditure reductions will help balance the fiscal 2021 budget. It remains an open question about how to close out-year general fund budget gaps. A major determinant will be the market's impact on pension system valuations. If sustained, the impact of the fair market value declines now being experienced will drive up reported net pension liabilities as of the city pension systems' fiscal 2021 audits. However, the hiring freeze will help control salary and benefit costs and the related pension and OPEB liabilities.

To date, city officials advise that few additional expenses have been incurred due to the coronavirus outbreak and there have been fewer fire and police calls due to the

"shelter-in-place" requirement. However, Fitch expects there will be increased expenditures on containment measures as the public health crisis unfolds.

To date, the city's financial status reports for fiscal 2020 have cited increased sworn and civilian employee remuneration, as well as unbudgeted costs related to wildfires, as the primary drivers of expenditure pressure. In light of the economic downturn, the city will be discussing potential spending adjustments with its bargaining units. The current contracts set out remuneration increases for fiscal 2021 but leave subsequent increases subject to negotiation. The city struggled to obtain labor concessions during the Great Recession and afterwards made little headway in obtaining greater labor contributions towards health care costs.

General fund expenditure flexibility is adequate given the city's modestly elevated debt, pension, and OPEB carrying costs at 21% of governmental expenditures (excluding debt, pension, and OPEB costs related to LADWP and other business-type activities). Fitch's supplemental pension metric, which assumes a 20-year level payoff of the Fitch-adjusted liability, indicates that even contributions at the actuarial level would likely be insufficient to reduce pension liabilities, meaning the contributions are likely to continue to rise. For more information, see "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)", dated May 31, 2017.

## LONG-TERM LIABILITY BURDEN

The city's long-term debt and pension liability burden is moderate at approximately 11% of personal income (excluding debt and pension costs related to LADWP and other business-type activities).

The vast majority of the debt burden is generated by overlapping jurisdictions outside of the city's control, in particular the Los Angeles Unified School District (Fitch IDR of 'A'/Negative Outlook) and the Los Angeles Community College District. The city has limited exposure to variable rate debt and no swap agreements are payable from the general fund.

Over the next two fiscal years, the city anticipates issuing general fund-supported new money bonds in amounts that are similar to the amount of outstanding bond principal rolling off each of those years. Consequently, Fitch expects the city's general fund-supported direct debt burden to remain low in the medium term. The fiscal 2020 budget was the first to program projects under the city's clean water action plan with revenues from a tax approved by voters specifically for that purpose. However, the city's estimated $7 billion share of Clean Water Act compliance projects over the next 24 years might necessitate additional bonding.

The city participates in two general fund-supported pension systems and makes its annual actuarially required contributions. (A third pension system covers LADWP employees.) Using its standard 6% discount rate, Fitch estimates the city's ratio of assets to liabilities at approximately 71%. The outstanding Fitch-adjusted net pension liability of $12.4 billion (excluding the liability related to business-type activities) represents about 44% of the city's general fund-supported liability profile.

The city's unfunded actuarial accrued OPEB liability (excluding liabilities related to LADWP and other business-type activities) is approximately $2.2 billion, low at less than 1% of personal income. The liability related to the city's two police overtime banks ($111 million) is holding steady as the city appropriates more funding for police overtime.

## OPERATING PERFORMANCE

The city has the highest level of gap-closing capacity. During the economic recovery from fiscal year 2012 to 2016, the city's general fund saw net operating surpluses after transfers, growing fund balances and reserves, and stronger liquidity. This was achieved in the face of increasing expenditures. After ongoing expenditure pressures resulted in a $143 million unrestricted general fund balance drawdown in fiscal 2017, the city resumed adding to its unrestricted general fund balance in fiscal years 2018 and 2019, resulting in a fiscal 2019 unrestricted general fund balance of just over $1 billion (18% of spending, equivalent to just over two months of general fund expenditures). Liquidity remained strong. The current economic downturn will likely upset the city's prior expectation that its general fund would end fiscal 2020 in balance. However, Fitch anticipates that the city will maintain a sufficient reserve safety margin for a 'aaa' financial resilience assessment throughout economic cycles.

On March 5, 2020, the city released its mid-year financial status report for fiscal 2020. That report projected overspending of $164 million, due primarily to increased labor costs generated by the city's new labor agreements and higher workforce numbers, unbudgeted costs associated with wildfires, and legal settlement costs. City officials recommended about $40 million in spending reductions and a further $38 million in potential future savings, leaving $86 million to be absorbed by departments and reserve funds. Expected revenue challenges for the remainder of fiscal 2020 are expected to make such balancing measures more difficult.

The city measures reserves in terms of its emergency, contingency, and budget stabilization reserves, plus its unappropriated general fund balance. Currently, the city estimates these cumulative reserves at just under 8% of the general fund budget. As noted above, Fitch measures reserves in terms of unrestricted general fund balance, which was 18% of spending in fiscal 2019.

The city's financial projections indicate operational imbalances in fiscal years 2020 through 2024, which the city expects to solve through a combination of revenue increases, expenditure reductions, and transfers from reserves. These operational imbalances could be exacerbated by revenue declines due to the coronavirus pandemic-related economic downturn, depending on the city's ability to commensurately reduce its expenditures.

## DEDICATED TAX KEY RATING DRIVERS

Developments That May, Individually or Collectively, Lead to Positive Rating Action

--City's IDR Upgraded: An upgrade of the city's IDR, along with continued strong solid waste resources fee revenue resilience and debt service cushion.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

--City's IDR Downgraded: A downgrade of the city's IDR.

--Unsustainable Debt Burden: Over-leveraging or an unexpectedly large decline in the number of residential properties paying the fee, both of which Fitch considers highly unlikely.

--Inadequate Fee Revenues: Failure of the city to raise the solid waste resources fee to the level needed to cover debt service and operational costs.

## DEDICATED TAX CREDIT PROFILE

Fitch does not consider that the pledged revenues clearly meet one of the definitions of 'special revenues' under Chapter 9 of the bankruptcy code. Therefore, the rating is capped at the city's 'AA' IDR.

The history of solid fee revenue growth is based largely on the city's ability to raise the solid waste resources fee, as demonstrated by strong 10-year CAGRs in recent years (ranging between 4% and 15% for the periods ending in fiscal years 2014 to 2017). The growth rate dropped to 4% and less than 2% in fiscal years 2018 and 2019, respectively, as the Bureau of Sanitation forestalled implementing a new rate increase until fiscal 2021 in order to draw down excess reserves. Nevertheless, the fiscal years 2018 and 2019 CAGRs remained above inflation.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis (-9%). As a flat fee collected as part of LADWP's bill, the pledged revenues have not been particularly sensitive to economic downturns, particularly given implementation of six fee increases during fiscal years 2004-2009. Two recent large fee revenue declines have been accounting artefacts, unrelated to economic shifts.

While bond repayment has first lien on fee revenues, the city's policy is to fund operational costs fully from that source. Therefore, Fitch does not expect the city to issue to the additional bonds test of 1.25x maximum annual debt service (MADS). Based on lowest projected coverage resulting from the city's plans of 2x MADS

(assuming no pledged revenue growth), debt service would still be covered with a 50% drop in fee revenues, 18x the scenario results and almost 6x the largest actual revenue decline in the review period. Fitch considers this level of resilience consistent with a 'aaa' assessment.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

## ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

## RATING ACTIONS

| ENTITY/DEBT | RATING |
|---|---|

| ENTITY/DEBT | RATING | | |
|---|---|---|---|
| Los Angeles (CA) [General Government] | LT IDR | AA | Affirmed |
| • Los Angeles (CA) /General Fund Contractual Obligations - Judgment/1 | LT | AA- | Affirmed |

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

## APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria – Effective January 10, 2020 to March 27, 2020 (pub. 10 Jan 2020) (including rating assumption sensitivity)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Los Angeles (CA) | EU Endorsed |
| Municipal Improvement Corporation of Los Angeles (CA) | EU Endorsed |

## DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING https://www.fitchratings.com/site/dam/jcr:6b03c4cd-611d-47ec-b8f1-183c01b51b08/Rating%20Definitions%20-%203%20May%202019%20v3%206-11-19.pdf DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

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US Public Finance North America United States

**Attachment 3**

**Kroll Bond Rating Agency, City of Los Angeles Surveillance Report, April 13, 2020**

# City of Los Angeles, CA

| Issuer: City of Los Angeles, CA | | |
|---|---|---|
| **Affirmed** | **Rating** | **Outlook** |
| General Obligation Bonds | AA+ | Stable |

**Methodology:**

**U.S. Local Government GO Methodology**

**Analytical Contacts:**

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**Rating Summary:** The City of Los Angeles' (the "City") general obligation bond rating reflects KBRA's view of the City's solid credit fundamentals and favorable trends pertaining to the City's finances and municipal resource base. Also reflected is KBRA's view that the City is relatively well positioned to weather the near to medium term challenges brought by the global COVID-19 pandemic. As of June 30, 2019, the City has $835 million GO debt and $1.5 billion lease revenue bonds outstanding.

This review incorporates information from the City's recently released fiscal year 2019 comprehensive financial statement (CAFR) and the City Administrative Officer's FY 2020 Mid-Year Financial Status Report[1] (Mid-Year FSR), the Mayor's "Belt-Tightening" Measures memo[2], as well as updated municipal resource base data. In light of the COVID-19 pandemic, KBRA closely examined the City's reserves and liquidity levels in addition to the recent performance of economically sensitive revenue sources.

KBRA considers the City's management structure and policies as continuing to provide a very strong framework for managing financial operations. The City has a track record of maintaining balanced operations, which, combined with conservative fund balance and debt management policies, provides the City with flexibility in the event of unexpected expenditure needs and adverse economic conditions such as those that have emerged due to the COVID-19 crisis.

Strong FY 2019 operational results allowed the City to build reserves. Unassigned general fund balance remains above 10% of expenditures and cash on hand exceeded 200 days for the sixth consecutive year. Moreover, the City's liquidity level as of FYE 2019 is the highest of the last five years. Based on the FY 2020 Mid-Year FSR, the City has a total of $519.9 million in reserves, equivalent to 7.92% of general fund revenues. While the COVID-19 crisis will cause budgetary challenges, KBRA views the City's sizable reserves, conservative budget practices, and ability to cut expenses as providing important flexibility for managing the City's budget. The estimated Coronavirus Aid, Relief, and Economic Security (CARES) Act funding available to the City is $670.4 million per the Legislative Analyst's Office[3] and does not adjust for overlapping jurisdictions.

The City's municipal resource base is among the broadest and most diverse in the country and the underlying economy has experienced a trend of steady expansion over the past decade. KBRA anticipates that the COVID-19 crisis and social distancing measures will have a significant negative impact on the City's economically sensitive revenues. While it is too early to fully assess the impact, KBRA notes that the City economy demonstrated resilience through the Great Recession and anticipates that less volatile elements of the City's revenue structure including property taxes (nearly 37% of FY 2019 General Fund revenues) will serve to moderate the revenue impact at least over the near term. KBRA will monitor the unfolding impact of the crisis on the City and will revise its assessment as warranted with the availability of relevant new information.

The City's direct debt burden is equivalent to 2.6% of the assessed value (AV) or about $4,041 per capita. Over the last decade, the City has funded the full actuarially determined contribution (ADC) for its pension plans and other post-employment benefits (OPEB). As a result, the fixed cost burden is sizable at 26% of total governmental expenditures. KBRA, however, views the City's disciplined approach to sustainably managing contingent liabilities, rather

| City of Los Angeles, CA | |
|---|---|
| Income Per Capita (2018) ($) | $35,089 |
| *as a % of U.S.* | *104%* |
| Population (2018) | 3,990,469 |
| *Growth 2010 to 2018* | *5.2%* |
| 2019 Assessed Value ($000) | 608,927,693 |
| General Fund Days Cash on Hand (FYE 2019) | 221 |
| Unassigned Fund Balance as a % of GF Expenditures | 13.4% |
| Fixed Costs as a % of Governmental Expenditures (2019) | 26.0% |
| Total Budgetary Reserve Balance Mid-Year FSR 2020 ($ millions) | $519.9 |
| % of General Fund Revenues | 7.91% |

[1] Released on March 6, 2020. The Mid-Year FSR is the City's latest financial disclosure on a budgetary basis.
[2] Released on March 19, 2020. This memo directs all City departments reduce costs for FY 2020.
[3] https://lao.ca.gov/Publications/Report/4217

than deferring such costs, as a distinguishing credit characteristic that is supportive of the City's long-term operating flexibility.

The Stable Outlook reflects KBRA's expectation that the City will continue to manage its finances effectively during and after the COVID-19 crisis. KBRA expects the City to close its FY 2020 budget through a combination of aggressive expenditure cuts and draw on reserves for operations under the extraordinary circumstance triggered by the COVID-19 pandemic. KBRA also expects that the City will continue to fund its pension and OPEB obligations on an actuarial basis.

## Key Credit Considerations

KBRA continues to monitor the direct and indirect impacts of the COVID-19 virus on the U.S. Local Government General Obligation sector. Please refer to our publication **KBRA Monitors COVID-19 Credit Impact by Sector** for more detail.

