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Ratings

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Summary:

New Orleans, Louisiana; General Obligation

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Table Of Contents

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Credit Profile		
US$9.5 mil ltd tax bnds ser 2020 due 05/01/2040		
Long Term Rating	AA-/Negative	New
New Orleans GO		
Long Term Rating	AA-/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to New Orleans' $9.5 million series 2020 Audubon Commission (a component unit of the city) limited-tax bonds. At the same time, we affirmed our 'AA-' long-term and underlying (SPUR) ratings on the city's limited property tax debt and general obligation (GO) debt outstanding. The outlook is negative.

The bonds are secured by the Audubon Commission's portion of a dedicated 6.31 mill special ad valorem tax. The commission's portion of the tax is expected to generate approximately $6.5 million in 2021 against maximum annual debt service of $686,000 on the bonds as well as funding the final payment on the city's outstanding 2011A-1 bonds (maturing in 2021 in the amount of $3.8 million). The city's GO bonds are secured by revenue from an unlimited ad valorem tax levied on all eligible property within the city's boundaries. The series 2012 limited-tax refunding bonds are secured by an irrevocable first lien on and dedication of funds derived from a 13.91-mill special ad valorem tax. The series 2014 drainage system refunding bonds are secured by a nine-mill special ad valorem tax, which is currently levied and collected at 7.06 mills as a result of reassessments. Given that the limited-tax obligations are levied on the same base as the GO bonds, combined with a demonstrated commitment to support the obligations, we rate these limited-tax GO bonds on par with our view of New Orleans' general creditworthiness, as expressed in the rating on the unlimited-tax GO bonds.

Though the Audubon Commission is an unattached board and separate legal entity, it is considered a component unit of the city. The governing board of the commission is appointed by the mayor and because of this, the city has financial accountability for the commission and can exert its will. Bond proceeds will be used for a number of capital projects , including to the commission's parks, zoo, and aquarium.

Credit overview

Following a prolonged period of economic expansion, resulting in material diversification of the economy, the COVID-19-driven recession has severely affected the city's vibrant local economy. Although New Orleans' local economy has diversified and grown into health care, technology, and financial sectors in recent years, the city is a popular tourist destination and a large portion of the economy is based on large events, conferences, and out-of-state visitors. Restrictions on travel and consumer activity--stemming from social distancing and stay-at-home orders intended to flatten the curve and slow the viral infection rate--led to hotel booking cancellations and deferrals, conference cancellations, and the widespread closure of bars and restaurants. The resulting shock to the city's operating revenue will materially limit the city's ability to achieve structural balance this fiscal year. The significant decline in economic activity will weaken the city's financial position, which, in our view, was already contending with large pension liabilities and hurricane and flooding risks. The negative outlook reflects our view that there is a one-in-three chance that we could lower the rating over the coming year once the economic and financial impact of the pandemic recession fully materializes, while also considering the expenditure adjustments implemented to stem the losses.

For more information on the coronavirus' effect on U.S. public finance, see the reports "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020, on RatingsDirect, and "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020.

The rating reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area;
- Strong management, with good financial policies and practices under our financial management assessment methodology;
- Weak budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2018 of 8% of operating expenditures;
- Very strong liquidity, with total government available cash at 35.8% of total governmental fund expenditures and 2.9x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 12.4% of expenditures and net direct debt that is 69.0% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but low overall net debt at less than 3.0% of market value and rapid amortization, with 66.8% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Environmental, social, and governance factors

While the city faces imminent pressure as a result of the social risks represented by the response to the pandemic, resulting in elevated unemployment and disruptions in consumer spending that we believe will have a material and sizable impact on the city's key operating revenue as compared with peers, we believe that the city's environmental risks represent a longer-term--and more outsized--risk to long-term credit quality. As a result of weak soils and the global incidence of sea level rise, the U.S. Army Corp of Engineers stated that engineering analysis indicates that the Greater New Orleans Hurricane and Storm Damage Risk Reduction System may not provide the intended mitigation by as early as 2023. Although the city has largely been spared from the historically active hurricane season in 2020, we believe that the city's risks remain elevated and not in line with the sector standard. Our analysis of governance risk factors incorporates a significant cyberattack to the city's digital infrastructure at the end of 2019. Despite the financial impact of this attack, we believe that the city's governance risks are in line with those of peers.

