S&P Global
Ratings

RatingsDirect®

Summary:

New Orleans; General Obligation

Primary Credit Analyst:
Alex Louie, Centennial + 1 (303) 721 4559; alex.louie@spglobal.com

Secondary Contact:
Joshua Travis, Dallas + 1 (972) 367 3340; joshua.travis@spglobal.com

Table Of Contents

Summary:

New Orleans; General Obligation

Credit Profile		
US$120.0 mil GO rfdg bnds ser 2022 due 12/01/2042		
Long Term Rating	A+/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'A+' rating to New Orleans, La.'s general obligation refunding bonds (GO), series 2022 ($120 million).
- The outlook is stable.

Security

The city's GO bonds are secured by revenue from an unlimited ad valorem tax levied on all eligible property within its boundaries. Officials intend to use the proceeds to refund the city's series 2021, series 2013A, and series 2014A debt outstanding.

Credit overview

The city continues to make steady progress in economic recovery, with multiple indicators like hotel occupancy, sales tax, and airport visit approaching pre pandemic levels. After two years of reserves declining, the city added to reserves in 2020 pushing available fund balances over 10%. The surplus is mostly attributed to growing revenues, federal stimulus funding, which offset a large portion of public safety costs, and expenditure cuts made in response to the pandemic. The city expects surpluses in the next two years, but we note that in 2019, management provided initially projected results that did not align with final audited results. In addition, the city faces long-term budgetary pressures given the low funding ratio and high liabilities related to the firefighters and city pension plan. New Orleans diversified in recent years into financial services and technology, and while tourism and conferences remain a significant portion of its economy, officials have focused economic development efforts on other sectors.

The rating reflects our view of the city's:

- Diverse, growing economy heavily reliant on tourism; with recovering tourism based revenues;
- Large surplus in 2020 driven primarily by federal stimulus funding;
- Large debt and pension obligations, with large pension liabilities; and
- Standard Financial Management Assessment.

Environmental, social, and governance

Our analysis of governance risk factors incorporates a significant cyber attack on the city's digital infrastructure at the end of 2019. Despite the financial effects of this attack, we believe that the city's governance risks are in line with those of peers. However, we believe that the city's environmental risks represent a long-term--and more outsized--risk to credit quality. As a result of soil issues 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 might not provide the intended mitigation by as early as 2023. The city reported the Army Corps of Engineers included $3.2 billion in its most recent president's budget request to address the issue. New Orleans' location exposes it to flooding and storm damage risks, as evidenced by the city's history with named hurricanes. In our view, the city's social risks are credit neutral.

Outlook

The stable outlook reflects our view that the city's recent financial results indicate recovering reserves. In addition, with the gradually recovering economy, we expect the city's financial position to remain stable for the next two years.

Downside scenario

If the city cannot maintain structural balance without federal stimulus funds, or if our view of the city's financial management practices weakens, we could lower the rating.

Upside scenario

If the economic recovery continues as expected, if the city increases available reserves and sustains balanced budgetary performance without federal funds, and if the city addresses its firefighters pension liability, we could raise the rating.

Credit Opinion

Economy that has diversified in recent years, but still with a large tourism and sales tax presence

Officials state that numerous indicators such as sales taxes, and hotel occupancy have increased to levels close to pre-pandemic levels in 2019. Initially, officials were expecting a full recovery by 2023 or 2024, but indicators have risen faster than expected.

Over the past decade, New Orleans continued to diversify its local economy, with strong growth in the technology, health care, manufacturing, and energy sectors. Three out of the top 10 taxpayers in the city are now in banking. Management focused economic developments on attracting businesses beyond just traditional tourism, and the city is looking to attract retailers like big box stores so that sales tax dollars do not all flow to neighboring Jefferson Parish. In addition, officials stated there is ongoing development for sports tourism and distribution centers in a large tract of land in the city.

Despite this ongoing growth and diversification, the area remains exposed to the tourism industry, with a large portion of jobs in retail and hospitality. Beginning in late February or early March 2020, the COVID-19 pandemic began having a severe effect on tourist visits to the city. With such a strong reliance on this sector, the sharp dropoff in visitors has had an outsized effect on the local economy, particularly on employment in vulnerable service industry sectors.

Adequate management practices, with some formal long-term planning practices

Officials use historical trends, economic reports from local universities, and routine contact with the assessor's office when developing budgetary revenue and expenditures. They 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 current state laws. New Orleans has a formal reserve target to improve the assigned fund balance to 10% of recurring revenues to cover insurance deductibles in case of a major hurricane. We also note that since the December 2019 cyber attack, the city strengthened protections in areas such as training, system access, and infrastructure improvements. In addition, the city updated its cyber-insurance policy to adapt to the previous attack.

