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Anatomy of Successful US Cities

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Summary

During and in the wake of the US recession, many large local governments in the country have proven just how resilient their credit quality has been to the systemic economic downturn and other challenges such as pension underfunding. In fact, 34 of the 50 largest US cities have either improved or maintained their credit quality since the onset of the Great Recession. In the context of this report we refer to these 34 as “successful cities.”

The inherent economic strength and effective financial management of these successful cities supported their resiliency since 2008.

» **Successful cities benefitted from atypically healthy tax base growth despite the overarching challenges in the broader economy, financial sector and housing market.** The taxable property bases of these successful cities experienced a median 6.6% increase since 2008, significantly outperforming the aggregate decline of 3.6% seen by large cities nationally.

» **Successful cities’ strong financial management supported revenue growth and improved reserve positions.** Driven primarily by tax base growth, revenues grew by 7.7%, exceeding expenditure growth of 7.0%, resulting in healthy reserves that were a median 18.6% of operating revenues in fiscal 2013. These cities balanced their budgets, even as many other municipalities fell into deficits amidst falling property tax revenues and state aid. Furthermore, their fixed costs, including debt service, pensions and retiree health benefits remained relatively manageable, providing these successful cities with budgetary flexibility.

Majority of large US cities maintained or improved credit quality since 2008

The ratings of 34 of the 50 largest US cities have improved or remained the same since the Great Recession began in 2008 (see Appendix). Some 32 of the 34 successful cities were able to maintain their ratings through the economic downturn, while two experienced rating upgrades. Overall, these successful cities maintain a median rating of Aa1 (see Exhibit 1), two notches above the sector median of Aa3.

EXHIBIT 1

Since 2008, Ratings of 34 of the 50 Largest Cities Have Remained Stable or Improved

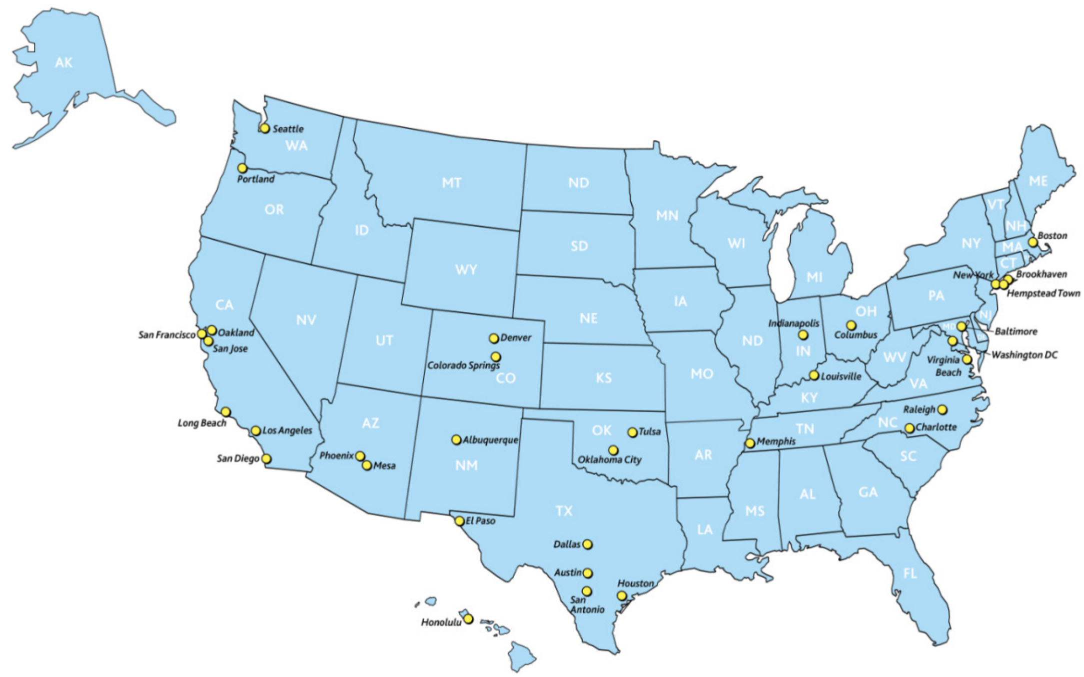
City	State	Population	Moody's Rating	Moody's Outlook
New York	NY	8,370,000	Aa2	STA
Los Angeles	CA	3,863,839	Aa2	STA
Houston	TX	2,160,821	Aa2	STA
Phoenix	AZ	1,485,719	Aa1	STA
San Antonio	TX	1,383,194	Aaa	NEG
San Diego	CA	1,326,238	Aa2	STA
Dallas	TX	1,232,243	Aa1	STA
San Jose	CA	984,000	Aa1	STA
Honolulu	HI	976,372	Aa1	STA
Indianapolis	IN	843,393	Aaa	STA
Austin	TX	841,649	Aaa	STA
San Francisco	CA	839,109	Aa1	STA
Columbus	OH	802,912	Aaa	STA
Charlotte	NC	796,921	Aaa	STA
Hempstead Town	NY	765,272	Aa1	STA
Louisville-Jefferson County Metro Government	KY	750,828	Aa1	STA
El Paso	TX	672,538	Aa2	NOO
Memphis	TN	657,457	Aa2	NEG
Denver	CO	649,495	Aaa	STA
Washington	DC	646,449	Aa2	STA
Boston	MA	636,479	Aaa	STA
Seattle	WA	626,600	Aaa	STA
Baltimore	MD	621,342	Aa2	STA
Oklahoma City	OK	595,000	Aaa	STA
Portland	OR	592,120	Aaa	STA
Albuquerque	NM	555,417	Aa1	STA
Brookhaven Town	NY	482,820	Aa2	STA
Long Beach	CA	467,646	Aa2	STA
Mesa	AZ	450,310	Aa2	STA
Virginia Beach	VA	447,489	Aaa	STA
Colorado Springs	CO	438,338	Aa2	NOO
Raleigh	NC	423,179	Aaa	STA
Oakland	CA	399,326	Aa2	STA
Tulsa	OK	397,139	Aa1	STA

