FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades New Orleans, LA's IDR to 'A' on Negative Watch

Mon 04 May, 2020 - 1:24 PM ET

Fitch Ratings - Austin - 04 May 2020: Fitch Ratings has downgraded the Issuer Default Rating (IDR) of the City of New Orleans, LA to 'A' from 'A+'.

Fitch also has downgraded the ratings on the following obligations of the city to 'A' from 'A+':

--$307.7 million in general obligation (GO) and public improvement bonds of the city and the Board of Liquidation, City Debt;

--$145.3 million limited tax refunding bonds, series 2012 (taxable);

--$10.4 million Audubon Commission aquarium tax bonds, series 2011A-1;

--$7.7 million drainage system refunding bonds, series 2014.

Fitch has placed all of the ratings on Rating Watch Negative.

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, aquarium tax and drainage system bonds are payable from limited ad valorem taxes (such rates subject to adjustment periodically due to reassessment) upon all taxable property in the city.

ANALYTICAL CONCLUSION

Underpinning the downgrade of the IDR and bond ratings to 'A' from 'A+' and the Rating Watch Negative is the significant economic damage due to the COVID-19 pandemic and accompanying shutdown of the city's vital tourism sector. Louisiana, and New Orleans in particular, has recorded a significant number of COVID infections, hospitalizations, and deaths in recent weeks. The shutdown is producing a sharp reduction in economically sensitive revenues, and the possibility of an extended period of recovery in tourism suggests a weaker revenue trend in coming months. This revenue pressure will require actions by the city to maintain recently bolstered reserves at a satisfactory level, including spending reductions and infusion of other revenues (either through government assistance programs or external borrowings, or both). Public safety spending and pension outlays will continue to be a source of operational pressure for the foreseeable future, contributing to expected weakened expenditure flexibility.

ECONOMIC RESOURCE BASE

New Orleans' status as a major tourism destination, along with its significant commercial presence, has been a major growth driver in recent years. The local economy also continues to diversify from a historical reliance on shipping and energy with gains in healthcare and technology. The estimated population is about 390,000, slightly more than 85% of the total before Hurricane Katrina in 2005.

KEY RATING DRIVERS

Revenue Framework: 'a'

New Orleans' 10-year compound average annual revenue growth history through 2018 exceeded U.S. GDP, as the city's economic expansion continued. Once the pandemic eases, Fitch anticipates a moderate pace of revenue recovery, leaving growth trends below recent strong levels for an extended period. 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 to marginally exceed revenue growth as the city adjusts to a potentially less robust revenue trend. A 2016 settlement with firefighters over back pay established a certain repayment schedule, and other spending 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 net pension liabilities is moderate at about 11% of total personal income. Fitch does not expect this level 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'

The city has adequate gap-closing capacity; operations likely would be stressed in a typical downturn. Limited revenue raising ability further constrains the overall financial resiliency assessment. The combination of public safety and pension spending pressures limit expenditure flexibility, a source of pressure that likely will worsen in the current environment.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A prompt, sustained recovery in the all-important tourism sector that produces a rebound in economically sensitive revenues, leading to a strengthening of the revenue framework assessment.

--A sustained downward trend in the long-term liability burden.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A more prolonged than expected period of economic weakness due to the COVID-19 pandemic that further erodes operating revenues and financial resilience.

--An increase in carrying costs that restricts the city's expenditure flexibility and weakens the overall assessment for expenditure framework.

BEST/WORST CASE RATING SCENARIO

International scale credit 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, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

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. While New Orleans' most recently available fiscal and economic data may not fully reflect impairment, 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.

Management currently is projecting a 20% decline in general fund revenues for all of 2020. They report roughly $2.5 million in COVID-related expenses to date and are anticipating approximately $20 million in total pandemic spending by year-end. Management also stated they are currently exploring cash flow borrowing options.

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 expected to employ 20,000 ultimately. Prior to the pandemic, tourism totals had posted a series of annual records as the city continued its post-Katrina rebound. The 2018 visitor count totaled 18.5 million and visitor spending was a record $9.1 billion. Cruise bookings also were at record levels in 2018 with nearly 1.2 million passengers. Mardi Gras, Jazz Fest, major sporting events and the National World War II Museum are other trademark tourism draws. New Orleans' recently stated it is unlikely the city will host any large gatherings/festivals for the remainder of 2020.