The rating was affirmed because of the following key credit considerations:

Credit Positives

- Experienced leadership team, well-established financial management practices, and demonstrated history of proactive fiscal controls are evidenced by consistent financial strength, stable reserves, and strong liquidity.
- Manageable debt burden with minimal exposure to variable rate debt and no exposure to interest rate swaps.
- The City has a substantial tax base, a diverse economy, and is the second largest city in the U.S. by population.

Credit Challenges

- Reliance on economically sensitive revenue sources to fund operations. These revenue sources are currently under pressure by the COVID-19 pandemic. The duration and severity of the impact of the current recession will present considerable challenges to the City's management team.
- Due to the recent downward revision of investment return assumptions used by the two City pension systems, increasing annual pension costs will likely outpace near term growth of overall governmental resources.
- New labor agreements for a substantial portion of the City's workforce will pressure near term spending.

## Rating Sensitivities

| | |
|---|---|
| • Trend of surplus operations and growth in unassigned general fund balance.<br>• Significant increase in pension and OPEB funding ratios. | + |
| • Trend of structural imbalance leading to significant decline in available fund balance and operating reserves.<br>• Significant decline in funding progress with respect to the City's pension and OBEB obligations.<br>• Weak economic recovery following the COVID-19 crisis resulting in significant and permanent revenue reductions. | - |

## ESG Considerations

When relevant to credit, ESG factors are incorporated into the credit analysis in the same manner as all other credit-relevant factors. Among the ESG factors that have impact on this rating analysis are:

Among the ESG factors that have impact on this rating analysis are:

- Discussions in RD 1 and 2 reflect Governance Factors. KBRA considered the City's overall management and policy practice, budgetary planning and control, long-term planning, as well as its commitment to fund pension and OPEB liabilities.
- Discussions in RD 2 reflect Environmental Factors. The City has had a "Sustainable City pLAn" since 2015. It is the City's efforts toward green job creation, and the issuance of Green Bonds for improvements to the City's wastewater system. The City is also committed to reduce and prevent homelessness by utilizing funding approved by voters.
- Discussions in RD 4 reflect Social Factors. KBRA has examined the City's trends in population, income levels, poverty, employment trends, and the potential impact of the COVID-19 pandemic.

More information on ESG Considerations for the Public Finance sector can be found **here**.

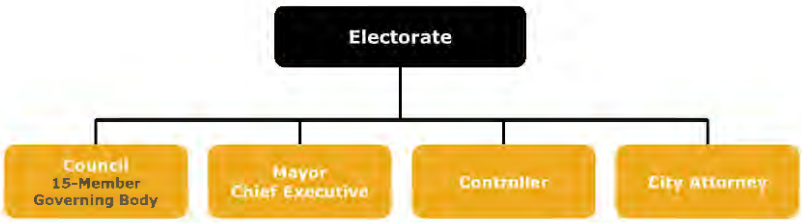
| Rating Determinants (RD) | |
|---|---|
| 1. Management Structure and Policies | AA+ |
| 2. Debt and Additional Continuing Obligations | AA |
| 3. Financial Performance and Liquidity Position | AA+ |
| 4. Municipal Resource Base | AA+ |

## RD 1: Management Structure and Policies

KBRA views the City of Los Angeles' organizational structure and financial management policies and procedures as providing a strong framework for managing the City's financial operations. The City's management structure is supported by an experienced management team. The City monitors its financial operations on an ongoing basis and reports on its budget-to-actual performance on a quarterly basis. The City's governing body meets quarterly to discuss historical performance and review budget adjustments to maintain structural balance.

The City operates under a mayor-council form of government (Figure 1). The Mayor, City Controller, and City Attorney are elected every four years. The fifteen-member Council is elected by fifteen separate council districts for staggered four-year terms.

**Figure 1**




The current mayor, Eric Garcetti, was elected to serve his first term starting in July 2013. He won re-election with over 81% of votes in March 2017 and is serving his second term for five and a half years[4] ending 2022. The Mayor, the City Attorney and the City Controller, took office in March of 2017.

The City Treasurer and the City Administrative Officer (CAO) are appointed by the Mayor and confirmed by the Council. The City operates under a city charter. The State Constitution gives all its cities and counties the power to become charter cities and gives all citizens the power to amend their charters through initiative and referendum.

The Mayor supervises the administrative process and works with the City Council ("the Council") for matters of legislation, budget and finance. The CAO is the chief fiscal manager and reports directly to the Mayor and the Council. Under the Garcetti administration, the City has instituted additional performance management measures. Under the new system, departments within the City are required to submit performance metrics in connection with the submission of budget funding requests. The Mayor's office works with the departments to ensure that appropriate and accurate data is collected for measuring performance.

The Council is the legislative body of the City and enacts and executes ordinances subject to Mayoral approval. Additionally, the Council levies taxes, authorizes public improvements, and approves contracts among other key functions.

### Comprehensive Budgeting and Forecasting Process

The City's fiscal year starts on July 1 and runs through June 30 of the following year. The Budget is based on mayoral budget priorities. The Controller's Revenue Forecast Report utilizes revenue projections from various city departments and economic forecasts from local economists including Beacon Economics, Krueger Economics, and the UCLA Anderson School of Management. The purpose of the revenue forecast report is to project revenue and estimate annual debt service requirements, cash flow and possible borrowing needs. The City is statutorily required to maintain a balanced budget which can include transfers from reserves and/or one-time solutions from year to year. KBRA views the City's inclusion of multiple sources of revenue forecasts and detailed revenue estimates positively.

The CAO prepares a multi-year budget outlook based on existing budgets and projections of new revenues and expenditures. The budget outlook helps identify future budget challenges and allows for earlier implementation of budget adjustments through the annual budget process or interim action. The budget outlook is updated annually with the preparation of the annual budget and informed by adjustments to the budget throughout the year.

[4] The mayor normally serves a four-year term. In 2017, the City changed its election calendar to better align with the California statewide election.

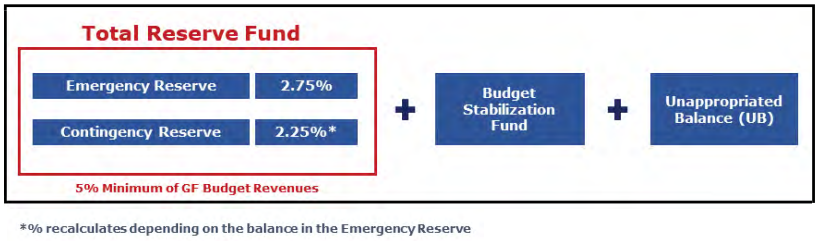
Historically, during the fiscal year, the CAO has provided four to five financial status reports (FSRs) to the Mayor and Council. The FSRs provide updates on the current-year budget including projected department deficits, trends in revenues, and the reserve fund, as well as current issues of concern, the potential impact to the City and recommended budget adjustments. The FSRs are referred to the Council's budget and finance committee for consideration and are subject to final review by the full Council and the Mayor. Over the last five years, the CAO has also submitted strategic reports to inform the Mayor and the Council on the City's long-term fiscal condition, which provide a review of expenditure factors and management recommendations. KBRA views the City's process of monitoring its financial performance, as well as its ability and willingness to actively adjust the budget within the current fiscal year as a key success factor in managing the City's finances.

## Reserve Policy

The City charter establishes a reserve fund, which is required to have a total balance equal to no less than 5% of budgeted GF revenue. The reserve fund, which is included in the general fund's unassigned fund balance, consists of two sub-funds, the emergency reserve fund and a contingency reserve (Figure 2). The emergency reserve can be used in the event of urgent economic necessity as identified by the Mayor and Council and is replenished in the subsequent financial year.

**Figure 2**

**Total Budgetary Balance**




In addition, the City Charter also provides for the maintenance of an additional reserve in the form of a Budget Stabilization Fund (BSF). The BSF was established in 2009 and is funded during times of economic growth to provide liquidity during subsequent downturns. When the aggregate growth of seven economically sensitive general fund tax categories[5] exceeds the growth threshold rate[6], the City may deposit such funds into the Budget Stabilization Fund. If the growth of cumulative receipts falls below the growth threshold rate, the Budget Stabilization Fund may be used to offset a portion of the lost revenue. The City Council and Mayor can suspend the policy in a fiscal emergency or otherwise find that it is in the interest of the City to do so. The BSF balances are limited exclusively to cover non-recurring expenditures.

The Unappropriated Balance Fund (UB) is a budgetary fund which includes reserves set aside to address budgetary contingencies as they arise throughout the budget year.

KBRA considers the City's reserve policies as providing a strong framework for maintaining operating flexibility and managing unforeseen budget pressures.

## Self-Insurance

The City maintains a self-insurance program for its general liability risks and its worker's compensation risks. While self-insurance of these areas represents some risk to the City, KBRA notes that the City has generally budgeted sufficient funds to manage claims based on historical experience.

In FY 2019, the City budgeted in the General Fund $80 million and $20 million in UB for liability claims and actual claim payments equaled $103.3 million. The City budgeted in the General Fund $80 million for liability claim payments in FY 2020 and has additionally set aside $20 million in the UB for extraordinary liabilities.

## Insurance for Natural Disasters

The City's exposure to unpredictable but potentially significant seismic activity is underscored as a perennial risk. The City does not maintain earthquake insurance coverage on its public buildings and City management has stated that the City would rely on its general reserves and additional funds from the Federal Emergency Management Agency (FEMA) to manage potential costs that could arise from this risk.

[5] The seven economically-sensitive revenue sources are: property tax, utility users' tax, business tax, sales tax, transient occupancy tax, documentary transfer tax, and parking users' tax.

[6] The growth threshold rate is based on the previous 20 years of growth. It is recalculated annually and approved by the City Council and Mayor. It was set at 3.4% this year.

### Bankruptcy Assessment

KBRA reviews the statutory framework regarding municipal bankruptcy and the state's existing statutes governing state assistance for fiscally distressed municipalities. It is KBRA's understanding that according to bankruptcy provisions in the State of California, local governments, including counties, cities, districts, public authorities, public agencies and other municipal entities, are generally allowed to file for relief under Chapter 9. While local governments within the State are granted broad authority to file Chapter 9, California Government Code sections 53760-53760.9 requires cities, counties, and special districts, to first attempt to resolve their fiscal problems with creditors, employee groups and other interested parties through a mediation process or to declare a fiscal emergency before they may file a petition for relief under the U.S. Bankruptcy Code. Given the strength of the City's management and its strong financial condition, KBRA views the risk that the City will access the process to file for bankruptcy as remote.

### ESG Efforts

The City of Los Angeles has been proactive in its efforts to address social and environmental issues. In 2015, the City developed the Sustainable City pLAn (the "Plan"), which is a 20-year framework to prepare the City for climate change issues and mitigate the adverse impact of climate change on the City's economy, infrastructure, and communities. Some of the City's goals are to supply all renewable energy by 2045, source 70% of water locally by 2035, convert all City's fleet vehicles to zero-emission by 2028, and reduce GHG emission and reach carbon neutral by 2045.

The City aims to create 400,000 green jobs by 2050. Additionally, it intends to ensure a third of the new housing units are built around public transit by 2035 to encourage the use of mass transit system.

The City's commitment to ESG efforts is also reflected by its issuance of Green Bonds in 2015, 2017, and 2018 for its wastewater system and GO bonds to address homelessness in 2018 using property taxes approved by voters under Proposition HHH.

## RD 2: Debt and Additional Continuing Obligations

KBRA views the City's overall debt and continuing obligations profile as strong based upon a low direct debt burden and a history of both full actuarial contributions, and good funding progress with respect to both pension and OPEB commitments.

### Debt Management

The City's GO bonds are payable from ad valorem taxes levied without limitation as to rate or amount upon all City property subject to taxation. The City may issue GO bonds subject to a two-thirds voting majority of the electorate. The City additionally adheres to a formal debt management policy which sets forth certain guidelines and procedures intended to ensure the issuance of debt on a prudent and sustainable basis. Per the policy, debt service on non-voter approved direct debt may not exceed 6% of general revenues.

Debt service on direct debt, inclusive of both voter-approved and non-voter approved debt, may not exceed 15% of general revenues. The debt burden has declined from 9.42% of general revenues in 2011 to an estimated 5.9% in FY 2020 leaving substantial available capacity for the issuance of additional debt going forward. The policy also designates a target of amortizing 50% of all outstanding principal within 10 years, which provides rolling availability of additional debt capacity.

The City revised its debt management policy in 2019 to better align with the City's ESG initiatives and priorities. Updated provisions clarify the City's policies to: 1) allow the exclusive application of green/social bonds proceeds to be used on environmental/social projects, 2) meet disclosure requirements on green/social bonds reporting, 3) hire a third party to provide an opinion, verification, or certification for bonds with a special designation, 4) commit to file additional disclosures to bonds with other special designations.

## Overall Direct and Overlapping Debt

As of FYE 2019, the City has $2.8 billion in direct debt outstanding (Figure 3).