Source: Ratings from Moody's.com as of 12 November 2014; 2012/2013 population data from US Census/Local Government Sources

These 34 successful cities, located in 19 different states, are concentrated in the mid-Atlantic, southwestern, and western portions of the US (see Exhibit 2).

EXHIBIT 2

Successful Cities Located Throughout US



Source: Moody's Investors Service

Successful cities have experienced healthy tax base growth compared to peers

Underpinning successful cities' credit stability over the economic downturn was their 6.6% median increase in tax base growth (full property valuation) between 2008 and 2013, compared with a decline of 3.6% for all US cities with populations over 100,000[1]. Even at the peak of the financial crisis from 2008 to 2009, the tax bases of successful cities increased by a median 6.6%. As in many cities across the nation, housing markets in eleven of the successful cities have not yet fully recovered from the downturn, but the remaining 23 cities experienced a sizeable 11.8% median increase in tax base valuations over this time period. Some of the successful cities that saw more sizable declines between 2008 and 2013, such as Phoenix (Aa1 stable), were able to offset this loss through prompt and aggressive budget actions.

[1] US Cities with populations over 100,000 include successful cities

Case Study 1: City of Phoenix (AZ)

The City of Phoenix (Aa1 stable) has been a time-tested leader in maintaining fiscal balance through a combination of aggressive and timely budget cuts and politically difficult revenue adjustments, most recently in response to severe revenue losses experienced during the Great Recession.

