FitchRatings

Fitch Affirms New Orleans, LA's IDR and Various Tax Bonds at 'A+'; Outlook Stable

Fitch Ratings-Austin-26 October 2018: Fitch Ratings has affirmed the 'A+' rating on the following City of New Orleans, Louisiana (the city) obligations:

--$554.9 million in general obligation (GO) and public improvement bonds of the city and the Board of Liquidation, City Debt;
--$155.8 million limited tax refunding bonds, series 2012 (taxable);
--$10.4 million Audubon Commission aquarium tax bonds, series 2011A-1;
--$9.4 million drainage system refunding bonds, series 2014;
--the city's Issuer Default Rating (IDR).

The Rating Outlook is Stable.

SECURITY
The GO and public improvement bonds are payable from an unlimited ad valorem tax levied against all taxable property in the city. The limited tax and aquarium tax bonds are special obligations of the city, payable from limited ad valorem taxes that are subject to rate adjustment from time to time due to reassessment. The drainage system bonds are payable from a limited ad valorem tax (such rate subject to adjustment periodically due to reassessment) upon all taxable property in the city.

ANALYTICAL CONCLUSION

The 'A+' IDR and bond ratings incorporate sound revenue growth prospects and a moderate liability burden, as well as adequate expenditure flexibility and strong gap closing capacity. The city's economy continues to perform well, as evidenced by recent gains in economically sensitive revenues. While reserves are now at satisfactory levels, remaining public safety and pension challenges will be a source of operational pressure for the foreseeable future.

Economic Resource Base
New Orleans' status as a major tourism destination, along with its significant commercial presence, supports Fitch's projection of solid growth prospects as the current economic expansion continues. The local economy continues to diversify from a historical reliance on shipping and energy with gains in healthcare and technology. The population is estimated at about 393,000, slightly more than 85% of the total before Hurricane Katrina in 2005.

KEY RATING DRIVERS

Revenue Framework: 'aa'
New Orleans' 10-year revenue growth history through 2017 exceeded U.S. GDP, as the city's post-Katrina recovery gathered momentum. Fitch anticipates solid revenue performance going forward given the current level of economic activity. The city's ability to increase revenues through fees and charges is balanced against an inability to increase property or sales tax rates without voter approval.

Expenditure Framework: 'a'
Spending increases should generally track revenue growth. A 2016 settlement with firefighters over back pay establishes a certain repayment schedule, although other pressures continue. Carrying costs (for debt and retiree benefits) are moderately high, but Fitch considers overall expenditure flexibility adequate.

Long-Term Liability Burden: 'aa'
The combination of debt and unfunded pension liabilities is moderate at about 11% of total personal income. This level is not expected to shift materially, as the city's debt plans appear manageable over the near term. However, pension contributions likely will increase given current net pension liabilities.

Operating Performance: 'a'
New Orleans has rebuilt operating reserves. The combination of public safety and pension spending pressures restrict spending flexibility, although some pressures have been addressed. Limited revenue raising ability further constrains the overall financial resiliency assessment.

RATING SENSITIVITIES
Reversal of Recent Gains: A material deterioration in recently bolstered financial flexibility likely would pressure the current rating.

Improved Financial Resilience: Given the inherent volatility of much of the city's operating revenues and its midrange inherent budget flexibility, an increase in operating reserves would help mitigate this risk and bolster financial resilience, improving chances for positive rating action.

CREDIT PROFILE

While still a tourism-based economy, New Orleans has diversified since Hurricane Katrina in 2005, most notably in healthcare. The new University Medical Center/Veterans Administration Hospital is a combined $1.9 billion complex. Tourism continues its post-Katrina rebound, with a 2017 visitor count of 17.7 million (up more than 5% from 2016; the New Orleans Convention & Visitors Bureau employed a new visitor research service beginning in 2017). Tourism spending in 2017 also set a new record at $8.7 billion, up 6% from the prior year. Airport traffic and cruise bookings also were at record levels in 2017.

Revenue Framework
Sales and property taxes are the two largest components of the general fund revenue total, and combined were more than one-half of the $675 million operating revenue total in 2017. The 10-year revenue history of 5.7% average annual gains through 2017 exceeded U.S. GDP over the same period, reflecting the healthy pace of recovery and expansion since Hurricane Katrina in 2005. The city's large tourism sector generates significant exposure to economic cycles.