**Figure 3**

| Direct Debt Outstanding as of June 30, 2019 | |
|---|---|
| Direct Debt Type | Amount Outstanding (dollars in millions) |
| Voter-Approved General Obligation Bonds | 835 |
| Judgement Obligation Bonds | 6 |
| MICLA COPs and Lease Obligations | 1,505 |
| Special Assessments - Solid Waste | 224 |
| Commercial Paper Notes | 190 |
| **Total Direct Debt** | **2,760** |

*Source: City of Los Angeles, CA*

Total direct debt amortization, excluding the CP notes, is rapid, with approximately 71% of principal set to amortize over the next decade. The City's overlapping debt burden, inclusive of the City's allocable share of debt issued by overlapping entities is low, in KBRA's view, at 2.6% of assessed value or $4,041 per capita (Figure 4).

**Figure 4**

| Debt Ratios<br>Debt Outstanding as of June 30, 2019 | |
|---|---|
| **KBRA Metric** | **Ratio** |
| Overall direct and indirect debt per capita | $4,041 |
| Overall debt as % of assessed value of property | 2.6% |
| Debt amortization within 10 years | 71% |
| Debt amortization within 20 years | 100% |
| FY 2020 Direct debt service as a % of total governmental expenditures | 26.0% |

*Source: City of Los Angeles, CA*

The City's FY 2020 direct debt service, excluding commercial paper notes, is estimated at $450 million, which is equivalent to a low 5.2% of FY 2019 governmental expenditures. The City's amortization schedule is front-loaded with declining debt service scheduled though final maturity in 2042.

The City annually issues tax and revenue anticipation notes (TRANs) to manage cash flow and voluntarily prefund a portion of its annual pension commitments prior to the receipt of certain inflows. Such borrowings, which are repaid within the then current fiscal year, have grown gradually from about $1.20 billion in FY 2012 to $1.66 billion in FY 2019. The increased cash flow borrowing over this period reflects escalation in the City's annual pension contribution while the range of borrowing for operating cash flow support has generally been stable. The City is in the process to determine the issuing size of the FY 2020/2021 TRANs borrowing pending the very volatile revenue collections from March to May.

## Pensions

The City provides defined benefit pension benefits to qualifying employees through three single-employer plans including (i) the Los Angeles Fire and Police Pension Plan (LAFPP), (ii) the Los Angeles City Employees' Retirement System (LACERS), and (iii) the Water and Power Employees' Retirement Plan (WPERS). The funded status for each of the plans as of the latest measurement date and the City's contribution in FY 2019 are summarized in Figure 5.

**Figure 5**

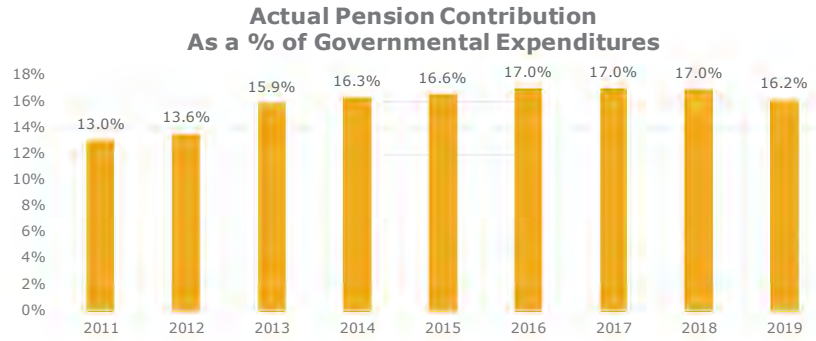
**Pension Funding Status and Annual Contributions**
**($ in millions)**

| | As of June 30, 2019 | | | | FY 2019 | | |
|---|---|---|---|---|---|---|---|
| | Total Pension Liability | Fiduciary Net Position | Net Pension Liability (NPL) | Fiduciary Net Position as a % of Total Pension Liability | Actual Contribution | Actuarially Determined Contribution (ADC) | Actual Contribution as a % of ADC |
| **Fire and Police (LAFPP)** | 21,737 | 20,482 | 1,255 | 94.2% | 505 | 505 | 100.0% |
| **City Employees' (LACERS)** | 19,945 | 14,235 | 5,709 | 71.4% | 479 | 479 | 100.0% |
| **Water and Power Employees' (WPERS)** | 13,188 | 12,010 | 1,178 | 91.1% | 410 | 409 | 100.3% |
| **Total** | **54,869** | **46,727** | **8,142** | **85.2%** | **1,394** | **1,392** | **100.1%** |

*Source: City of Los Angeles | Actuarial Valuation Reports of respective pension funds*

In aggregate, the fiduciary net position of the three plans is equivalent to approximately 85% of the City's total pension liability. The City has contributed amounts close to the full actuarially determined contribution (ADC) in each of the last ten years. The $1.39 billion contributed to the plans in FY 2019 represents an increase of 3.8% YOY. Pension contributions represented 16.2% of governmental expenditures in FY 2019, down from 17.0% in the prior year (Figure 6).

**Figure 6**




*Source: City of Los Angeles | Actuarial Valuation Reports of respective pension funds*

Annual contributions are expected to ramp-up due to a revision in the investment return assumption utilized by LAFPP and LACERS to 7.25% from 7.50%. This changed assumption will result in increased annual contribution requirements going forward, placing some pressure on the City's budgetary balance in the near term. The FY 2020 adopted budget includes a $149 million YOY increase in appropriations toward the two plans due in part to revisions to the investment return and other actuarial assumptions.

## Other Post-Employment Benefits

The City also provides other post-employment benefits (OPEB) to qualifying employees through single-employer OPEB plans associated with the aforementioned pension plans. Contributions to the OPEB plans are funded by both the employer and employees. As shown in Figure 7, the three plans in the aggregate are funded at a level of approximately 70.5% resulting in a net OPEB liability of $2.8 billion. KBRA views this level of prefunding very positively, given that many local governments fund such obligations on a pay-as-you-go basis.

The City has contributed amounts approximating the ADC of the OPEB plans in nearly all of the last ten years, resulting in rising funded levels. The total contribution in FY 2019 was $399 million marking an increase of approximately 6.4% YOY. This contribution constituted 4.6% of governmental expenditures in FY 2019, which is in line with contributions over the last decade.

**Figure 7**

**OPEB Funding Status and Annual Contributions**
**($ in millions)**

| | As of June 30, 2019 | | | | FY 2019 | | |
|---|---|---|---|---|---|---|---|
| | Total OPEB Liability | Fiduciary Net Position | Net OPEB Liability (NOL) | Funded Ratio | Actual Contributions | Actuarially Determined Contribution (ADC) | Actual Contribution as a % of ARC |
| **Fire and Police (LAFPPS Health Subsidy Plan)** | 3,588 | 1,878 | 1,710 | 52.3% | 188 | 188 | 100.0% |
| **City Employees' (LACERS Postemployment Plan)** | 3,257 | 2,676 | 580 | 82.2% | 108 | 103 | 104.6% |
| **Water and Power Employees' (WPERS Health Benefits Plan)** | 2,613 | 2,113 | 500 | 80.9% | 103 | 82 | 125.1% |
| **Total** | **9,458** | **6,668** | **2,791** | **70.5%** | **399** | **373** | **106.8%** |

*Source: City of Los Angeles | Actuarial Valuation Reports of respective pension/OPEB funds*

Total fixed costs of the City are high at 26.0% of total governmental expenditure, but this partly reflects the City's disciplined approach to sustainably managing contingent liabilities. While many local governments have responded to similar rising cost pressures by deferring full actuarial funding of their pension and OPEB obligations, Los Angeles has consistently maintained full actuarial contributions to both pension and OPEB commitments over the last decade while maintaining a conservative portfolio of bonded debt. Although the City's finances may be pressured by cost increases in the near-term relating to its pensions, KBRA views the City's willingness to address rather than defer rising costs as a distinguishing credit characteristic that has served to sustain the City's strong financial flexibility over time.

## RD 3: Financial Performance and Liquidity Position

KBRA reviewed the City's FY 2019 audit and continues to view the City's financial management practices and results as very strong. The strong operating performance in FY 2019 provides a favorable cushion for the City to navigate the challenges brought by the COVID-19 pandemic crisis. As various revenue sources are expected to experience significant downward pressure over an uncertain period of time, the City will need to identify savings and execute mid-year budget adjustments to steer its fiscal ship on course.

On March 19, 2020, Mayor Garcetti placed a "belt-tightening" order, which requires citywide departments to cut expenditures drastically to preserve the City's core functions as well as manage the unknown impact of COVID-19 on the City's operations. While the City's CAO is coming up with a plan to make mid-year budget adjustments, an important takeaway from the Mid-Year FSR, the City's latest budgetary disclosure, is that the City has almost $520 million in reserves (over 7.92% of general fund revenue) in place and can be used for operations.

Moreover, as of June 30, 2019, the City's total governmental fund cash position was $5.2 billion, which is available for general purposes. This figure includes cash and pooled investments, cash deposits, and other short-term investments that have maturities of less than three months. This level of liquidity equates to 221 days' cash, which KBRA considers very strong.

KBRA notes that a strong liquidity position is crucial to managing the impact of the COVID-19 crisis. The City's management team is confident that it has sufficient liquidity on hand for the remainder of the fiscal year. Based on discussion with management, the City will take necessary actions to close any budget gaps that arise in FY 2020. Additionally, the City will closely monitor revenue collections from March through June to inform the development of a realistic and conservative budget for FY 2021 and its 2021 TRANs borrowing needs.

## Audited FY 2019 Operating Results

As a result of strong growth in revenues and a small increase in expenditures, the general fund recorded a healthy operating surplus of $540 million in FY 2019. Inclusive of recurring below-the-line transfers, the net change in general fund balance equaled $163 million (Figure 8). The total unassigned general fund balance increased by $110 million to $683 million in FY 2019, representing a healthy 13.4% of general fund expenditures. The City's balance sheet is shown in Figure 9.

In KBRA's view, the City's historical use of conservative budget assumptions has fostered a pattern of frequently achieving better than budgeted year-end results.

**Figure 8**

**City of Los Angeles, CA**
**INCOME STATEMENT - General Fund ($ in Million)**

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Property Tax | 1,612 | 1,708 | 1,858 | 1,958 | 2,076 |
| Sales Tax | 373 | 438 | 522 | 534 | 596 |
| Other Taxes | 1,813 | 1,809 | 1,799 | 1,865 | 1,953 |
| **Total Tax Revenues** | **3,797** | **3,955** | **4,179** | **4,357** | **4,625** |
| *YOY % Chg* | *4.0%* | *4.2%* | *5.7%* | *4.3%* | *6.2%* |
| Licenses & Permits | 23 | 33 | 37 | 39 | 34 |
| Fines & Forfeits | 156 | 152 | 147 | 141 | 136 |
| Charges for Services | 617 | 636 | 572 | 632 | 633 |
| Intergovernmental Revenue | 39 | 21 | 15 | 18 | 23 |
| Other Rev | 375 | 97 | 57 | 63 | 186 |
| **General Fund Revenues** | **5,007** | **4,893** | **5,008** | **5,250** | **5,637** |
| *YOY % Chg* | *4.6%* | *-2.3%* | *2.3%* | *4.8%* | *7.4%* |
| **Expenditures** | | | | | |
| General Government | 1,333 | 1,316 | 1,357 | 1,333 | 1,336 |
| Public Safety | 2,772 | 2,798 | 2,874 | 2,964 | 3,095 |
| Public Works | 171 | 112 | 268 | 186 | 194 |
| Health, Social Services & Sanitation | 174 | 131 | 88 | 96 | 112 |
| Culture & Recreation | 55 | 58 | 12 | 62 | 61 |
| Capital Outlay | 30 | 46 | 23 | 28 | 110 |
| Debt Service | 2 | 5 | 10 | 14 | 24 |
| Other Expenditures | 154 | 108 | 209 | 158 | 162 |
| **General Fund Expenditures** | **4,691** | **4,575** | **4,841** | **4,841** | **5,094** |
| *YOY % Chg* | *7.2%* | *-2.5%* | *5.8%* | *0.0%* | *5.2%* |
| **General Fund Surplus (Deficits)** | 316 | 318 | 166 | 409 | 543 |
| Transfers In | 302 | 350 | 298 | 277 | 266 |
| Transfers Out | 573 | 601 | 603 | 643 | 724 |
| Other Sources | | | | | 78 |
| **Net Transfers & Other** | **-271** | **-251** | **-305** | **-366** | **-380** |
| **Net General Fund Surplus (Deficit)** | 45 | 67 | -139 | 43 | 163 |
| **Fund Bal - Beginning** | **901** | **961** | **1,025** | **886** | **943** |
| **Fund Bal - Ending** | **946** | **1,028** | **886** | **929** | **1,106** |
| *Unassigned Fund Balance as a % of General Fund Expenditures* | *13.8%* | *12.9%* | *10.9%* | *11.8%* | *13.4%* |
| Unassigned General Fund Balance | 648 | 590 | 527 | 573 | 683 |
| Total Gov't Liquidity (DCOH) | 206 | 210 | 215 | 205 | 221 |