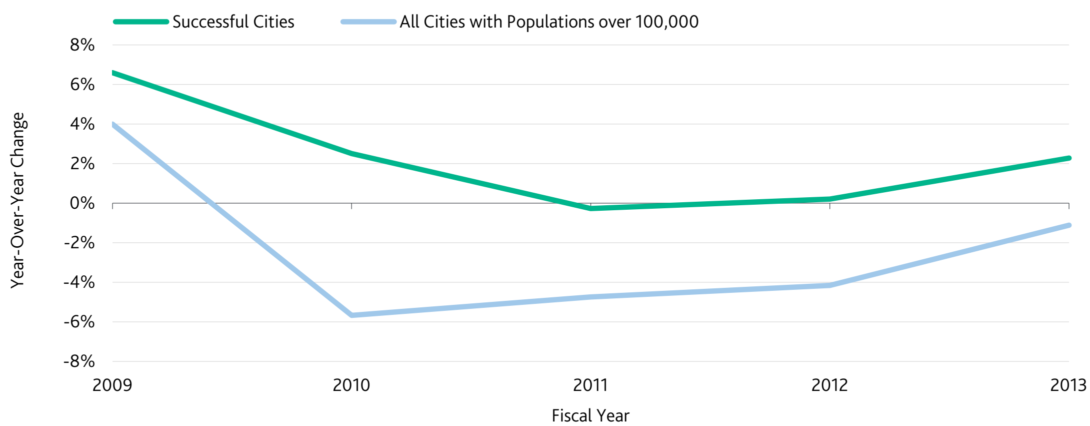
The city's financial operations were first impacted by the slowing economy in fiscal 2008 as city sales taxes began to falter in the second half of the fiscal year. By mid-2009, the city had identified a $270 million (two-year) budget gap and proposed a number of gap closing items that paved the way for a balanced budget heading into fiscal 2010. Key actions included the elimination of 924 positions (27.3% cuts to non-public safety departments and 7.5% cuts to public safety), a modest level of one-time savings mostly in the form of lease purchase financing and, importantly, the enactment of a 2% sales tax on food for home consumption. Further, the city eliminated nearly 600 positions in fiscal 2010, followed by another round of cuts totaling nearly 635 positions in fiscal 2011.

Throughout this difficult period, the city was able to maintain General Fund reserves in excess of 25% of revenues. Further, the cumulative headcount reductions resulted in its smallest workforce in nearly 40 years (10.3 employees per 1,000 residents), leaving the city well-positioned to face future budgetary challenges.

Successful cities were by no means immune to the downturn, as their year-over-year tax base valuations declined slightly in 2011. But, as shown in Exhibit 3, the dip was much less severe than in other cities and the recovery has been more robust.

EXHIBIT 3

Tax Bases of Successful Cities Fared Better Through Recession than Cities with Populations Over 100,000



Source: Moody's Investors Service database

Overall, development tended to gravitate to successful cities when the recession took hold, driving overall healthy tax base growth. As a result of this more robust expansion, these cities experienced a 2.4% increase in population (2010-13) and 2.1% increase in labor force (2008-13), outpacing population (2.2%) and labor force (0.6%) growth among peer cities.

Other supporting factors for the successful cities were their diverse tax bases, the significant presence of large institutions, and their status as regional economic centers. In terms of economic diversity, in 2013 successful cities' top 10 taxpayers accounted for 5.4% of the total tax base, compared to a median 6.5% for all large cities. Having a diverse tax base makes cities more resilient to economic shocks because it means the government is less exposed to one particular industry or a large individual taxpayer.

Large public institutions and agencies that form the economic foundation of the successful cities also support their credit quality. For example, nine of the cities are state capitals that benefit from the stability of state government institutions. Similarly, federal government agencies underpin the economy of the District of Columbia (Aa2 stable). A number of the cities are home to military installations. Notably, Virginia Beach, VA (Aaa stable) has four military bases employing over 32,000 military personnel and civilians. As one of the few successful cities with a tax base that has not returned yet to its pre-recession levels, Virginia Beach demonstrates that a major institutional presence can counteract other negative credit forces. Although government agencies can downsize just as private enterprises can, they tend to be more stable employers and rarely move locations entirely.

Furthermore, many successful cities benefit from the presence of major educational or health care institutions. These institutions fuel employment and private investment in the city and surrounding areas, helping to offset their tax-exempt status. For example, seven out of 10 top employers in Boston, MA (Aaa stable) are rooted in the healthcare sector. Boston is home to 35 universities and colleges with over 152,000 students making up 23% of the city's population. The growth of healthcare and higher education institutions helped boost Boston's tax base by 15.5% between 2008 and 2013. Houston (Aa2 stable) is another example of a city that benefits from a major healthcare institution, as the city is home to the Texas Medical Center, one of the world's largest concentrations of healthcare and research institutions. The Center includes 54 medicine-related institutions and employs over 100,000 people.