REVENUE FRAMEWORK

Sales and property taxes are the two largest components of general fund revenue, providing more than half of the $732 million operating revenue total in 2018. Other major revenue sources are charges for services (12.5%) and licenses and permits (10.5%).

The city's revenue growth trend in recent years was strong. The 10-year revenue history of more than 7% average annual gains through 2018 comfortably exceeded U.S. GDP over the same period, reflecting the healthy pace of recovery and expansion since Hurricane Katrina in 2005. However, the COVID-19 pandemic is sharply reducing sales tax and other economically sensitive revenues. The likelihood of a moderate pace of recovery in tourism traffic suggests that the revenue trend will be weaker for some time.

The city's legal ability to independently increase operating 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, permits) 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 2018 outlays), and ongoing spending associated with a police consent decree and parish prison operations will keep overall spending pressures elevated. Parish prison operating expenses totaled $53 million in 2018, roughly 7% of total general fund spending and up from roughly $35 million in 2015.

Spending levels over the near term will likely be higher than a materially weaker revenue stream before an economic recovery eventually restores a more balanced picture.

The city retains adequate flexibility regarding main expenditure items. However, civil service commission rules that govern certain workforce-related adjustments (e.g. layoff procedures) would hamper the pace at which the city could affect staff reductions. Carrying costs (combined debt and retiree benefit outlays) in 2018 were moderately high at 21% of governmental spending, and expected increases to pension contributions likely will keep carrying costs elevated 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 above average at roughly 64% in 10 years. Voters approved a $500 million bond proposal in November 2019 by a 65% to 35% margin that will finance a variety of infrastructure improvements over the next several years, as well as public safety, parks, public buildings and affordable housing improvements.

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. Long-term liabilities, including the combined overall debt and net pension liability for the city, represent a moderate 11% of total personal income. The 2018 combined net pension liability (adjusted for a 6% investment return assumption) totaled $1.2 billion and the adjusted ratio of pension assets to liabilities was low at 42%, suggesting future contribution increases are likely. Fitch expects the overall liability burden to remain in the moderate range. Other post-employment benefit liabilities total $123.7 million or 0.6% of personal income.

OPERATING PERFORMANCE

The city's satisfactory revenue-raising ability and a somewhat constrained expenditure flexibility profile provide adequate gap-closing ability in the event of a moderate economic decline. That gap-closing ability will be further constrained in coming months due to the sharp drop in economically sensitive revenues. Continued spending pressures will likely combine with the volatile revenue picture to erode financial resilience coming months.

The city's positive performance prior to the pandemic enabled it to boost reserves and increase pension contributions. These actions indicated a commitment to bolster the city's financial profile during periods of expansion when economically sensitive revenues are increasing. While a significant portion of the total general fund balance ($50 million out of a total of $97.9 million in fiscal 2018) is categorized as either non-spendable or restricted, staff reports these funds (consisting primarily of an emergency reserve and a portion of the BP settlement from the 2010 Deepwater Horizon oil spill) can be used for operational support with city council approval.

General fund results in 2018 included a surplus after transfers of more than $22 million, as healthy revenue gains kept pace with increased spending amounts. Sales tax revenues of $253 million represented a solid gain of nearly 6% from the prior year. Preliminary 2019 general fund results include a roughly $20 million surplus after transfers and addition to fund balance. Staff reports the combination of available reserves and restricted/non-spendable reserves that could be accessed through council action was approximately $100 million at 2019 year-end.

Management currently projects a roughly 20% drop in 2020 general fund revenues below original budget projections, led by a more than $100 million decline in sales tax revenues. Sales tax receipts were originally budgeted at $264 million for 2020, or 36% of general fund revenues. When the COVID-19 outbreak occurred in New Orleans in early March, the city enacted a hiring freeze and departmental spending reductions. Management anticipates receiving a portion of the state allocation under the federal CARES Act and is also pursuing FEMA grant funds to reimburse pandemic-related expenditures. They also report efforts to secure a loan to assist with cash flow pressures for the remainder of the year.

The Sewerage and Water Board operates and maintains the city's drainage system. Operations currently 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.

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

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to 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		
New Orleans (LA) [General Government]	LT IDR	A	Downgrade
• New Orleans (LA) /General Obligation - Limited Tax/1 LT	LT	A	Downgrade
• New Orleans (LA) /General Obligation -	LT	A	Downgrade

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 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

New Orleans (LA)	EU Endorsed
New Orleans Board of Liquidition, City Debt (LA)	EU Endorsed

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