*Source: City of Los Angeles, CA CAFR*

**Figure 9**

| City of Los Angeles, CA<br>BALANCE SHEET - General Fund ($ in Millions) | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash & Investments | 1,084 | 1,136 | 1,138 | 1,059 | 1,292 |
| Taxes Receivable, Net | 554 | 750 | 651 | 669 | 676 |
| Other Receivables | 278 | 262 | 261 | 267 | 277 |
| Due from Other Funds | 51 | 110 | 69 | 115 | 84 |
| Other Assets | 42 | 44 | 45 | 42 | 55 |
| Total Assets (excluding Deferred Outflows) | 2,009 | 2,301 | 2,164 | 2,152 | 2,384 |
| Deferred Outflows of Resources | | | | | |
| **Total Assets** | **2,009** | **2,301** | **2,164** | **2,152** | **2,384** |
| **Liabilities** | | | | | |
| Accounts Payable | 70 | 77 | 88 | 83 | 93 |
| Deferred Revenue | | | | 1 | 2 |
| Due to Other Funds & Component Units | 48 | 85 | 90 | 133 | 142 |
| Due to Other Governments | | | | | |
| Other Liabilities | 353 | 420 | 485 | 389 | 381 |
| Total Liabilities (excluding Deferred Inflows) | 471 | 581 | 664 | 607 | 618 |
| Deferred Inflows of Resources | 593 | 692 | 614 | 616 | 660 |
| **Total Liabilities** | **1,063** | **1,273** | **1,278** | **1,223** | **1,278** |
| **Fund Balance** | | | | | |
| Nonspendable | 42 | 44 | 45 | 42 | 55 |
| Restricted | | | | | |
| Committed | 2 | 1 | 10 | 25 | 33 |
| Assigned | 253 | 392 | 304 | 289 | 334 |
| Unassigned | 648 | 590 | 527 | 573 | 683 |
| **Total Fund Balance** | **946** | **1,028** | **886** | **929** | **1,106** |
| **Total Liabilities & Fund Balance** | **2,009** | **2,301** | **2,164** | **2,152** | **2,384** |

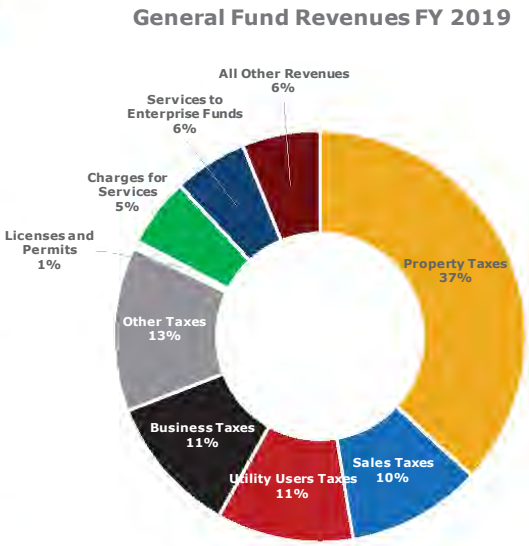
*Source: City of Los Angeles, CA CAFR*

Shown in Figure 10, the City's general fund revenues grew at a compound annual growth rate (CAGR) of 3% between FY 2015 and FY 2019 (Figure 10). Overall revenue growth was primarily driven by the seven economically sensitive revenues : (i) property tax, (ii) sales tax, (iii) utility users' tax, (iv) business tax, (v) transient occupancy tax[7], (vi) documentary tax[8], and (vii) licenses and permits revenues. KBRA expects that the COVID-19 crisis will adversely impact many of these revenues. Although the impact on property taxes may be milder than transient occupancy tax, business taxes, and sales tax, the City's revenue will likely miss its budget projections in FY 2020. The severity of such impact cannot be quantified currently. Non-economically sensitive revenues represented approximately 17% of general fund revenues, comprising of charges for services, services to enterprise funds, and other revenues comprised.

**Figure 10**

| 5 Year Trend of Major General Fund Revenue Items ($ in Millions) | 2015 | 2016 | 2017 | 2018 | 2019 | CAGR |
|---|---|---|---|---|---|---|
| * Property Taxes | 1,612 | 1,708 | 1,858 | 1,958 | 2,076 | 6.5% |
| *YOY % Chg.* | *4.6%* | *6.0%* | *8.8%* | *5.4%* | *6.0%* | |
| * Sales Taxes | 373 | 438 | 522 | 534 | 596 | 12.5% |
| *YOY % Chg.* | *4.3%* | *17.4%* | *19.2%* | *2.3%* | *11.7%* | |
| * Utility Users Taxes | 637 | 615 | 611 | 641 | 606 | -1.2% |
| *YOY % Chg.* | *0.9%* | *-3.5%* | *-0.6%* | *4.8%* | *-5.4%* | |
| * Business Taxes | 501 | 508 | 546 | 535 | 617 | 5.4% |
| *YOY % Chg.* | *5.0%* | *1.4%* | *7.7%* | *-2.1%* | *15.4%* | |
| * Other Taxes | 553 | 586 | 642 | 689 | 730 | 7.2% |
| *YOY % Chg.* | *5.8%* | *6.1%* | *9.4%* | *7.3%* | *5.9%* | |
| * Licenses and Permits | 23 | 33 | 37 | 39 | 34 | 10.9% |
| *YOY % Chg.* | *0.8%* | *44.8%* | *13.5%* | *4.4%* | *-11.9%* | |
| Charges for Services | 617 | 318 | 243 | 316 | 306 | -16.1% |
| *YOY % Chg.* | *13.5%* | *-48.4%* | *-23.6%* | *29.8%* | *-3.0%* | |
| Services to Enterprise Funds | 273 | 317 | 329 | 316 | 327 | 4.6% |
| *YOY % Chg.* | *7.8%* | *16.1%* | *3.5%* | *-3.7%* | *3.3%* | |
| All Other Revenues | 419 | 370 | 220 | 222 | 344 | -4.8% |
| *YOY % Chg.* | *-4.8%* | *-11.7%* | *-40.6%* | *1.2%* | *55.0%* | |
| **Total Revenues** | **5,007** | **4,893** | **5,008** | **5,250** | **5,637** | **3.0%** |
| *YOY % Chg.* | *4.6%* | *-2.3%* | *2.3%* | *4.8%* | *7.4%* | |
| **Total Economically Sensitive Revenues** | **3,698** | **3,887** | **4,216** | **4,395** | **4,660** | **6.0%** |
| | *4.1%* | *5.1%* | *8.5%* | *4.3%* | *6.0%* | |

*Source: City of Los Angeles, CA CAFR*




[7] Shown as other taxes
[8] Shown as other taxes

General fund expenditures grew at a 2.1% CAGR between FY 2015 and FY 2019 (Figure 11). Public safety has been the largest cost driver. Public safety expenditures increased at a 2.8% CAGR over the last five years due primarily to contractual wage increases and rising pension costs. Growth in public safety costs have moderated over the last two years but have represented an increasing portion of overall spending over the last decade, and KBRA notes that disciplined management of these costs will be critical to maintaining structural balance in the future.

Labor contracts associated with nearly three-quarters of City workers including uniformed police, expired on June 30, 2018. New terms were reached earlier this year. The City is working to update its payroll system to reflect the new contract terms but has not finalized its assessment of the budgetary impact for the current 2020 fiscal year. Projections from the Third FSR Report of 2020 estimate $17.8 million in unbudgeted Fire Department salary adjustments this year due to the new agreements but estimates for excess spending due to new labor agreements in other Departments are not identified.

In recent years, liability claim payouts have weighed on operating performance. The City administers the litigation and settlement of claims and budgets for payouts year to year based on historical trends and anticipated resolutions. In FY 2019, the City paid $109.1 million in liability claims and budgeted $110.5 million for FY 2020.

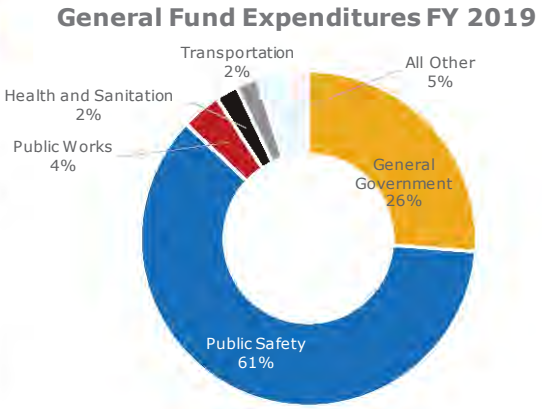
Note that general fund below-the-line adjustments included inflows of the DWP power transfer ($232.6 million), recurring outflows for debt service on MICLA bonds ($239.9 million), and operating subsidies to various nonmajor governmental funds ($484.2 million). The general fund's financial flexibly was very strong at FYE 2019 at $683 million or 13.4% of expenditures. As a result, the general fund completed FY 2019 with a net surplus of $163 million or 3.2% of operating expenditures.

**Figure 11**

**5 Year Trend of Major General Fund Expenditure Items ($ in Millions)**

| | 2015 | 2016 | 2017 | 2018 | 2019 | CAGR |
|---|---|---|---|---|---|---|
| General Government | 1,333 | 1,316 | 1,357 | 1,333 | 1,336 | 0.1% |
| *YOY % Chg.* | *5.5%* | *-1.3%* | *3.1%* | *-1.8%* | *0.3%* | |
| Public Safety | 2,772 | 2,798 | 2,874 | 2,964 | 3,095 | 2.8% |
| *YOY % Chg.* | *8.2%* | *0.9%* | *2.7%* | *3.1%* | *4.4%* | |
| Public Works | 171 | 112 | 268 | 186 | 194 | 3.3% |
| *YOY % Chg.* | *-5.6%* | *-34.0%* | *138.5%* | *-30.5%* | *4.0%* | |
| Health and Sanitation | 174 | 131 | 88 | 96 | 112 | -10.5% |
| *YOY % Chg.* | *18.9%* | *-24.5%* | *-33.3%* | *9.1%* | *16.7%* | |
| Transportation | 110 | 105 | 130 | 119 | 108 | -0.6% |
| *YOY % Chg.* | *3.6%* | *-4.5%* | *23.3%* | *-8.2%* | *-9.8%* | |
| All Other | 131 | 112 | 125 | 143 | 249 | 17.5% |
| *YOY % Chg.* | *11.3%* | *-14.6%* | *11.5%* | *14.9%* | *74.0%* | |
| **Total Expenditures** | 4,691 | 4,575 | 4,841 | 4,841 | 5,094 | **2.1%** |
| *YOY % Chg.* | *7.2%* | *-2.5%* | *5.8%* | *0.0%* | *5.2%* | |

*Source: City of Los Angeles, CA CAFR*




## FY 2020 Mid-Year Financial Status Report (FSR)

On March 6, 2020, the CAO released the Mid-Year FSR report for the ongoing fiscal year ending June 30. The most important takeaway of the FSR is the City has a total budgetary balance of $519.9 million or 7.92% of general fund revenues (Figure 12). In light of the COVID-19 crisis, the Mayor published a "Belt-Tightening" Measures memo directing City departments to cut expenses for the fiscal year. If the expense reductions are insufficient to address budget shortfalls by year-end, the City will utilize its reserves to balance the current year budget. KBRA considers the City's reserve balance as a sizable amount to weather the challenges presented by the COVID-19 crisis.

**Figure 12**

**City of Los Angeles Budgetary Reserve Balance**
Cash Basis ($ millions)

| | FY 2019[1] | FY 2020 Adopted Budget[1] | FY 2020 Mid Year[2] |
|---|---|---|---|
| Unappropriated Balance (UB) | $20.3 | $20.0 | $0.0 |
| Reserve Fund Balance: | | | |
| Emergency Reserve | $170.2 | $180.7 | $180.7 |
| Contingency Reserve | $180.7 | $229.8 | $224.0 |
| Budget Stabilization Fund | $106.9 | $115.9 | $115.3 |
| **Total Budgetary Reserve Balance** | **$478.2** | **$546.5** | **$519.9** |
| % of General Fund Revenues | 7.72% | 8.32% | 7.92% |

*Source: City of Los Angeles, CA*
(1)As of July 1.
(2) As presented in March 6, 2020 Third (Mid-Year) Financial Status Report. Figures assume implemnetation of measures recommended in the FSR to allocate all of a $39.7 million UB recorded at mid year to meet anticipated departmental overspending.

The Mid-Year FSR indicated that FY 2020 revenues through January 2020 exceed budgeted amounts by $23.7 million due to higher receipts in property, documentary transfer, parking fines, franchise income, and interest earnings. Outperformance here was offset by shortfalls in former CRA/LA remittances, departmental and grant receipts, and utility users, business, transient occupancy, and parking occupancy taxes.

From July 2019 through January 2020, the City projected a $164.4 million in citywide year-end over expenditure compared to its adopted budget. The increase is attributable to higher attorney fees and administrative costs related to a recent settlement as well as higher healthcare-related costs, both of which offset the slightly higher than budgeted revenues received during the same period. In the meantime, City departments will be making mid-year budget adjustments in response to the Mayor's "Belt-Tightening" Measures.

