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RATING ACTION COMMENTARY

Fitch Rates New Orleans, LA $120MM GO Rfdg Bonds 'A', Affirms IDR; Outlook Stable

Thu 15 Sep, 2022 - 12:01 PM ET

Fitch Ratings - Austin - 15 Sep 2022: Fitch Ratings has assigned an 'A' rating to the following obligations of New Orleans, LA:

--$120.0 million GO refunding bonds, series of 2022.

The bonds are scheduled for a negotiated sale in early October. Proceeds will refund a portion of the city's tax-supported debt for interest savings.

Fitch also has affirmed the Issuer Default Rating (IDR) of the city of New Orleans, Louisiana at 'A' and affirmed the 'A' rating on the following obligations:

--$782.4 million in GO, public improvement bonds (PIBs) and limited tax (LT) debt of the city and the Board of Liquidation, City Debt (pre-refunding); and

--$2.0 million drainage system refunding bonds, series 2014.

The Rating Outlook is Stable.

SECURITY

The series 2022 GO refunding bonds and outstanding GO bonds and PIBs are payable from an unlimited ad valorem tax levied against all taxable property in the city. Outstanding LT bonds 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. Certain series of the city's GO debt have been issued by the Board of Liquidation, which has an independent board and manages all bonded debt matters of the city, including setting millage rates for repayment.

ANALYTICAL CONCLUSION

The affirmation of the 'A' IDR and bond ratings is based on a satisfactory operating profile and an expenditure framework assessment pressured by weak pension funding levels, balanced against solid revenue growth prospects and a moderate long-term liability burden. Recent positive economic trends and federal pandemic assistance have eased near-term budgetary pressures, and longer-term economic prospects remain positive due to the city's role as a major tourism and convention destination.

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 population is estimated at about 375,000, more than 80% of the total before Hurricane Katrina in 2005.

KEY RATING DRIVERS

Revenue Framework: 'a'

New Orleans' 10-year CAGR growth history through 2020 exceeded U.S. GDP, as the city's economic expansion continued. As the tourism sector recovers from the pandemic Fitch anticipates a solid pace of revenue growth over the near term. 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. A 2016 settlement with firefighters over back pay establishes a certain repayment schedule, and other spending pressures continue. Carrying costs (for debt and retiree benefits) are moderate, and Fitch considers overall expenditure flexibility adequate.

Long-Term Liability Burden: 'aa'

The combination of debt and net pension liabilities is moderate at about 10% 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'

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.

RATING SENSITIVITIES

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

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

--A marked, sustained increase in operating reserves that boosts the financial resilience assessment.

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

--Recurring failure to address future budget gaps that erodes the current satisfactory gap-closing capacity and weakens the budget-management assessment.

--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 Sovereigns, Public Finance and Infrastructure 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 general fund posted positive results in 2020 (FYE Dec. 31) despite a pandemic-induced shutdown of the city's all-important tourism sector in the spring of that year. Weakness in sales tax receipts ($164 million compared with $206 million budgeted) and other economically sensitive revenues was offset to a degree by gains in property tax revenues and one-time monies. Spending also came in sharply below budget -- general fund outlays totaled $635 million compared with $725 million budgeted. The unrestricted general fund balance increased by $42.6 million from the $27.6 million reported at YE 2019, bringing available reserves at year-end to $78.3 million or 12% of spending.

Management reports preliminary fiscal 2021 results featured a moderate recovery in sales tax receipts ($184 million or a 12% increase from the prior year) and the infusion of federal pandemic assistance ($194 million of the city's $388 million American Rescue Plan Act [ARPA] allocation). The assistance was used largely to replace lost revenue and support various public safety expenditures. Operating revenues for 2021 are currently projected to exceed outlays by roughly $20 million, and the receipt of grant monies is expected to boost the surplus and reserve levels higher. The city's 2021 audit is expected to be completed in late fall 2022; staff reports ongoing recovery and system improvements following a December 2019 cyber attack and pandemic-related staffing challenges have contributed to the delay in completion of the report.