Case Study 2: City of Raleigh (NC)

Between 2008 and 2013, the City of Raleigh's (Aaa stable) tax base increased by 45.8% to $51.2 billion. Raleigh's tax base growth is boosted by the city's role as state capital of North Carolina (Aaa stable) and by several major higher education institutions including North Carolina State University (NCSU). The city's private sector benefits from continued expansion of the neighboring Research Triangle Park headquartered by various technology and financial firms. Raleigh's tax base is very diverse. The top 10 taxpayers account for only 3.8% of the city's full property valuation. The full valuation does not include state properties including NCSU.

Strong financial management supported revenue growth and growth in reserves

While many other cities' budgets ran deficits over the economic downturn, successful cities generally managed to balance their budgets. Between 2008 and 2013, many of the successful cities were able to maintain or expand public services, with average five-year expenditure growth of 7.0%. Their operating revenues grew even more, by an average 7.7% over the same timeframe. In contrast, the expenditure growth of other US cities with populations over 100,000 increased by 2.8% and outpaced revenue growth that averaged 2.0% over the same period (see Exhibit 4).

EXHIBIT 4

Successful Cities Experienced Steady Growth in Revenues and Expenditures

Operating Revenues Operating Expenditures

Source: Comprehensive Annual Financial Reports

In addition, these successful cities effectively navigated their legal and operating environment despite the economic hurdles. This was demonstrated through the cities' ability to match recurring revenues with expenditures. With balanced budgets in tow, the majority of our successful cities were able to increase their available fund balance reserve levels from 2008 to 2013. On a nominal basis, the successful city's cities' average median reserves jumped 37.7% between 2008 and 2013, compared with the larger peer group that only saw a 31.1% increase. By 2013, successful cities' average median reserves had grown to 18.6% of operating revenues, up from 14.5% in 2008. In addition, the successful cities have experienced positive annual reserve growth since 2008, compared to only one year of growth seen in all cities with populations over 100,000 (see Exhibit 5).

EXHIBIT 5

Successful Cities Realize Positive Year-over-Year Change in Reserves Since 2008

Source: Comprehensive Annual Financial Reports

Case Study 3: City of Austin (TX)

Between 2008 and 2013, Austin's (Aaa stable) operating reserves increased by a sizable $61.2 million to $146.3 million. This improved financial position can be attributed to growing revenues, conservative budgeting, close monitoring of expenditures, and established formal reserve policies. Overall, the city saw operating revenues increase by 19.7%, outperforming operating expenditures that grew at a slower 14.5% over this six-year period. Property taxes are the city's largest revenue source representing 47.2% of the 2013 operating budget, and experienced a 43.9% increase between 2008 and 2013. This growth was driven by a simultaneous 21.2% expansion in the city's tax base. At the end of 2013, reserves represented a healthy 19.1%, just slightly below the national median of 21.8% for cities within population over 100,000.

The city has a formal General Fund policy to maintain an emergency reserve equal to $40 million, a contingency reserve equal to 1% of annual departmental expenditures, a budget stabilization reserve, and a small property tax reserve. The city is expecting to end fiscal 2014 with another surplus, owing to the positive performance of sales taxes and conservative expenditures budgeting.

Successful cities maintained manageable debt ratios despite recession

The 34 successful cities did add debt faster than peers. The 34 cities had a median debt burden, as measured by net direct debt to full valuation, of 1.6% in 2013, up slightly from 1.5% in 2008, which is above the national median of 1.0% for all cities. Overall, total outstanding debt for these successful cities increased by a median 12% between 2008 and 2013, while the debt for other large cities increased by 9.2%. Above-average debt burdens clearly did not impair their credit strength, and were mainly the result of tending to the ongoing capital needs of large city infrastructure.

Long-term liabilities account for moderate portion of operational budgets

Successful cities stayed resilient despite their growing pension burdens. Pension expenses are above average, but not inordinately high among the successful cities. Although eight cities had an adjusted net pension liability (ANPL) greater than 3.0 times operating revenues, pensions and OPEB expenses were a combined 23.9% of operating expenditures in fiscal 2012.