## RD 4: Municipal Resource Base

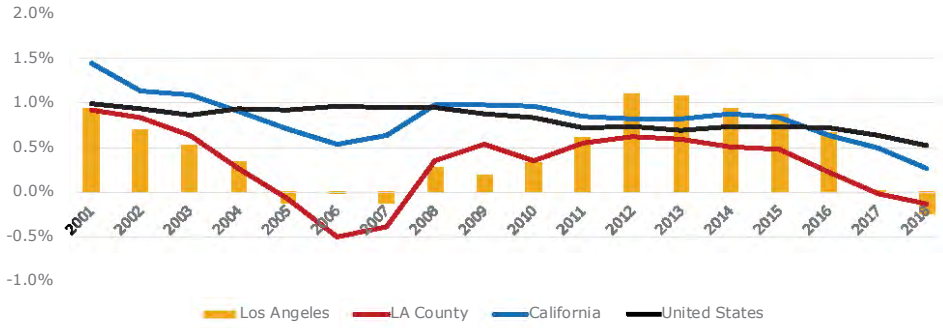
KBRA views the City of Los Angeles' municipal resource base as very strong and diverse but also caution that the COVID-19 crisis is causing significant disruptions to the economy. While the magnitude of such disruption remains an unknown and the path to recovery is unfolding, the City had robust growth in employment as well as assessed value (AV) leading up to the crisis, two measures that KBRA considers central to the City's economic health. A large and stable property tax base lends stability to the City's operations as property taxes are a lagging and less volatile indicator of economic activity relative to other economically sensitive revenue sources.

Los Angeles is the second-largest city in the nation by population and the principal City of Southern California. The City is the seat of Los Angeles County and home to nearly 40% of the County's 10 million residents. The City has a broad employment base that includes the headquarters of 26 Fortune 500 companies within Los Angeles County. Los Angeles is widely recognized as an established center for media and entertainment, while tech and information sectors have increased their presence in the City in recent years due to a lower cost of doing business when compared to the Bay Area.

In 2019, the City ranked seventh on A.T. Kearney's Global Cities Index based on an assessment of factors including business activity, human capital, and information exchange. Before the COVID-19 pandemic began to unfold in the U.S., the City was a leading destination for business and tourism. Los Angeles International Airport (LAX) was the second busiest airport in the country with 62 million domestic and 26 million international passengers in 2019 (up 0.6% YOY). Starting in January 2020, LAX began to experience declines in passenger traffic (YTD down 2.33% in February 2020). The County was one of the larger manufacturing centers in the nation and is home to the adjacent ports of Los Angeles and Long Beach, which together represent one of the busiest container ports in the United States.

**Figure 13**

**% Change in Population**

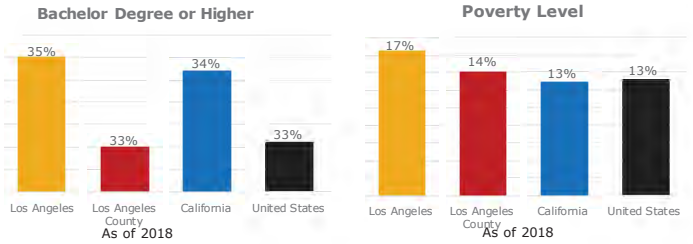



| | 2000 | 2010 | 2018 | % Δ 2010 to 2018 |
|---|---|---|---|---|
| Los Angeles | 3,679,600 | 3,714,515 | 3,740,481 | 0.7% |
| LA County | 9,538,191 | 9,626,034 | 9,705,913 | 0.8% |
| California | 33,987,977 | 34,479,458 | 34,871,843 | 1.1% |
| United States | 282,162,411 | 309,321,666 | 326,687,501 | 5.6% |

*Source: U.S. Bureau of Economic Analysis*

Population growth in both the City and the County was healthy between 2010 and 2016, but slowed down in 2017 and 2018 (Figure 13). The City has higher than average educational attainment with a favorable (higher than average) concentration of working aged individuals. The poverty rate, as in other urban centers, is somewhat above the domestic average (Figure 14). Income per capita has improved and grown slightly faster than the nation overall since 2010, indicating a trend of rising relative earning power (Figure 16).

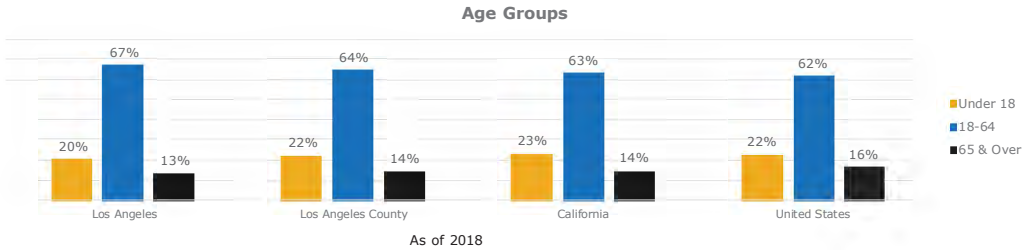
**Figure 14**




| | Point Δ 2010 to 2018 | Point Δ 2010 to 2018 |
|---|---|---|
| Los Angeles | -0.50 | -5.100 |
| California | 15.10 | -3.000 |
| United States | 14.90 | -2.200 |

*Source: U.S Census*
*Bachelor degree or higher defined as "% of population over 25 with Bachelor's degree or higher".*
*Poverty level defined as "portion of population living below the poverty line".*

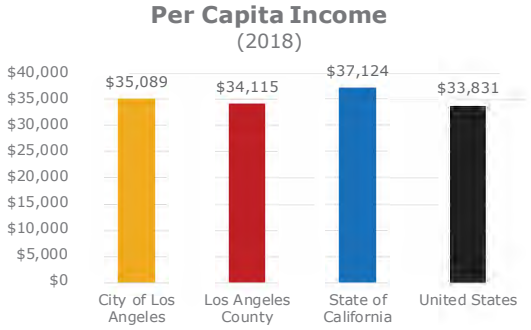
**Figure 15**




| | % Δ 2010 to 2018 | % Δ 2010 to 2018 | % Δ 2010 to 2018 | % Δ 2010 to 2018 |
|---|---|---|---|---|
| Under 18 | -13.6% | -10.3% | -3.5% | -1.1% |
| 18-64 | 1.8% | 0.4% | 4.8% | 3.4% |
| 65 & Over | 25.9% | 28.6% | 32.7% | 29.7% |

*Source: U.S. Census*

**Figure 16**




| | 2010 | 2018 |
|---|---|---|
| City as % of County | 102% | 103% |
| City as % of State | 96% | 95% |
| City as % of United States | 101% | 104% |

*Source: U.S. Census Bureau*

## Employment

The number of employed individuals living in the City has increased each year since 2009, growing more than 18% through 2018. This rate of growth is faster than the county, state and the nation overall (Figure 17). Top employment sectors for the encompassing the Los Angeles-Long Beach-Anaheim, CA MSA include trade, government, professional/business services, and education/health services, with healthcare representing the largest net contributor to employment growth in recent years. The emergence of a growing number of technology firms focused in biomedical engineering, digital information technology, and environmental technology are also increasingly important economic drivers (Figure 18). KBRA expects that job additions will be challenged as the impact of the COVID-19 pandemic continues to unfold.

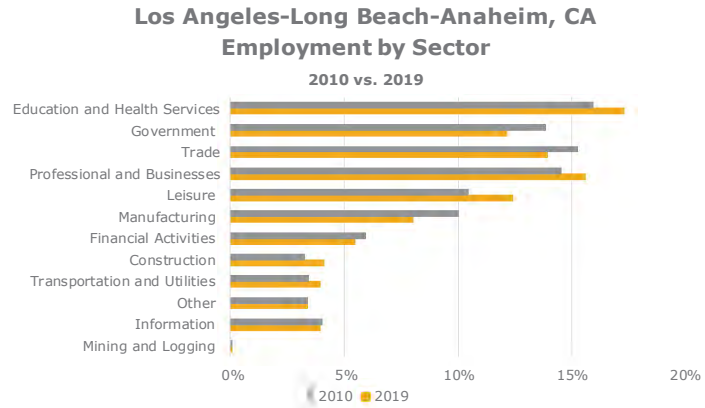
## Figure 17

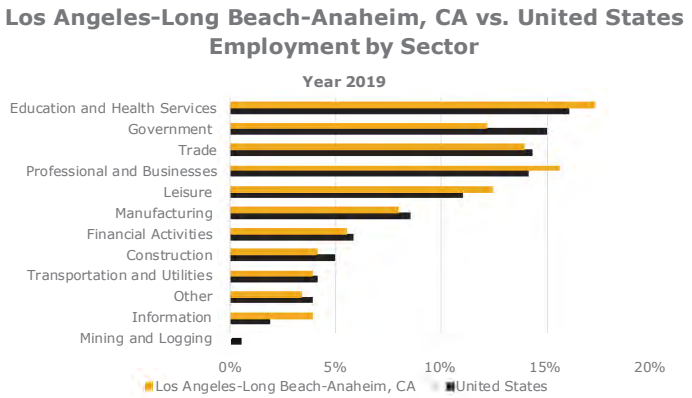
| Total Employment | Los Angeles | % Δ | Los Angeles County | % Δ | California | % Δ | United States | % Δ |
|---|---|---|---|---|---|---|---|---|
| 2009 | **1,679,925** | -4.6% | 4,345,182 | 0.0% | 16,182,572 | -4.0% | 16,182,572 | -4.0% |
| 2010 | 1,709,964 | 1.8% | **4,302,274** | -1.0% | **16,091,945** | -0.6% | **16,091,945** | -0.6% |
| 2011 | 1,721,395 | 0.7% | 4,327,923 | 0.6% | 16,258,133 | 1.0% | 16,258,133 | 1.0% |
| 2012 | 1,744,031 | 1.3% | 4,378,392 | 1.2% | 16,602,672 | 2.1% | 16,602,672 | 2.1% |
| 2013 | 1,788,399 | 2.5% | 4,482,594 | 2.4% | 16,958,403 | 2.1% | 16,958,403 | 2.1% |
| 2014 | 1,830,136 | 2.3% | 4,580,294 | 2.2% | 17,310,937 | 2.1% | 17,310,937 | 2.1% |
| 2015 | 1,872,312 | 2.3% | 4,650,739 | 1.5% | 17,681,849 | 2.1% | 17,681,849 | 2.1% |
| 2016 | 1,927,617 | 3.0% | 4,765,899 | 2.5% | 18,002,773 | 1.8% | 18,002,773 | 1.8% |
| 2017 | 1,965,331 | 2.0% | 4,841,864 | 1.6% | 18,285,492 | 1.6% | 18,285,492 | 1.6% |
| 2018 | 1,982,618 | 0.9% | 4,860,309 | 0.4% | 18,582,802 | 1.6% | 18,582,802 | 1.6% |
| **Δ 2010 to 2018** | | **15.9%** | | **13.0%** | | **15.5%** | | **15.5%** |
| **Δ Since Trough** | | **18.0%** | | **13.8%** | | **16.5%** | | **15.5%** |
| December- 2019 | 1,983,984 | 0.1% | 4,894,296 | 0.7% | 18,739,549 | 0.8% | 18,739,549 | 0.8% |

*Source: U.S Bureau of Labor Statistics*

**Bold = trough during the Great Recession (2008-2012)**

## Figure 18



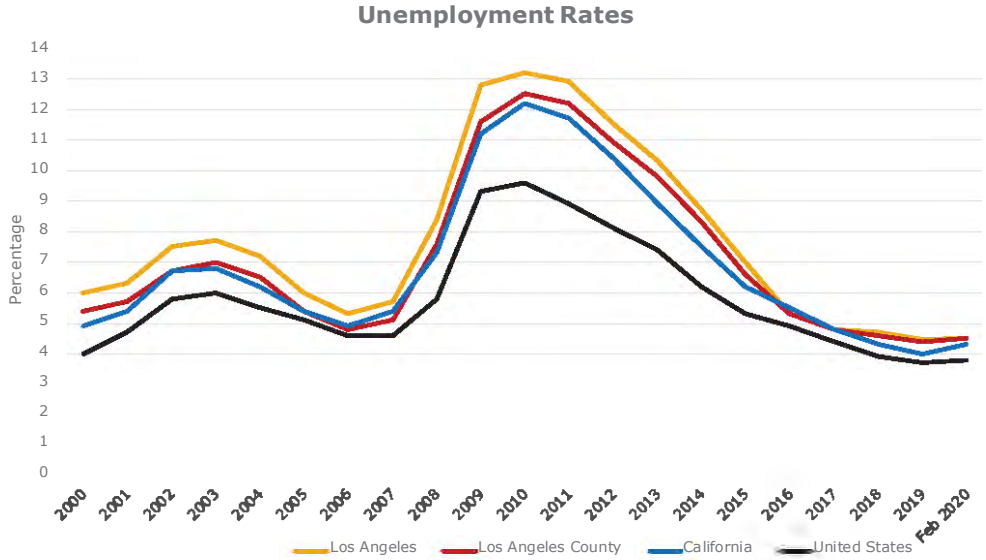




*Source: U.S. Bureau of Economic Analysis*

City unemployment has trended slightly higher than that of the state since 2000 and is structurally elevated relative to the U.S. overall. Annual unemployment has declined each year since 2010 and rests at a low 4.5% as of February 2020 (Figure 19).

Like many governments across the county, Los Angeles County issued a "stay-at-home" order on March 23, 2020 in response to the COVID-19 crisis. All nonessential retail and other businesses were ordered to close, requiring those who are able to work remotely and preventing many others from being able to work. Unemployment claims have surged here and elsewhere, and it is not clear when such orders will be lifted. Although the March 2020 employment data corresponding to the City, County, State, and the U.S. is not available, KBRA expects the local and U.S. employment picture to deteriorate measurably in the near term, and the pace of ultimate recovery remains to be seen.