Staff reports 2022 is seeing a sharp rebound in tourism-related revenues. The return of large visitor events (Mardi Gras, JazzFest, Essence Festival, etc.) and an uptick in convention business are behind the revenue gains. Sales taxes for 2022 were budgeted at $203 million and are currently projected to end 2022 at least 10% higher than the budgeted amount. General fund revenues and spending were each budgeted at $652 million. Given this reported economic recovery and continued use of ARPA monies the city is projecting another general fund surplus in 2022.

CREDIT PROFILE

While still a tourism-based economy, New Orleans has diversified since Hurricane Katrina in 2005 -- most notably in healthcare. Prior to the pandemic, tourism totals posted a series of annual records as the city continued its post-Katrina rebound. Annual cruise bookings were also at record levels before the pandemic with more than one million passengers. Mardi Gras, Jazz Fest, major sporting events and the National World War II Museum are other major tourism draws. Tourism traffic in recent months has trended higher, with staff reporting tourism-related economic activity approaching pre-pandemic levels.

Revenue Framework

Sales and property taxes are the two largest components of general fund revenue, providing more than half of the $689 million operating revenue total in 2020. Other major revenue sources are charges for services (19%) and licenses and permits (10%).

The city's revenue growth trend in recent years was strong. The 10-year revenue history of 4% average annual gains through 2020 exceeded U.S. GDP over the same period, reflecting the healthy pace of recovery and expansion since Hurricane Katrina in 2005. Fitch anticipates a solid pace of revenue growth over the near term as the tourism sector rebounds and other sectors expand.

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 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 (40% of 2020 outlays), and ongoing spending associated with a police consent decree and parish prison operations will keep overall spending pressures elevated. General government is the second largest spending category at 39% of 2020 outlays.

Inflationary effects as well as public safety and pension pressures are expected to keep spending at or above a projected solid revenue growth trend.

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 to a degree the pace at which the city could affect staff reductions. Carrying costs combined debt and retiree benefit outlays in 2020 were moderately elevated at nearly 18% of governmental spending, and expected increases to pension contributions and additional borrowings likely will keep carrying costs elevated going forward.

Long-Term Liability Burden

The city's long-term liability burden is moderate at roughly 10% of total personal income. Fitch expects the overall liability burden to remain in this range, as additional debt will be balanced against expansion of the resource base. 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 city in 2021 issued the initial installments from a $500 million bond proposal approved by voters by a 65% to 35% margin in November 2019 that will finance a variety of infrastructure improvements, 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. The 2020 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 45%, suggesting future contribution increases are likely. Other post-employment benefit liabilities total $173 million, or 0.8% 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 a typical moderate economic decline. Budgetary pressures will continue, but recent positive revenue performance and pandemic-related assistance are expected to provide additional budgetary maneuverability over the next several years.

The Fitch Analytical Stress Test (FAST) scenario analysis tool anticipates moderately elevated negative revenue pressure on the city under a moderate economic downturn scenario, although the revenue volatility is likely overstated due to sharp post-Katrina revenue declines in 2005 and 2006. FAST relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria and provides a relative sense of the risk exposure of a particular local government compared with other U.S. local governments. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance.

The city's positive performance prior to the pandemic enabled it to increase both reserves and pension contributions. These actions indicated a commitment to bolster the city's financial profile during periods of expansion when economically sensitive revenues are increasing. Fitch expects this pattern to resume as the city's tourism sector approaches pre-pandemic levels and management utilizes federal pandemic financial assistance on various operational and capital priorities.

The Sewerage and Water Board operates and maintains the city's drainage system. Operations are supported by three millages that 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 nine mills (expiration in 2031), with residual collections available for other drainage purposes. Of the two other levies, the three-mill tax expires in 2046 (renewed in 2016 for 30 years), and the six-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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

New Orleans (LA) [General Government]	LT IDR	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
New Orleans (LA) /General Obligation - Limited Tax/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
New Orleans (LA) /General Obligation - Unlimited Tax/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
New Orleans (LA) /Limited Ad Valorem Tax Revenues/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

New Orleans (LA)	EU Endorsed, UK Endorsed

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