The city's revenue prospects are solid. Management anticipates some moderation from recently strong growth rates, as a number of new large retail and hospitality projects are now included in annual totals.

The city's legal ability to independently increase revenues is constrained, as any increase in property tax millage or sales tax rate must be approved by voters. However, Fitch believes that the other locally controlled operating revenues (e.g. fees, charges) that are the only avenues to independently raise revenues provide satisfactory flexibility in this area.

Expenditure Framework
As with most U.S. cities, public safety is the largest general fund expenditure category (42% of 2017

outlays), and ongoing spending associated with a police consent decree and parish prison operations will keep overall spending pressures elevated. Parish prison operating expenses were budgeted for $53 million in 2018, roughly 8% of general fund budgeted spending and up from $35 million budgeted in 2015.

Spending levels over the near to intermediate term generally should track an expected solid pace of revenue growth.

The city retains adequate flexibility regarding main expenditure items, although civil service commission rules govern certain workforce-related adjustments (e.g. layoff procedures). Carrying costs (combined debt and retiree benefit outlays) in 2017 were moderately high at 23% of governmental spending, and expected increases to pension contributions likely will move carrying costs higher in coming years.

Long-Term Liability Burden

The city issues both unlimited tax debt (through both the city and the Board of Liquidation) and limited tax debt, for general infrastructure purposes. The city issued the series 2014 drainage system refunding bonds on behalf of the New Orleans Sewerage and Water Board, which maintains the city's drainage system. The amortization pace of the city's tax-supported debt is fairly rapid at roughly 62% in 10 years.

The city provides pension benefits through three major pension plans, one of which it administers as a single-employer program. The other two are a state police pension plan and a state firefighter pension plan, the benefits and contributions for which are set by the state legislature. The combined overall debt and net pension liability for the city represents a moderate 11% of total personal income; combined pension assets to liabilities (adjusted for a more conservative 6% investment return assumption) are relatively low at 42.5%, suggesting future contribution increases are likely, but Fitch expects the overall liability burden to remain in the moderate range. Other post-employment benefit liabilities total $101 million or 0.6% of personal income.

Operating Performance

The city's improved reserves, along with a satisfactory revenue-raising ability and a somewhat constrained expenditure flexibility profile, provide strong gap-closing ability in the event of a moderate economic decline. Continued spending pressures, along with a comparatively volatile revenue stream, likely would result in a modest erosion of reserve levels during a downturn.

The city's record during the current economic recovery of boosting reserves and increasing pension contributions indicates a commitment to bolster the city's financial profile during periods of expansion when economically sensitive revenues are increasing. Fitch's expectation is that any deferral of required spending in the future would be minimal during growth periods. The city also resolved a long-simmering dispute regarding firefighter back pay in 2016 with voter approval of a 2.5 mill property tax that over 12 years will fund the $75 million settlement.

General fund results in 2017 included a modest surplus after transfers of $1.7 million, increasing the unrestricted fund balance to $75.3 million or 11% of spending and transfers out. Healthy revenue gains kept pace with increased spending amounts, and the final results were aided by the inclusion of $10 million in one-time bond proceeds. Management projects general sales tax revenues in 2018 to come in 3% ahead of 2017 totals, bettering the original 1% budgeted increase. General fund revenues are projected to total $702.5 million (compared to $691.2 budgeted), and the current projection anticipates an addition to general fund reserves of roughly $1 million at year-end, reversing the $17.6 million use of reserves that was originally budgeted.

The Sewerage and Water Board operates and maintains the city's drainage system. Operations are supported by three millages that combined total 16.23 mills; the rates can be adjusted periodically based on reassessment. The series 2014 drainage system bonds have first claim on a tax levy originally authorized at 9 mills (expiration in 2031), with residual collections available for other drainage purposes. Of the two other levies the 3 mill tax expires in 2046 (renewed in 2016 for 30 years), and the 6 mill tax expires in 2027.

The system features 24 pumping stations, and the overall pumping capacity is roughly 30 billion gallons per day. The drainage network includes approximately 90 miles of open canals and 90 miles of subsurface canals.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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