## Figure 19




| | Los Angeles | Los Angeles County | California | United States |
|---|---|---|---|---|
| Peak | 13.2 | 12.5 | 12.2 | 9.6 |
| Feb 2020 | 4.5 | 4.5 | 4.3 | 3.8 |
| Point Δ Since Peak | -8.7 | -8.0 | -7.9 | -5.8 |

*Source: U.S Bureau of Labor Statistics*

## Commercial Activities

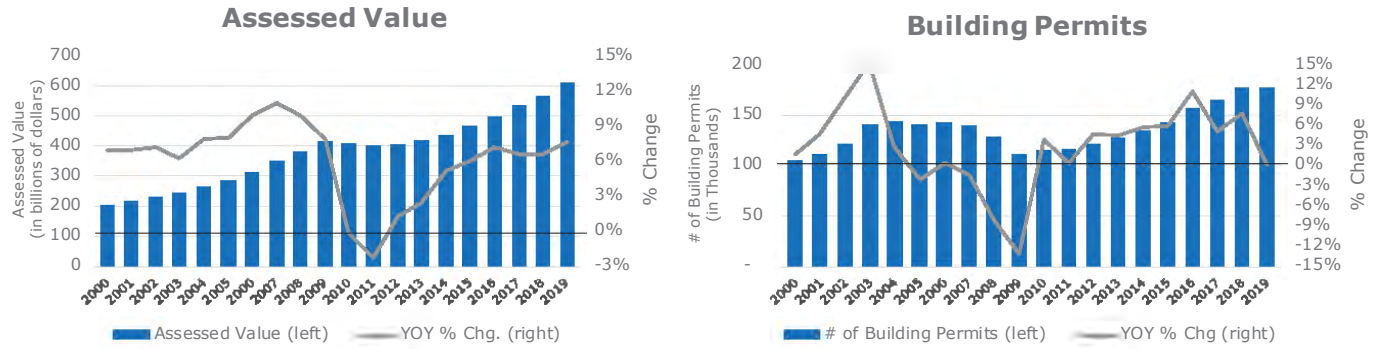
The City's operations are supported by a variety of revenue sources, with 10% of the City's general fund revenue derived from business taxes. Business development in the City gained momentum after the last recession with healthy growth in demand for commercial space, evidenced by rising prices for commercial property accompanied by strength in new construction. While the City had favorable trends in business activities in the past, the COVID-19 crisis will have a sizable and unknown impact on the City's business activities as it will have on other U.S. cities.

## Property Tax Base

Assessed values flattened but experienced very downside volatility through the severe economic disruption of the great recession. While the impact of full extent of the COVID-19 disruption on the economy generally and AV specifically are difficult to project, KBRA anticipates that downside AV volatility will likely be limited, though growth may be halted in the near term. KBRA notes that the City has a substantial AV base totaling $608.9 billion as of 2019 and that assessment has more tripled from 2000 (Figure 20). The City recorded a trend of strong and steady AV growth at CAGR of 7.0% for the last five years, exceeded the U.S. consumer price index of 1.6%.

Strong development activity has added positive momentum for Los Angeles' tax base over the last five years. Building permit issuance informs the extent to which new development and improvements to existing property are supporting AV growth. The number of building permits issued by the City has increased each year since 2009 and was higher in 2019 than at any point over the previous 20 years. YOY growth rose to a notable 11.0% in FY 2016 but slowed somewhat from FY 2017 through FY 2020.

**Figure 20**




*Source: City of Los Angeles CAFRs*

## Proposition 13 Limits Full Access to City Resource Base

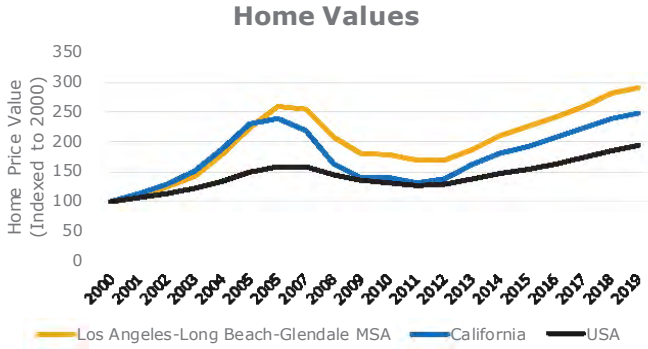
While the City benefits from a very substantial assessment base, KBRA notes that the City's ability to benefit from appreciating property value is strictly limited by the provisions of a statute known as Proposition 13. Under Proposition 13, the general property tax rate is subject to an absolute levy cap of 1% of assessed value while the assessment of existing properties is limited to the 1975-76 assessment level, subject to an inflation adjustment factor not to exceed 2% annually. Properties are only reassessed to a value reflective of actual market value upon the occurrence of a qualifying event, such as a change in ownership or major improvement. As a result of Proposition 13, AV has diverged significantly below actual market value. While the law has had the benefit of insulating the City's property tax receipts from the cyclical volatility of the real estate market, it has also prevented the City from benefitting from the full extent of real market value appreciation.

KBRA notes that the City's general fund revenue is comprised of seven different sources, which offsets some of the Prop. 13 limitations.

## Market Value of Property

The City does not disclose information with respect to the estimated market value of property. However, according the Federal Housing Finance Agency, home values throughout the greater Los Angeles-Long Beach-Glendale, CA metropolitan statistical area ("the MSA") have experienced robust growth in recent years following a period of significant volatility in the aftermath of the 2007-08 financial crisis. Home values now exceed their pre-crisis peak by 12.8% compared to peak-to-peak gains of the state and nation at 3.4% and 23.3%, respectively (Figure 21).

**Figure 21**




*Source: Federal Housing Finance Agency*

**Attachment 4**

# S&P Global Ratings-COVID-19:
# A Closer Look at How it Affects 10 Mayor U.S. Cities

# COVID-19: A Closer Look At How It Affects 10 Major U.S. Cities

**April 2, 2020**

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## Key Takeaways

- COVID-19 will have a significant effect on major U.S. cities, increasing expenditures and reducing revenues.
- The projected hit to U.S. economic growth from the ensuing recession will exacerbate the situation, presenting even more challenges for cities as they struggle to maintain structural balance, especially for those reliant on economically sensitive revenues.
- While we expect the federal relief package to aid state and local governments in the near term, the timing and support remains unknown, placing more pressure on liquidity levels.

The COVID-19 pandemic continues to evolve rapidly and has already plunged the entire world—and the U.S. with it--into recession. Projections for GDP contraction start in the first quarter (negative 1.3%) and worsening substantially in the second (negative 12.7%). Over the course of 2020, S&P Global Ratings forecasts an annualized decline in real GDP of 2.1%. The forecast is predicated on a precipitous drop in tax collections on consumer spending, coupled with a surge in unemployment. See S&P Global Ratings' most recent forecast, "It's Game Over for the Record U.S. Run; The Timing Of A Restart Remains Uncertain," (published March 27, 2020, on RatingsDirect. As a result, all of S&P Global Ratings' sector outlooks in U.S. public finance are now negative (See "All U.S. Public Finance Sector Outlooks Are Now Negative," published April 1, 2020).

## Prolonged Revenue Declines Will Lead To Pressure On Liquidity

In our view, American cities that entered the recession with weak liquidity and reserves or with a high amount of economically sensitive revenues will be particularly vulnerable to the looming pressures. When unbudgeted COVID-19 expenditures are added to the mix, the pressure to make ends meet becomes exponentially harder for local governments, straining already tight city budgets. Federal aid from the recently passed relief package, the CARES Act, will likely provide some help but is unlikely to make budgets whole since $150 billion in federal aid earmarked for state and local governments will likely only cover COVID-19-related expenditures and not revenue declines.

For all U.S. cities, sales and uses taxes; leisure and hospitality revenue; lottery revenue; licenses, fees, and permits; and motor fuel taxes will be the hardest hit. Those that rely less on this revenue will be more insulated in the short term. However, even property taxes are likely to be affected should the recession be prolonged.

## With Revenue Down, Management Will Make The Difference

In times of crisis, proactive and nimble management with robust governance policies are critical in maintaining credit quality. This includes carefully monitoring liquidity, particularly where revenue streams start to falter, reaching out to access external liquidity sources when needed.

The cities in this article all enjoy proactive management teams focused on both current and future pressures. As the situation unfolds over the course of 2020, cities who respond quickly and adequately to major budgetary shifts will have a much better ability to allay negative credit action, particularly if they start in a position of relative financial strength.

## Ten Cities Facing The COVID-19 Pandemic

### New York City

New York City's (AA/Stable) strong liquidity threshold positions it well for the evolving COVID-19 situation in the near term. In support of this view, we cite a high average cash balance of about $7.6 billion for fiscal 2019, an average daily cash balance of $5.6 billion (six months ended Dec. 31), and total cash receipts that are up 5.3% in the first half of fiscal 2020 over the prior year. These factors partly offset our belief that New York City could experience acute economic challenges amid ongoing severe limitations on global travel, given its role as an international tourist hub and as the No. 1 U.S. port of entry (according to the U.S. Department of Commerce).

Furthermore, the city predicts its cash balances daily, which is operationally instrumental when one-time shock events such as COVID-19 occur. In addition, its forecast for wage growth (which generate its personal income tax revenue projections) for 2020 is 2.3%, conservatively lower than the nation's forecast of 2.9% (prior to incorporating the COVID-19 outbreak).

Officials report that expenditures to date (as of March 24) related to COVID-19 are approximately $130 million, of which 75% will be reimbursable by the Federal Emergency Management Agency (FEMA). The expenditures are mostly associated with equipment purchases to address the increasing need for personal protective equipment and to bolster the city's available hospital beds. We expect virus-related expenditures will increase significantly as the pandemic peaks. That said, management implemented a program to eliminate the gap (PEG) to immediately reduce costs for non-COVID-19 programming and services equal to $1.3 billion over fiscal years 2020 and 2021, some of which will recur in the outyears of the financial plan. Furthermore, the city is poised to receive substantial federal fiscal stimulus, including $1 billion to cover Medicaid costs while it will receive billions more to offset health and safety costs, pay unemployment benefits, and support small businesses. In addition, with public schools closed at least until April 20, the governor reports that the state will hold districts harmless if they do not meet the 180 days of required instruction; we anticipate that this will translate to no significant loss in state aid supporting the city's education costs (approximately 30% of expenditures in fiscal 2019).

We believe New York City's economy could experience more significant economic headwinds over the medium term given the state-imposed shutdown of non-essential businesses, limitations on

restaurant and bar services to takeout and delivery, and other social distancing requirements that curtail discretionary spending and consumption habits. The city's comptroller estimates revenue could decline by as much as $6 billion over fiscal years 2020 and 2021 with sales tax revenue receiving the most significant hit (collections accounted for about 10% of the city's revenue in fiscal 2019). Depending on the length of the city's virtual shutdown to control the community spread of COVID-19, we believe that weakness in certain revenue sources could persist into fiscal 2021 (which begins July 1, 2020) and calendar 2021 given S&P Global Ratings' expectations for a slow U-shaped economic recovery.

## Los Angeles

Los Angeles (AA/Stable) has seen a large number of COVID-19 cases--over 1,300 so far--and it has a shelter in place order, along with the entire state, to stop the spread of the virus. We expect that these orders will continue over at least the next month and contribute to a sharp decrease in certain city revenues. However, Los Angeles maintains a very large liquidity position with $8.8 billion in cash and cash equivalents across all funds as of June 30, 2019, consistent with prior fiscal years. The city is preparing for a decrease in sales tax and transient occupancy tax revenue for the first time since the end of the Great Recession, but does not have exact numbers on the revenue decreases. On March 19, the mayor issued a memo implementing a hiring freeze and an overall reduction in spending across city government to offset some of the expected revenue losses. We believe that the city's broad revenue mix, anchored by property taxes, should help insulate it from potential steep revenue losses in the near term. Its largest taxes are property tax (37.2%), utility users tax (12.2%), and sales taxes (10.2%). We expect that management will continue to decrease expenditures to offset reduced revenue.

The 2019-2020 budget reflected $6.57 billion in general fund revenue, a 5.5% increase from the 2018-2019 adopted revenue budget. Projected revenue assumptions included growth in property taxes (6.5%); business tax (8.8%); licenses, permits, and fees (7.8%); and sales taxes (3.5%). Not included in the budget was any additional funding for employees whose contracts expired at the end of fiscal 2019. The city's third (midyear) financial status report showed overspending of $164.4 million, primarily due to unaccounted-for salary adjustments and costs related to wildfires. Revenue was above budget by $23.7 million, primarily due to property and transfer taxes. Prior to the outbreak, the city had identified expenditure reductions to offset almost half of the overspending, but expected to use some of the $519.9 million in reserves to balance its budget. We expect that it may need to use additional reserves to balance fiscal 2020. We also expect the city may need to continue to reduce expenditures into fiscal 2021, depending on how long the recession lasts.