Negative Outlook

Downside scenario

If the severe effects on the city's key operating revenue continue, resulting in a material reduction to available reserves, we could lower the rating. We could also lower the rating if expenditure pressures arise, compounding the impact of revenue declines, as a result of either a natural disaster or rising fixed costs.

Return to stable scenario

Conversely, we could consider revising the outlook back to stable if the city is able to make the budgetary adjustments it deems necessary to ensure near-balanced operating results, with immaterial impact to available reserves.

Credit Opinion

Strong economy

We consider New Orleans' economy strong. The city, with an estimated population of 398,611, is located in Orleans Parish in the New Orleans-Metairie metropolitan statistical area, which we consider broad and diverse. The city has a projected per capita effective buying income of 93.4% of the national level and per capita market value of $104,424. Overall, the city's market value grew by 18.2% over the past year to $41.6 billion in 2020. The parish unemployment rate was 4.9% in 2019, though we note that unemployment is elevated as a result of the pandemic and recessionary pressures.

New Orleans, located in southeastern Louisiana, is the state's largest metropolitan area and features a diverse economy. Over the past decade, New Orleans has continued to diversify its local economy, with strong growth in the technology, health care, manufacturing, and energy sectors. Pre-COVID, developments included growth in the South Market District and the construction of a Four Seasons hotel. New businesses in the city include DXC technology, a digital media company that expects to hire 2,000 employees in the next several years, and other technology companies such as iMerit, Fortive, and DreamLeague Gaming, and small expansions have taken place at Boeing, Advanced Cutting Solutions, and LM Wind Power. Despite this growth and diversification, the area remains exposed to the tourism industry, which has been a major contributor to the vibrant economy and the strong historical growth. Leading up to the COVID-19 pandemic, the sector had seen sustained growth in visitors and cruise ship passengers.

Beginning in late February/early March, the COVID-19 pandemic began having a severe impact on visits to the city. Given the strong reliance on this sector, the drop-off in visitors has had an outsized effect on the local economy, particularly employment in vulnerable service industry sectors. Parish unemployment, which has historically trended above national levels but tracked that of the state, peaked in April at 22.2%. While reopening has helped moderate this number, July monthly unemployment remained elevated at 15.1%. Until consumer confidence returns, we believe that travel to the city will remain depressed, likely taking years to fully recover. Year-to-date enplanements at Louis Armstrong New Orleans International Airport were down 56% in July, compared with the prior-year period. Given the uneven recovery and outsized reliance on tourism, we believe that the local economy remains exposed to volatility and poses a risk to many of the city's economically sensitive revenue streams.

Strong management

We view the city's management as strong, with good financial policies and practices under our financial management assessment methodology, indicating our view that financial practices exist in most areas but that governance officials might not formalize or monitor all of them on a regular basis.

The city implemented a hazard mitigation plan in 2015, and officials report having implemented 70 of the 93 action items. Officials expect to update the plan in 2020, and will include the U.S. Army Corps of Engineers and National Weather Service in discussions. The U.S. Army Corp stated in a Federal Register dated April 2, 2019, that engineering analysis indicates that the Greater New Orleans Hurricane and Storm Damage Risk Reduction System no longer provides a 1% risk reduction as early as 2023, given weak soils and the global incidence of sea level rise.

The city has identified deferred maintenance costs, but has included only some costs related to hazard mitigation in the long-term capital plan. In addition, it has identified no city-specific expenses related to the Hurricane and Storm Damage Risk Reduction System. While we believe the city has maintained quality hazard mitigation plans, we believe that a failure by the city to take additional steps to identify future costs related to hazard mitigation may put pressure on the rating.