The institutional framework score for Louisiana is very strong.

Strong reserves due to fiscal 2020 surplus, driven mostly by federal stimulus funding

For fiscal 2020, the city posted a significant surplus, mostly due to CARES Act and American Rescue Plan Act (ARP) funding offsetting a significant amount of public safety expenditures. The surplus drove reserves to 12.7 percent from %6 percent in 2019.

We have adjusted available fund balance to include BP proceeds in the restricted line, but we are not including funds listed as non-spendable or committed. Non-spendable reserves, according to the city, contain amounts awaiting reimbursement from various grant sources, decreased from $36.6 million to $29.6 million. The city states that these funds are related to U.S. Department of Housing and Human Development (HUD)/ Federal Emergency Management Agency (FEMA) grants outstanding, which is reflected by negative balances in its HUD and FEMA funds and that it will receive them in the near term, which will reduce the non-spendable line while increasing the unassigned fund balance line. Committed funds, which are related to purchased orders made by the city did increase to $29 million from $14 million. Meanwhile, unassigned increased to $22 million given receipt of FEMA/HUD funds. Management reports the fund balances are classified in this way to protect reserves and based on auditor recommendations. Officials plan on increasing reserves as much as possible in the future and they hope to achieve 20%, if possible.

For fiscal 2021, the city expects another surplus due to ARP, and the continued recovery in sales tax revenue. Officials expect to receive $387 million in total. Prior to the pandemic, the city leveraged a line of credit in preparation for COVID-19, and officials did use $20 million. Sales taxes have increased, and while not at 2019 levels, officials state collections are close. Officials do not expect to spend down reserves in 2022 and they hope to increase reserves to 20%. In recent years, information from the city has occasionally missed audited results, and while 2020 had a significant increase in reserves, we believe the city will have to navigate continuing challenges in the future.

The city disclosed two privately placed issues, both for $10 million, issued in 2016 and 2017, with 10-year terms. Officials state there are no acceleration or default provisions. Given that the total amount is covered by fund balances available to the city, we do not currently have any liquidity concerns about these two issues. New Orleans also entered into a revenue note in 2020 for $50 million in response to the pandemic and the city used $20 million. We note the city is currently facing a lawsuit from Orleans Parish School Board over the collection of property taxes, with damages initially set at $7.6 million; the legal matter is not yet scheduled for trial.

Very weak debt profile, with concern about pensions, particularly the firefighters' plans

In November 2019, the electorate approved up to $500 million in GO bonds to be issued for a variety of projects. Currently, the city does not have immediate plans to issue the remaining $200 million. Officials are planning on a refunding issue that could come as soon as August 2022. The city has approximately $863 million in debt outstanding.

In our opinion, a significant credit weakness is New Orleans' large pension and other postemployment benefits (OPEB) liability, given the lack of a firm plan that we think will sufficiently address it by managing the low funded ratios and large pension liabilities long term of the firefighters' plans.

The city sponsors and participates in four separate pension systems and provides OPEB benefits as follows:

As of Dec. 31, 2020:

- Fire Fighter's Pension and Relief Fund (Old Fire System), funded at 4.62% with a liability of $113.5 million;
- Fire Fighter's Pension and Relief Fund funded at 9.69% with a liability of $390.8 million;
- Municipal Police Employment Retirement System funded at 71.0% with liability of $233.5 million; and
- An OPEB plan which is unfunded with a net liability of $173.2 million.

As of Jan. 1, 2021:

- New Orleans Municipal Employees Retirement System (NOMERS) funded at 58.4% with a liability of $307.2 million.

Management made changes to the actuarial assumptions for NOMERS, reducing the discount rate to 7.25%, making changes to the payroll growth assumptions and switching to a close amortization. We view these changes as beneficial, and while contributions could increase depending on investment returns, the city now expects to make progress towards funding. Officials report that the Old Fire System plan is handled on a pay-as-you-go basis, with benefit payments made as needed. Historically, the city has not made required payments on the firefighters' plans, although it did so in 2018. The previous board of the firefighters' plan was removed and a new board 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. The city passed a 2.5-mill property tax increase to help fund the firefighters' plan in 2016, but funded ratios continue to decline, and the liability continues to grow. Management recently stated it expects to contribute $5 million a year to the firefighters' pension relief fund, and hope that adequate funding occurs in 2028.

We do not believe that these liabilities will overwhelm the city's finances in the near term, but in the medium term, we believe that the pension obligations will reduce 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 these city-managed pension plans for the foreseeable future. We believe that management will soon need to increase contributions to its city-managed plans, which will reduce budget options for other operations.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2020 Update Of Institutional Framework For U.S. Local Governments