Of concern is the city's annual TRAN issuance. The $1.7 billion fiscal 2019-2020 TRAN, issued in June 2019, was to prepay its pension actuarially required contribution (73.5%) for fiscal 2019-2020, as well as to manage uneven cash receipts and disbursements (26.5%) throughout the year. We note that if the bond market continues with its current instability, the issuance could be significantly more expensive next year. The city could choose to not issue the portion of the TRAN for pension pre-payment, which would necessitate a significantly smaller cash-flow TRAN to manage lumpy cash-flow receipts.

## Chicago

Chicago's (BBB+/Stable) uphill climb has gotten harder with the addition of COVID-19 and recession pressures on a city already struggling to regain structural balance. Last fall, the new mayoral administration laid out clear plans for regaining that balance by maintaining constant

vigilance to ensure any changes in revenue collections are met with expenditure adjustments. However, for Chicago the absolute essentiality of staying on the path to ramp up pension fund contributions leaves very little room for error. Without staying on plan to meet growing pension funding requirements, the city will jeopardize its credit quality and rating.

While the full extent of the cost of COVID-19 response will not be known for some time, the city remains confident that it has sufficient expenditure flexibility to address the pandemic's related costs. However, while Chicago may be able to keep controls on costs, economically sensitive revenues like home-rule and state-shared sales, transaction, transportation, recreation, and state-shared income taxes made up 35% of key operating revenues in fiscal 2018. With a shelter-in-place order since March 21, the tax revenue is expected to continue flowing, but the amount collected is likely to dip significantly before stabilizing. In the short term, this could result in cash-flow fluctuations to Chicago's historically robust liquidity position (total available cash of $2 billion at year-end 2018 (not including investments). However, given the city's close attention to cash management, we expect it should be able to maintain sufficient cash flow for operations and debt service even if revenues start to decline.

In the long term, the damage the ensuing recession will inflict on the city's pension plans could range from benign to catastrophic. Chicago participates in four pension plans with a combined funded ratio of only 22.9% and a combined net pension liability of $30.1 billion as of Dec. 31, 2018. Therefore, the effects of market volatility could have an outsized effect on the funds. In 2018, Chicago's combined required pension and actual OPEB contributions totaled 29.0% of total governmental fund expenditures, which we view as very high and limits overall budgetary flexibility. Given the magnitude of the problem and reliance on market returns to stay on track with pension funding, it is possible that even if the city takes all the right steps to align expenditures with revenue, the effects from COVID-19 and the recession could still result in credit deterioration.

## Houston

Houston (AA/Stable) was awarded $5 million for the City of Houston Health Department to fund COVID-19 preparedness and response activities. The city will be creating a grant fund called the "COVID-19 Disaster Fund" and requesting City Council authorization to transfer up to $5 million into that fund from the budget stabilization fund as seed money for expenditures related to the public health emergency response efforts. The expectation is that up to 75% of this will be reimbursed by FEMA.

Compounding these challenges is the fact that crude oil prices fell sharply at the beginning of 2020 to points that were comparative to those of fiscal 2016. Despite the continued diversification in the local economy, with sectors other than the energy sector strengthening, the city and its local economy are still very closely tied to the oil and gas industry and prolonged weak oil prices will add to Houston's challenges.

In fiscal 2019, general fund revenue was derived mainly from property taxes (48.8% of total general fund revenue). Roughly 30% of the city's general fund revenue came from more economically sensitive revenue streams such as sales, mixed beverage, and hotel occupancy taxes. We anticipate special taxes of the city will be shrink--leading up to March, sales tax performance remained solid. The city's latest Monthly Financial Report for the period ended Jan. 31, projected sales tax of $702.6 million, which is $8 million above the adopted budgeted amount of $694.6 million. January receipts came in 8.63% above the same period in the prior year. The city expects February receipts to be strong and will not receive details on March receipts until May. While Houston's fiscal performance is not directly tied to oil and gas royalties, similar to 2016, if oil prices remain weak for a prolonged period, employment, spending, and other factors in the local

economy could suffer. Given that the greater region has generally been on a growth trend in population, development, and market value, the depth and breadth of the risk would depend on how long the current challenging environment persists.

At fiscal year-end 2019, the city's unassigned general fund balance totaled $350 million, or a very strong 15.3% of adjusted expenditures when calculating transfers out of the fund. As of January 2020, general fund performance was better than the adopted budget, which did anticipate the use of reserves. Trends through January indicated that general fund reserves would be maintained at $35 million above the city's target of holding 7.5% of total expenditures in reserve.

## Phoenix

Phoenix (AA+/Stable) and the state lagged national peers in announcing its stay-at-home order, which the governor issued March 30. Business operations slowed over the last month, with many shuttering their doors before the official announcement. In response to national orders, all non-essential retail, lodging, and large events for which the region is known, including MLB Spring Training, have been closed or canceled. While the scope of the economic and financial challenges remains to be seen, Phoenix has begun implementing cost-containment measures to better position itself for future difficulties. We understand that the city is working to assess and adjust its budget for the current and subsequent fiscal years by using prior recessionary scenarios and data from national and local economists. Given the two-month lag in sales tax collections, it does not expect to see the revenue effects of COVID-19 until May. In the meantime, the city has halted all non-essential expenditures and curbed all hiring, excluding critical positions. In the coming weeks, management intends to present possible scenarios and potential budget reductions to the governing council for fiscal 2021, when it anticipates the financial effects being most noticeable.

Phoenix relies heavily on volatile revenue streams for operations, including local sales, use and franchise taxes, as well as state-shared sales, income, and vehicle registration taxes, which together account for over 70% of general fund revenue and 75% of total governmental revenue. We note, however, that potential correlated budgetary pressures are somewhat alleviated by the city's very strong fund balance position and very strong financial management policies and practices.

The city's balanced fiscal 2020 budget as adopted includes $55.4 million in general fund contingency, which in recent years has been largely unused and results in a surplus at year-end. Through January 2020, Phoenix's general fund revenue collections were 6.5% higher compared to the same timeframe last year, although governmental fund revenue was tracking 2.5% lower than budgeted for the period. Additionally, the majority of the city's existing debt is secured by excise tax, including the local and state-shared components and, while some deterioration in pledged revenue is likely in the medium term, we do not anticipate pressure on its current ability to pay debt service considering the historically very strong coverage.

## Boston

Boston (AAA/Stable) is well positioned in the short term to manage revenues and expenditure pressures from the COVID-19 outbreak. It has a stable revenue mix derived primarily from property taxes, along with high reserve and cash levels. In fiscal 2019, real and personal property taxes accounted for 66.1% of audited general fund revenue. Intergovernmental revenue was 16.3%, of which more than half is school formula aid. The remaining 17.6% of operating revenue includes excise taxes (7.2%) and all other revenue. We believe the city's revenue that is most exposed to immediate deterioration is excise taxes, which include hotel room occupancy and meals taxes,

along with aircraft fuel and vehicle rental surcharges related to Logan Airport. Additionally, if state revenue significantly lags the budget, it could pressure unrestricted operating aid. However, given the city's available general fund reserves totaling $1.19 billion (or approximately 34.5% of operating expenditures) and availably liquidity totaling $1.55 billion (or approximately 8.5x governmental debt service, not including special revenue or capital projects funds) at year-end 2019, we believe, in the short term, its high reserve and liquidity levels will ensure service continuity and debt service payments. The entirety of the city's debt is general obligation (GO), with all revenue sources available for debt service payments.

The school department is accounted for in the city's general fund and is its chief expenditure, with education accounting for more than one-third of operating costs. Boston schools are currently planning to reopen on May 4, although this could change. The city is implementing distance-learning measures, which includes procurement of a variety of supplemental instructional materials. Management does not expect the supplemental instructional costs to materially pressure finances, with projections showing costs will be absorbed within the current school operating budget with supplemental support from the city's new Boston Resiliency Fund.

We believe the city has very strong management, with significant planning and coordination. We understand management is working closely with departments to track and document COVID-19-related activities and costs. In our view, the city's financial management team is addressing the current public health crisis while working to ensure Boston's financial position remains stable, although we believe year-end reserve reductions are possible. Additionally, if an economic downturn persists, it could pressure growth in the property tax base. While the city's reserves and cash balances may decline in the short term, we do not expect material pressure on its current ability to pay debt service, given the high reserve and cash balances.

## Miami

Miami (AA-/Negative) has a population of nearly 500,000 people, is well-known as a beach and tourist destination, and serves as an international trade hub and a regional business, financial, and health care center for south Florida. Given the city's size and unique characteristics, we believe tourism and retail activity and employment are likely to be affected in the near term as beaches, hotels, cruise lines, and non-essential retail have closed to reduce the spread of COVID-19. In addition, restaurant services are limited like in many other local governments across the nation, which could also affect sales tax activity. The city has implemented additional procedures to limit the spread of the virus, such as screenings for all employees and visitors prior to entering city buildings, and the provision of drive-thru and on-site testing services for seniors (ages 65 and older). At this time, there is limited information available in terms of how reduced sales tax and tourism-based revenue will affect the budget, as there is typically a two-month lag in collections data. We believe the city's budget effects may be somewhat offset by the above-average level of sales and visitor activity the city experienced in February 2020 as host of Super Bowl LIV. However, there is a great deal of uncertainty as to how long the current curb on economic activity will last.

The city of Miami's governmental funds liquidity position has remained very strong in recent years, amounting to $475.2 million for fiscal 2019, whereas total budgetary flexibility is also consistently strong, with available reserves of $103.0 million or 13.3% of expenditures (including recurring transfers). Additionally, the city's primary general fund revenue sources are diverse, consisting of property taxes (46%), charges for services (16%), franchise and other taxes (15%), and intergovernmental revenue (10%). We believe this flexibility, stability, and diversity will be beneficial in times of distress. The city adopted a balanced budget for 2020 and the most recent monthly financial report (Jan. 31, 2020) shows total revenue remaining above the prior year by

6.6% and expenditures staying 2.7% above the prior year. The 2020 budget includes a $5 million contingency reserve pursuant to city code, and so far, COVID 19-related expenses have amounted to about $2 million. We believe the city's charges for services (a large portion of which is parking fee revenue) and economically sensitive tax revenue will be the most vulnerable revenue streams in the current environment.

## Philadelphia

Philadelphia (A/Positive) is in a better financial position than it has been in years to handle the financial stress of the current COVID-19 pandemic. At the close of fiscal 2019 (June 30), the city's available general fund balance was $439 million, or 10.9% of general fund expenditures. Total government cash (including short-term investments) was approximately $2 billion (29% of total governmental fund expenditures). For fiscal 2020, the city was expecting the general fund balance to decrease to $352 million (6.9% of expenditures) on a budgetary basis; however, the budget incorporated several contingencies, including $55 million as a federal funding contingency and $20 million for a recession readiness fund. The mayor has called for $85 million (1.7% of general fund expenditures) to cover costs related to COVID-19, which will include increased labor and IT costs and expenditures for quarantine and testing sites. Management expects the $85 million would come from general fund balance, but would be offset by the contingency funds. The mayor presented the proposed fiscal 2021 budget in March, but it did not include the potential effects of the COVID-19 outbreak. The city expects to revise its revenue and expenditure projections prior to budget adoption in May.

We believe Philadelphia's primary general fund revenue sources to be somewhat resilient to near-term economic shocks, but would be vulnerable over the medium term if the current economic disruption persists. Both the governor and the mayor have issued stay-at-home orders until further notice. The city's largest general fund revenues are wage and earnings taxes (33% of general fund revenue), real property taxes (14%), and business income receipts tax (BIRT, 11%). Notably, the city reports that only about 8% of its wage and earnings tax receipts come from the service and hospitality sector, which is experiencing the most severe effects, and its largest sector is health and human services, which should be resilient. The city has not yet revised its revenue forecasts as economic data are still coming in and subject to rapid change, but plans to do so in the coming weeks.

The city's pension reforms, including lowering its discount rate and contributing above the required contributions, have put its pension plans in a better position than before. However, funded ratios remain low and the liability large. The city recently made a $550 million contribution to the plan as part of its long-term goal to improve funded levels, which will provide additional near-term liquidity. It reports it has cash available to pay seven-to-eight months of benefits without needing to rely on investments.

## San Francisco

San Francisco's (AAA/Stable) economy, tax revenue, and service demands will show more polarity than most of its big-city peers due to COVID-19, in our view, but its very strong management profile and voter-approved reserve set-asides should allow for the city to maintain its credit quality.

Already a center of finance, the city has competed with Silicon Valley during the recent economic expansion for high-skilled IT and life science jobs, many of which can be performed remotely with minimum disruption under social distancing rules. This points to a source of resiliency in the local

housing market and the likelihood that its (till now) hot market for office space will quickly warm up again when public health conditions improve. By contrast, the city's robust restaurant, retail, and lodging industries, which typically enjoy a diverse mix of demand from tourism, business and convention travel, face a tougher road because the high local cost of living may push employees in this industry out of the region.

The city's March 31, 2020 budget outlook update characterized the economic and tax revenue losses from COVID-19 as "stark and immediate." We expect the revenue effects to first show up in economically sensitive tax revenue such as lodging taxes and sales and use taxes, although the large interval between when property values are measured and when taxes are levied makes an outright decline in the city's largest general fund revenue source, property taxes (38% of general fund revenue in fiscal 2019), unlikely through the fiscal year ending June 2022. However, we think other, more economically sensitive revenues are likely to show year-over-year drops by fiscal 2021. The city's March revision shows estimated fiscal 2020 lodging tax revenues (equivalent to 14% of adjusted general fund expenditures in fiscal 2019) likely to come in 32% below budget under a limited COVID-19 impact scenario and sales tax revenues (8% of adjusted expenditures) at 10% below budget. The city anticipates further weakening in these two revenue streams in fiscal 2021 under both its limited and extended-impact scenarios but slight growth in property tax revenues next year.