Even so, successful cities' pension burden might be a more formidable challenge in future downturns. The successful cities had a median three-year average Adjusted Net Pension Liability (ANPL) of $1.6 billion, or 2.1 times operating revenues compared with a median of about 1.0 times operating revenues (see Exhibit 5). Net of the outliers with an ANPL greater than 3.0 times operating revenues, the remaining successful cities have a lower, but still above-average ANPL of 1.7 times operating revenues.

OPEB contributions represented a modest 2.5% of the cities' 2012 operating budgets, while the total OPEB Annually Required Contribution (ARC) represented 4.7%. These successful cities funded a median of 40.9% of their total OPEB ARC in 2012. Five cities, Phoenix, Baltimore, Virginia Beach, Los Angeles and the District of Columbia, are funding at least, if not more, than the OPEB ARC. When excluding these cities, the median funding for the OPEB ARC drops to 36%.

Case Study 4: District of Columbia

The District of Columbia maintains a strong pension position compared with that of the other successful cities, with an ANPL (three-year average) of $1.2 billion or 0.18 times operating revenues, the lowest of all the successful cities.

The District of Columbia has also managed its OPEB liabilities very well. It established a trust in 2006 to pre-fund OPEB obligations and since then has appropriated the actuarially-calculated annual required contribution each year. The funded ratio of the city's OPEB trust was a very strong 85.7% as of September 2013. Overall, total fixed costs including debt service, pensions, and OPEB, are a moderate 11.2% of operating expenditures, providing the city with a significant amount of budgetary flexibility.

Appendix

Rating History for 34 Successful Cities (2008-Present)

City	State	Population	Moody's Current Rating	Rating History (2008-2014)	Moody's Current Outlook	Outlook History (2008-2014)
New York	NY	8,370,000	Aa2	Recalibrated to Aa2 from Aa3 (April 2010)	STA	No Change
Los Angeles	CA	3,863,839	Aa2	Upgraded to Aa2 from Aa3 (January 2013) Downgraded to Aa3 from Aa2 (July 2011) Recalibrated to Aa2 from Aa3 (April 2010) Downgraded to Aa3 from Aa2 (April 2010)	STA	Revised to STA from RUR (January 2013) Revised to RUR from STA (October 2012) Revised to STA from NEG (July 2011) Revised to NEG from STA (February 2010) Revised to STA from POS (July 2008)
Houston	TX	2,160,821	Aa2	Recalibrated to Aa2 from Aa3 (April 2010)	STA	Revised to STA from POS (July 2011)
Phoenix	AZ	1,485,719	Aa1	No Change	STA	Revised to STA from NEG (May 2010) Revised to NEG from STA (September 2009)
San Antonio	TX	1,383,194	Aaa	Recalibrated to Aaa from Aa1 (April 2010)	NEG	Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
San Diego	CA	1,326,238	Aa2	Upgraded to Aa2 from Aa3 (November 2013) Recalibrated to Aa3 from A2 (April 2010) Upgraded to A2 from A3 (August 2008)	STA	Revised to STA from NEG (August 2008)
Dallas	TX	1,232,243	Aa1	No Change	STA	Revised to STA from NEG (April 2010) Revised to NEG from STA (March 2010)
San Jose	CA	984,000	Aa1	Downgraded to Aa1 from Aaa (March 2012) Upgraded to Aaa from Aa1 (April 2010)	STA	No Change
Honolulu	HI	976,372	Aa1	Recalibrated to Aa1 from Aa2	STA	No Change
Indianapolis	IN	843,393	Aaa	Recalibrated to Aaa from Aa1 (May 2010)	STA	Revised to STA from NEG (July 2013)* Revised to NEG from STA (February 2013)*
Austin	TX	841,649	Aaa	Recalibrated to Aaa from Aa1 (April 2010)	STA	Revised to STA from POS (August 2008) Revised to POS from STA (February 2008)
San Francisco	CA	839,109	Aa1	Upgraded to Aa1 from Aa2 (February 2013) Downgraded to Aa2 from Aa1 (November 2010) Recalibrated to Aa1 from Aa2 (April 2010) Upgraded to Aa2 from Aa3 (August 2008)	STA	Revised to STA from RUR (February 2013) Revised to RUR from STA (October 2012) Revised to STA from NEG (November 2010) Revised to NEG from STA (June 2010) Revised to STA from POS (August 2008)
Columbus	OH	802,912	Aaa	No Change	STA	No Change
Charlotte	NC	796,921	Aaa	No Change	STA	No Change
Hempstead Town	NY	765,272	Aa1	Downgraded to Aa1 from Aaa (April 2014) Upgraded to Aaa from Aa1 (April 2010)	STA	Revised to STA from RUR (April 2014) Revised to RUR from NEG (January 2014) Revised to NEG from NOO (December 2013)
Louisville-Jefferson County Metro Government	KY	750,828	Aa1	Recalibrated to Aa1 from Aa2 (April 2014)	STA	Revised to STA from NEG (November 2014) Revised to NEG from NOO (May 2013)
El Paso	TX	672,538	Aa2	Recalibrated to Aa2 from Aa3 (April 2010)	NOO	No Change
Memphis	TN	657,457	Aa2	Recalibrated to Aa2 from A1 (April 2010)	NEG	Revised to NEG from STA (December 2013) Revised to STA from POS (March 2010) Revised to POS from STA (April 2008)