In addition, the city has not identified plans to address the substantial pension liability related to the pension plans it manages. For example, the city has not identified actuarial assumption changes or crafted a funding plan. If, in subsequent reviews, our assessment of the city's long-term planning has not changed and the city makes no progress in addressing these long-term risks, we may adjust our assessment of the city's financial management.

Officials use historical trends, local economic reports from local universities, and routine contact with the assessor's office when developing budgetary revenue and expenditures. Officials also use an informal five-year operational financial plan that is reviewed and updated annually. Strengths include strong oversight in terms of monitoring progress against the budget during the year through monthly review of budget-to-actual results, a formal five-year capital plan that is reviewed annually, and strong investment management policies. Although officials have a formal debt policy to govern the issuance of GO debt, the city lacks a formal policy that governs other security types beyond the constraints of state laws. The city has a formal reserve target to improve the assigned fund balance to 10% of recurring revenue to cover insurance deductibles in case of a major hurricane. The city has not met the target on an audited basis but appears to have met the mark at fiscal year-end 2019. However, given the crisis, we believe that the city will be challenged to maintain reserves.

Weak budgetary performance

Notwithstanding the city's positive operating performance in fiscal 2018 and unaudited 2019, our forward looking assessment of budgetary performance incorporates that risk that larger economic headwinds posed by the COVID-19 pandemic will impact the city's revenues, causing budget results to moderate in the near-term. The city had operating surpluses of 3.1% of expenditures in the general fund and of 17.9% across all governmental funds in fiscal 2018. Weakening our view of New Orleans's budgetary performance is the city's deferral of significant expenditures, which we think inflates the budgetary result ratios. We negatively adjust our performance score based on the city's underfunding of its firefighters pension plans in three of the past four years.

The primary government revenue sources are property taxes (37%), sales taxes (36%), and franchise fees (6%). For fiscal 2018, the city reported strong operating results, with a surplus of $22.3 million, primarily as a result of an increase in sales taxes and a substantial increase in revenue from the city's hotel and motel business. For fiscal 2019, unaudited results indicate that the city will realize another general fund surplus, increasing fund balance by more than $20 million. However, a cyberattack that occurred late in the year has delayed the city's audit. The cyberattack reportedly cost approximately $7 million, but has caused significant time investment to restore and recover key infrastructure. Despite the cyberattack, the surplus was again primarily attributed by the city to continued tax growth, particularly sales tax and hotel/motel tax increases. In November, voters approved a 6.75% short-term rental tax, with preliminary estimates of an additional $10 million in revenue per year, with 75% dedicated to local infrastructure and 25% to tourism activities. However, at the same election, voters denied a three-mill special tax whose proceeds would have been directed to infrastructure needs.

With an adopted surplus budget, the city entered fiscal 2020 on sound financial footing but for the lingering aftereffects of the cyberattack. However, the pandemic brought with it sharp declines in key revenue sources, largely sales taxes and hotel/motel taxes (though these account for a comparatively small part of the budget). In response to the expected declines, the city implemented a citywide hiring freeze and a freeze on nonessential expenses, and all departments were required to submit a budget reduction plan, which also led to savings on contractual items. Through July 2020, sales taxes were down nearly 22% compared with the prior-year period, while hotel/motel taxes were down by 53%. Based on preliminary estimates provided by the city, year-end revenue will come in at around $610 million compared with the budgeted $726 million. Included in these estimates is a $39.5 million one-time payment for the renewal of a lease by Harrah's Casino. Personnel savings are estimated at around $19 million, while other department spending reductions may save another $62 million. Included in the results is approximately $42 million in Coronavirus Aid, Recovery, and Economic Security (CARES) Act funding that has been received, with additional fund likely later in the year. Based on these revised estimates, the city will likely realize an operating deficit of nearly $10 million.

As part of the 2021 budget process, the city intends to carry most of the expenditure saving measures into next year, but it is still revising revenue projections. Given the severity of the revenue interruptions and the uncertainty regarding the recovery, we believe that the city will remain challenged in achieving structural balance, especially when considering the underfunding of the city's firefighter pension plans. Future considerations of the city's rating will hinge on the fiscal year-end 2020 performance and projections for fiscal 2021. If the city is unable to maintain the strong progress made in 2018 and 2019 while adequately managing its long-term fixed costs, we could consider a lower rating.