San Francisco has shown caution in its revenue assumptions during the recent economic expansion, in our view, and we think the city has room to pull back on spending growth as the revenue effects of COVID-19 become better known, but we also expect to monitor the extent to which the city needs to escalate support for public hospital and social service operations if sufficient state and federal support is not forthcoming.

## Seattle

Seattle (AAA/Stable) and its surrounding cities received early publicity as for a large number of COVID-19 cases in the region and the state was an early adopter of social distancing rules that quickly wound down large gatherings, cut business and tourism travel, and forced restaurants to close or convert to take-out operations. We anticipate that COVID-19 will have a material negative effect on the city's revenues in 2020 and at least temporarily bring hope for a lodging tax revenue boom--multiple sites are in the development pipeline with openings scheduled through 2022 to capture heretofore strong demand growth--to an end. At the same time, we think that the city's very strong management profile and accumulated reserve growth as part of automatic set-asides position it to respond to the potential for medium-term revenue losses or operational disruptions.

We think at least two of the city's main tax revenue sources could show weakness starting in the fiscal year ending December 2020. The budget as adopted before the threat of COVID-19 became known anticipated that property taxes would represent the leading general subfund (a budgetary-basis fund that substantially overlaps with the city's general fund on a generally accepted accounting principles basis) tax revenue source, at 23% of total revenue. Due to statutory limitations on growth that also protect against revenue declines and an active construction pipeline, we think this revenue source is unlikely to weaken through 2021, but we anticipate that sales and use tax revenue (20% of total revenue) and business gross receipts tax revenue (also 20%) are poised for declines as taxable activity drops through at least the second quarter of the year. Management reports that the lag between economic activity and collection for sales and use and gross receipts tax revenue means that representative revenue data will not start to be available until May at the earliest and the city is studying prior recessions to develop a budgetary response to the current one.

All ratings are current at the time of publication. We will review all GO ratings on the included cities individually and could revise the rating and/or outlook on a case-by-case basis. S&P Global Ratings will continue to publish on local government credit as conditions change and in response to market interest.

Table 1

## Financial Data By City

| City | Most recent audited available reserves (adjusted) ($ Thou.) | As % of expenditures | Days' cash ($ Thou.) | Property taxes as % of operating revenues | Sales and use taxes as % of operating revenues | Income taxes as % of operating revenues | Intergovernmental revenues as % of operating revenues | TGF debt service, Pension ARC, and OPEB contribution as % of TGF expense | FMA |
|---|---|---|---|---|---|---|---|---|---|
| Boston | 1,186,610 | 34.50 | 192 | 66 | 7 | 0 | 16 | 16 | Strong |
| Chicago* | 959,320 | 25.80 | 145 | 22 | 12 | 6 | 4 | 40 | Good |
| Houston | 350,268 | 15.30 | 375 | 56 | 33 | 0 | 2 | 29 | Strong |
| Los Angeles | 1,017,601 | 17.50 | 373 | 37 | 10 | 0 | 0 | 26 | Good |
| Miami** | 103,038 | 13.30 | 173 | 46 | 5 | 0 | 10 | 20 | Strong |
| New York | 8,900,000 | 9.70 | 45 | 30 | 10 | 15 | 26 | 25 | Strong |
| Philadelphia | 438,700 | 10.91 | 104 | 14 | 5 | 33 | 17 | 16 | Strong |
| Phoenix*** | 483,536 | 42.18 | 306 | 10 | 45 | 8 | 23 | 26 | Strong |
| San Francisco | 2,714,961 | 56.50 | 483 | 44 | 4 | 0 | 18 | 22 | Strong |
| Seattle | 267,553 | 17.28 | 258 | 23 | 20 | 0 | 2 | 12 | Strong |

*Chicago operations include general, debt service, sales tax securitization, and pension funds. **Miami intergovernmental revenue includes state-shared sales tax. ***Phoenix TGF is used for operating revenues; actuarially determined contribution unavailable. TGF--Total government funds. ARC--actuarially required contribution. OPEB--Other postemployment benefits. FMA--Financial management assessment. Most recent audited available reserves: Assigned and unassigned general fund balance and available reserves outside the general fund considered available. Days' cash: Primary government cash and liquid investments/TGFE. Source: Most recent CAFRs with analytical adjustments; S&P Global Ratings Financial Management Assessment (FMA).

Table 2

## Analytical Contacts

| | Rating | Rating date | Primary analyst | Email contact |
|---|---|---|---|---|
| Boston | AAA/Stable | Feb. 2019 | Christian Richards | christian.richards@spglobal.com |
| Chicago | BBB+/Stable | Nov. 2019 | Jane Ridley | jane.ridley@spglobal.com |
| Houston | AA/Stable | Aug. 2019 | James Hobbs | andy.hobbs@spglobal.com |
| Los Angeles | AA/Stable | May 2019 | Jennifer Hansen | jen.hansen@spglobal.com |
| Miami | AA-/Negative | Dec. 2018 | Jennifer Garza | jennifer.garza@spglobal.com |
| New York | AA/Stable | March 2020 | Nora Wittstruck | nora.wittstruck@spglobal.com |
| Philadelphia | A/Positive | Nov. 2019 | Cora Bruemmer | cora.bruemmer@spglobal.com |
| Phoenix | AA+/Stable | May 2017 | Alyssa Farrell | alyssa.farrell@spglobal.com |
| San Francisco | AAA/Stable | March 2020 | Chris Morgan | chris.morgan@spglobal.com |
| Seattle | AAA/Stable | July 2019 | Chris Morgan | chris.morgan@spglobal.com |

Related Research

- All U.S. Public Finance Sector Outlooks Are Now Negative, April 1, 2020
- The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions, April 2, 2020
- It's Game Over for the Record U.S. Run; The Timing Of A Restart Remains Uncertain, March 27, 2020
- Global Macroeconomic Update, March 24: A Massive Hit To World Economic Growth, March 24, 2020
- Economic Research: A U.S. Recession Takes Hold As Fallout From the Coronavirus Spreads, March 17, 2020
- COVID-19 Credit Update: The Sudden Economic Stop Will Bring Intense Credit Pressure, March 17, 2020
- COVID-19's Potential Effects In U.S. Public Finance Vary By Sector, March 5, 2020

This report does not constitute a rating action.

**Attachment 5**

# Moody's revises City of Los Angeles, CA's outlook to stable from positive, affirms outstanding Aa2 GO

MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's revises City of Los Angeles, CA's outlook to stable from positive, affirms outstanding Aa2 GO and related Aa3 & A1 long-term ratings

17 Apr 2020

New York, April 17, 2020 -- Moody's Investors Service has revised the outlook on the City of Los Angeles, CA's long-term ratings to stable from positive. Concurrently, Moody's has affirmed the City's Aa2 general obligation (GO) bond rating, Aa3 rating on lease revenue bonds and certificates of participations (COPs) with more essential assets, Aa3 rating on the Municipal Improvement Corporation of Los Angeles (MICLA) Refunding Certificates of Participation (COPs) (Pershing Square Program AS) Series 2002 with less essential assets but non-general fund revenue pledged and fully funding debt service, A1 rating on Lease Revenue Refunding Bonds, Series 2018-C (Real Property - Taxable), and A1 rating on the City's Judgment Obligation Bonds, Series 2010-A . The rating action affects $835.0 million GO bonds, $1.5 billion lease-backed obligations, and $6.2 million judgment obligation bonds.

RATINGS RATIONALE

The revision of the outlook to stable from positive reflects our changed view of the city's likely revenue and reserve trajectory. Our prior expectation was for continued revenue growth and increasing reserves over our 18-24 month outlook horizon. Such near-term improvement is no longer probable in the current economic environment, even if the coronavirus downturn proves short and the recovery relatively rapid. Our current expectation is that the city will manage this downturn as it has prior economic downturns, making the necessary adjustments to maintain its healthy, long-term credit profile.

The Aa2 GO bond rating reflects the city's exceptionally large tax base, which has shown a strong growth trend from new commercial and residential development, resulting in a high AV per capita, and a somewhat below average resident socioeconomic profile. It further reflects the city's strengthened and solid general fund position, supported by eight years of healthy revenue increases and implementation of reserve policies put in place in 2011. The city's financial position benefits from substantial special revenue funds available for governmental operations that would otherwise require general fund resources. The Aa2 rating positively incorporates the city's low level of rapidly retired direct debt, balanced against the city's substantial unfunded pension and OPEB liabilities. It further incorporates the city's strong management of an unusually large and complex operation.

The Aa3 lease revenue bond ratings, associated bank bond rating and COP ratings reflect a one-notch distinction from the GO bond rating. This is typical for a California city's standard, abatement lease obligation for more essential leased assets; or in the case of the MICLA COPs (Pershing Square Program AS) Series 2002 with a less essential asset, it reflects narrowed notching from our standard two notches due to dedicated, non-general fund revenues that fully offset what would otherwise be a general fund debt service burden.

The A1 Lease Revenue Refunding Bonds, Series 2018-C (Real Property - Taxable) rating is two notches below the GO bond rating, reflecting a standard abatement lease and a less essential leased asset.

The A1 Judgment Obligation Bonds, Series 2010-A rating reflects a two-notch distinction from the GO rating, typical of this type of obligation which has no pledged asset or pledged revenue source.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is a key driver for this rating action. Given its currently strong balance sheet, the City of Los Angeles is not susceptible to immediate material credit risks related to coronavirus. However, we anticipate that previously expected revenue growth will not materialize in the near term due to the economic effects of the coronavirus, resulting in a stable rather than positive outlook for the city's long-term credit ratings. The longer-term impact of coronavirus will depend on both the severity and duration of the crisis. The situation surrounding coronavirus is rapidly evolving. If our view of the credit quality of Los Angeles changes, we will publish our updated opinion at that time.

RATING OUTLOOK

The outlook on the city's long-term ratings is stable, notwithstanding the emergent risk from coronavirus. The

city is well positioned financially and has the management wherewithal to meet the challenges of a near-term decline in revenue and increase in expenditures that will result from this public health emergency. Following nine out of ten consecutive fiscal years with operating surpluses, the city's balance sheet is currently at an all-time strong point. This combined with proactive cost cutting measures and a staffing freeze will sustain the city's ability to address increasing fixed costs and anticipated revenue declines. While it is early in this event, credit risks could emerge as fiscal impacts of the pandemic become more clear. The outlook recognizes the city's large and diverse tax base, which is fundamentally healthy, as well as the sound financial policies implemented by city management.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- A rapid return to recent rates of revenue growth

- Material decrease in balance sheet leverage, including both direct debt and unfunded pension and OPEB liabilities

- Continued strong financial position, including maintaining or building available reserves

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Prolonged deterioration of the tax base and economy

- Weakened financial position through deficit spending or significant increases in fixed costs

- Material increase in leverage from unfunded pension and OPEB liabilities

LEGAL SECURITY

The Aa2 rated GO bonds are secured by the city's dedicated, voter-approved unlimited property tax pledge. The ad valorem property taxes levied and collected for the bonds are restricted for use to pay the GO bond debt service.

The Aa3-rated lease revenue bonds are secured by lease payments from the city to Municipal Improvement Corporation of Los Angeles (MICLA) for use and occupancy of specified leased capital assets and real property, which we consider more essential and subject to standard abatement lease agreements, or in the case of Aa3-rated lease revenue bonds secured with less essential assets, have dedicated revenues that fully offset the debt service burden on the city's general fund. Any bank bonds associated with the MICLA commercial paper (CP) program would be secured by lease payments from the city to MICLA for use and occupancy of the same leased assets securing the MICLA CP program. These include a wide range of essential real property assets.

The A1-rated lease revenue refunding bonds are secured by lease payments from the city to MICLA for use and occupancy of the Dolby Theater on Hollywood Boulevard and airspace lots located on the real property, which we consider less essential, and subject to a standard abatement lease agreement.

The A1 rated judgment obligation bonds are secured by an unconditional pledge to annually appropriate revenues for debt service from the general fund.

PROFILE

The City of Los Angeles encompasses 470 square miles of Los Angeles County (Aa1 stable) and has an estimated population of 4.0 million, making it the second most populous city in the US. Los Angeles was established in 1781 and adopted its original charter in 1850, most recently amended in 1999. The city's governing body consists of a mayor and a fifteen-member city council.

The Municipal Improvement Corporation of Los Angeles (MICLA) is a nonprofit public benefit corporation formed in 1984 for the purpose of financing, acquiring, constructing, improving, leasing and developing equipment and property. MICLA's five-member governing board is initially appointed by the mayor with vacancies filled by the MICLA board subject to city council approval. No city staff or elected officials are members of the MICLA board.

METHODOLOGY

The principal methodology used in the general obligation ratings was US Local Government General

Obligation Debt published in September 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1191097 . The principal methodology used in the lease and judgment obligation bond ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1102364 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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