Rating History for 34 Successful Cities (2008-Present)

City	State	Population	Moody's Current Rating	Rating History (2008-2014)	Moody's Current Outlook	Outlook History (2008-2014)
Denver	CO	649,495	Aaa	Recalibrated to Aaa from Aa1 (May 2010)	STA	Revised to STA from NEG (February 2013)* Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
Washington	DC	646,449	Aa2	Recalibrated to Aa2 from A1 (April 2010)	STA	Revised to STA from NEG (July 2013) Revised to NEG from STA (September 2011)
Boston	MA	636,479	Aaa	Recalibrated to Aaa from Aa1 (April 2010)	STA	No Change
Seattle	WA	626,600	Aaa	No Change	STA	Revised to STA from NEG (December 2011)* Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
Baltimore	MD	621,342	Aa2	Recalibrated to Aa2 from Aa3 (May 2010)	STA	No Change
Oklahoma City	OK	595,000	Aaa	Recalibrated to Aaa from Aa1 (May 2010)	STA	Revised to STA from NEG (July 2013)* Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
Portland	OR	592,120	Aaa	No Change	STA	Revised to STA from RUR (August 2013) Revised to RUR from STA (April 2013) Revised to STA from NEG (December 2011)* Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
Albuquerque	NM	555,417	Aa1	Recalibrated to Aa1 from Aa2 (May 2010) Upgraded to Aa2 from Aa3 (May 2008)	STA	Revised to STA from NEG (April 2014) Revised from NEG from STA (January 2011)
Brookhaven Town	NY	482,820	Aa2	Recalibrated to Aa2 from Aa3 (April 2010)	STA	Revised to STA from NOO (January 2013) Revised to NOO from POS (June 2010)
Long Beach	CA	467,646	Aa2	Recalibrated to Aa2 from Aa3 (April 2010)	STA	Revised to STA from RUR (December 2012) Revised to RUR from STA (October 2012)
Mesa	AZ	450,310	Aa2	Recalibrated to Aa2 from A1 (May 2010)	STA	No Change
Virginia Beach	VA	447,489	Aaa	Recalibrated to Aaa from Aa1 (May 2010)	STA	Revised to STA from NEG (July 2013)* Revised to NEG from RUR (August 2011)* Revised to RUR from STA (July 2011)*
Colorado Springs	CO	438,338	Aa2	Recalibrated to Aa2 from Aa3 (May 2010)	NOO	No Change
Raleigh	NC	423,179	Aaa	No Change	STA	Revised to STA from NOO (August 2013)
Oakland	CA	399,326	Aa2	Recalibrated to Aa2 from A1 (April 2010)	STA	Revised to STA from RUR (January 2013) Revised to RUR from STA (October 2012)
Tulsa	OK	397,139	Aa1	Recalibrated to Aa1 from Aa2 (May 2010)	STA	Revised to STA from NOO (November 2012)

* Outlook revision related to review of indirect linkage to US government bond rating

Source: Ratings from Moody's.com as of 12 November2014; 2012/2013 population data from US Census/Local Government Sources Moody's Related Research

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