Adequate budgetary flexibility

New Orleans' budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2018 of 8% of operating expenditures, or $56.4 million. Fund balances overall have grown in the past two years, to $98 million in fiscal 2018, from $75.7 million in fiscal 2017 and $73.9 million in fiscal 2016. The city reported $21 million in unassigned funds in fiscal 2016, but then recorded a negative $20 million entry in fiscal 2017 and a negative $33 million in fiscal 2018. Officials attribute the negative unassigned fund balance to the classification of fund balance based on auditor's recommendations and to better protect the city's fund balances.

The city has reclassified a significant amount of funds into the nonspendable ($18.3 million) and committed ($23.2

million) categories, and has also reclassified BP settlement funds from assigned to restricted ($31.6 million). The nonspendable line indicates funding awaiting reimbursements from respective grant funding sources, and the committed line accounts for funds set aside for purchase orders. The restricted line contains BP settlement funds. Officials report that the funds can be repurposed with council approval. We have adjusted the fund balance to include BP proceeds in the restricted line, but are not including funds listed as nonspendable or committed, taking a conservative approach to our fund balance metrics.

Based on the city's unaudited fiscal 2019 results, the unassigned and assigned reserves grew to $46.9 million (from $24.8 million). When considering the $31.6 million in BP funds, we calculate that the city was able to enter fiscal 2020 with an available reserve balance of more than $78 million, representing approximately 11.3% of 2019 expenditures.

Very strong liquidity

In our opinion, New Orleans' liquidity is very strong, with total government available cash at 35.8% of total governmental fund expenditures and 2.9x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

In addition to the cash reported in the audit, we have included investments with maturities of less than one year in our calculations. New Orleans has demonstrated an exceptional ability to tap the capital markets through the issuance of GO debt, utility revenue debt, and sales-tax-supported debt during the past 15 years. The city has no variable-rate debt or swaps in is portfolio. We consider the city's governmental investments liquid and nonaggressive, as they are held primarily in U.S. Treasuries and a state pool. The city disclosed two privately placed issues, both for $10 million, issued in 2016 and 2017, with 10-year terms. Officials report no acceleration or default provisions. Given fund balances available to the city cover the total amount, we see no liquidity risks regarding these two issues.

In response to the acute revenue pressure that the pandemic and ensuing recession pose, the city has begun the process of obtaining a line of credit in the amount of $50 million to manage operating capital needs. Officials intend to draw the full amount by next February. While we have not analyzed the terms of the prospective agreement, we see no provisions that would pose a contingent risk to liquidity.

Weak debt and contingent liability profile

In our view, New Orleans's debt and contingent liability profile is weak. Total governmental fund debt service is 12.4% of total governmental fund expenditures, and net direct debt is 69.0% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, and approximately 66.8% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following this issuance, the city will have approximately $730 million in net direct debt outstanding. In November, 2019, the electorate approved as much as $500 million in GO bonds to be issued for a variety of projects. Officials expect to use the funds for a significant number of projects that would cover infrastructure, housing, recreational and cultural facilities, drainage, and public safety. The city intends to issue the $500 million over a five-year period. Given the already very weak debt profile, we don't expect the additional issuance to change our view of the city's debt. However, if debt issuance outpaces the city's ability to manage its growing fixed costs, leading to budgetary stress, we could lower the rating.

Officials disclosed two privately placed issues, both for $10 million, with 10-year terms. Documentation provided by the city indicates no cross-default provision or acceleration provisions. The city is also in the process of issuing the aforementioned line of credit. We understand that the prospective loan provisions are standard.

Pension and other postemployment benefit (OPEB) liabilities

In our opinion, a significant credit weakness is New Orleans' large pension and OPEB liability, given the lack of a firm plan that we think will sufficiently address the obligation by addressing the low funded ratios and large pension liabilities long term.

