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Los Angeles Has Been Hammered by Covid. But Its Muni Bonds Are Holding On. Here's Why.

Los Angeles is suffering what may be the hardest Covid-related health and economic hit of any big city. But the city's $2.6 billion in municipal bonds outstanding, while hardly thriving, appear in decent shape.

Unemployment in the Los Angeles region, at 9.6% in November, was the highest among the five biggest metropolitan areas and 3.2 percentage points worse than the national average. And that was before the surge of infections and deaths in Southern California accelerated into the new year, straining hospitals and morgues and dashing hopes for a rebound in the city's revenue.

Fitch Ratings analyst Alan Gibson last month revised the outlook to negative on Los Angeles' AA issuer default rating, citing "the extensive budget-balancing actions necessitated by the current economic downturn, which have the potential to reduce the city's financial resilience during the subsequent economic recovery period."

The pandemic threatens to reverse much of the progress the city made in the decade since the Great Recession, as it built its rainy-day reserves to almost $600 million in 2019. With the revenue shortfall for fiscal 2021 at $700 million, the city is about to pull a quarter of a billion dollars from reserves. Having already agreed to furloughs and early retirement for some city employees, Los Angeles is poised to start layoffs at its 10,000-member police department, a sign of fiscal distress to municipal bond professionals.

"When you see they're starting to cut into a significant number of employees, they're not just cutting fat in the budget," says Tom Kozlik, head of Municipal Strategy and Credit at Hilltop Securities. "They're cutting into the muscle."

Los Angeles' budget woes mirror those of cities, states, and authorities across the nation, as they struggle to fill a trillion-dollar revenue shortfall over three years caused by the pandemic. An unexpected dip in U.S. jobs in December dashed hopes that the U.S. economy will rebound quickly enough to ease the budget pain.

"The revenue decline that the City of Los Angeles has suffered as a result of Covid is multiples more than the decline during the Great Recession," says City Councilman Paul Krekorian, who chairs the council's budget committee. "We're now experiencing the biggest surge [in Covid] in the county. We have no reason to think our revenue is going to get better in the next months."

At the same time, Democratic victories in the Georgia runoffs for the Senate raised expectations that the new Biden administration will be able to enact direct federal aid to help states and cities like Los Angeles avoid layoffs that could cascade into the private sector and prolong the recession. Democrats last year proposed as much as $1 trillion in aid, an amount that was whittled down to nothing as Republicans argued the money would amount to a bailout for cities that had mismanaged pensions and finances.

Moody's Investors Service in the midst of the first Covid surge in April revised its outlook on the Los Angeles' Aa2 rating to stable from positive. The city's $2.6 billion in debt outstanding includes $585 million of general obligation bonds. It issued $1.8 billion of short term tax and revenue anticipation notes to bolster liquidity early in the fiscal year.

Moody's cited the city's large and diverse economy, strong management, and relatively modest debt burden. Los Angeles' $614 million of debt service is a fraction of the $5.8 billion New York City pays to investors, according to a separate Moody's report. Debt service plus retirement-benefit costs amount to only 22% of revenue, compared with Chicago's 46% burden, the heaviest in the nation. Moody's is still monitoring the situation, and the $250 million draw on reserves is in line with expectations, analyst Lori C. Trevino said on Jan. 13.

Investors have stood by the city's debt. Based on analysis by Ice Data Services, the price of a Municipal Corp. of Los Angeles lease revenue bond maturing in 2037 has risen to $122.427 on Jan. 14, from $120.51 at the beginning of 2020.

"I don't really see L.A. bonds trading much cheaper than the general market," says John Mousseau, head of fixed income at Cumberland Advisors. "This is why cities have reserves and why bonds have debt-service reserve funds—for those times. No doubt federal aid will help post-inauguration."

Barron's

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