The city sponsors and participates in four separate pension systems: Fire Fighter's Pension and Relief Fund (Old Fire System), Fire Fighter's Pension and Relief Fund (New System FPRF), Municipal Police Employment Retirement System (MPERS), and the Employees' Retirement System of the City of New Orleans (NOMERS).

The city manages all of the plans except for MPERS. The funded ratios for the city-managed plans vary from 2.82% to 55.0%, and funded ratios have been decreasing for the two firefighter and employees retirement systems. The city is contributing more than the annual debt contribution (ADC) for the employee's retirement system, and has contributed less than the ADC three of the past four years for both the new and old firefighter's retirement system. The old firefighters system is only for employees who joined the force prior to 1968.

Management plans to contribute to the plans as it has in recent years, but is also considering implementing some of the recommendations outlined in a recent five-year actuarial experience study on employee retirement. These recommendations include lowering the discount rate to 7.0% from 7.5%, changing the rates of liability, and changing the annual pay increase assumptions. These changes, in particular to the discount rate, will likely increase the actuarially determined contribution and other contributions.

Officials report that the firefighter's old system plan is handled on a pay as you go basis, with benefits payments as needed. This has resulted in the funded ratio of the plan decreasing to 2.82% with a liability of nearly $135 million. The new firefighter's system plan was underfunded from 2014 through 2017, according to the fiscal 2018 financial statements, and the city made payments in excess of the ADC only in fiscal 2018, but the funded ratio is still at 10.27% with a net pension liability of $373 million. The previous board of the firefighters plan has been removed and a new board was instituted in the past year as a result of management issues with the plan. In addition, officials disclosed that the previous investment mix of the pension plan included properties and riskier securities that lost significant value during the financial crisis. According to 2018 financial results, the plan is still heavily invested in real estate, with 45% of assets in real estate and 40% of investments in equity securities. We view this investment portfolio as risky and exposed to market conditions, which could increase the liability. The new plan has a discount rate of 7.5%, which we believe indicates that the plan assets are subject to market risk. Finally, the plan's mortality table is from 1994, and if the mortality table is updated, the liability could increase. Officials plan on making the ADC payment and reallocating funds in the investment portfolio, but report that they will wait approximately a year before making changes.

As of fiscal 2018, MPERS was funded at 71.89%, with funding ratio increase in the past two years. The city's net pension liability proportion is $205 million. The discount rate to measure total pension liability was lowered to 7.2% in fiscal 2018. Although this rate is above our guidance of 6.5%, the growth in the net pension liability indicates that this plan is not a significant concern for the city. The city also provided OPEB benefits for retired employees in 2018 and made $8.4 million in payments. The plan is funded on a pay-as-you-go basis and the total liability is $123.7 million.

In our opinion, the underfunded pensions and large liabilities are a significant financial concern for the city. The three plans that the city manages have a combined liability of nearly $800 million. The city passed a 2.5-mill property tax increase to help fund the firefighter plan in 2016, but funded ratios continue to decline and the liability continues to grow. We do not believe that these liabilities overwhelm the city's finances, but in the medium term we believe that the city's pension obligations will lessen budgetary flexibility and performance. In particular, we believe that the firefighters plan is a significant credit risk, and that the city will deal with financial pressures from the city-managed pension plans for the foreseeable future. We will monitor the city's progress in creating a realistic plan to address these concerns.

Very strong institutional framework

The institutional framework score score for municipalities in Louisiana is very strong. The score reflects our view of the state's legislation, specifically the Lawrason Act, which describes financial reporting activities required by municipalities in the state. In addition, the score reflects the state's program to appoint a fiscal administrator for municipalities that are in severe distress and the recent history of ballot initiatives, none of which have significantly impaired the city's ability to raise revenue through taxes.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of September 25, 2020)		
New Orleans taxable GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO		
Long Term Rating	AA-/Negative	Affirmed
New Orleans GO		
Long Term Rating	AA-/Negative	Affirmed
New Orleans GO		
Long Term Rating	AA-/Negative	Affirmed
New Orleans GO		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
New Orleans GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

Ratings Detail (As Of September 25, 2020) (cont.)

Many issues are enhanced by bond insurance.