Santa Monica, California

New Issue Report

Ratings

Long-Term Issuer Default Rating	AAA

New Issue

$35,000,000 Santa Monica Public Financing Authority (Downtown Fire Station Project) Lease Revenue Bonds, Series 2018	AA+

Outstanding Debt

Santa Monica (Library Improvements Project) General Obligation Bonds	AAA
Santa Monica Public Financing Authority (City Services Building Project) Lease Revenue Bonds (Green Bonds)	AA+
Santa Monica Public Financing Authority (Civic Center Parking Project) Lease Revenue Refunding Bonds	AA+
Santa Monica Public Financing Authority (Public Safety Facility Project) Lease Revenue Refunding Bonds (Bank qualified)	AA+
Santa Monica Public Financing Authority Lease Revenue Bonds	AA+
Santa Monica Public Financing Authority Lease Revenue Refunding Bonds	AA+

Rating Outlook

Stable

Analysts

Graham Schnaars
+1 415 732-7578
graham.schnaars@fitchratings.com

Karen Ribble
+1 415 732-5611
karen.ribble@fitchratings.com

New Issue Summary

Sale Date: May 22, 2018 via negotiation.

Series: Lease Revenue Bonds, Series 2018, Downtown Fire Station Project.

Purpose: To finance the construction of a new fire station and its training facilities.

Security: Lease payments from Santa Monica (the city) to the trustee for use of various governmental assets, subject to abatement.

Analytical Conclusion

The 'AAA' Issuer Default Rating is based on the city's exceptional resilience in economic downturns and a strong expenditure framework in the context of a very strong economic resource base. The rating also reflects a moderate debt burden and a solid revenue framework.

Economic Resource Base: Santa Monica is an affluent coastal enclave bordering Los Angeles with about 92,500 residents. The city is well situated within a diverse metropolitan area economy, and has a significant local service sector economy, with technology, healthcare, research, governmental, tourism and retail employers supplementing a large high-end lodging sector. Per capita personal income is more than twice the national average, and both the poverty and unemployment rates run lower than national averages.

Key Rating Drivers

Revenue Framework: 'aa'
Santa Monica benefits from a strong revenue base that consistently provides growth above the level of national economic growth. Revenue flexibility is limited but satisfactory relative to very limited revenue volatility.

Expenditure Framework: 'aaa'
Fitch Ratings expects expenditures to grow at a slower pace than revenues. Expenditure flexibility is solid, with moderate fixed costs of debt and retiree liabilities, a reasonably flexible labor negotiating framework and significant flexibility to adjust the timing of the city's sizable ongoing pay-as-you-go capital investments.

Long-Term Liability Burden: 'aa'
Debt and unfunded pension liabilities are moderate relative to the city's wealthy economic base.

Operating Performance: 'aaa'
Financial resilience through downturns is exceptionally strong. The city maintains very robust reserves to offset limited revenue volatility and has adequate ability to adjust budgets to maintain balance via spending adjustments. Budget management in times of recovery is very strong, with consistent attention to long-term fiscal sustainability.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	4/27/18
AAA	Affirmed	Stable	11/25/09
AAA	Assigned	—	6/4/98

Related Research

Fitch Rates Santa Monica, CA's Series 2018 Lease Revenue Bonds 'AA+'; Outlook Stable (April 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Rating Sensitivities

Continued Increases in Liability Burden: The rating could come under downward pressure if the city or overlapping entities were to issue substantially more debt than currently expected, exceeding the rate of growth for personal income, or pension liabilities were to rise substantially despite the city's ongoing efforts to improve its pension funding position.

Credit Profile

Revenue Framework

The city's revenue structure is unusually diverse, with five significant sources of tax revenues (property, sales, transient occupancy, utility use and business license taxes) providing about 60% of revenues. No single source dominates, with sales, property and lodging taxes each providing about 15% of general fund revenues. Even with several cyclical components, the diversity of tax revenues yields overall tax revenues that are not particularly cyclical and do a good job of capturing growing economic activity over time.

Revenue growth is expected to remain strong. The compound annual growth rate of general fund revenues was in excess of inflation and national economic growth at 4.4% over the decade ending in fiscal 2017. Revenue outperformance reflects both strong growth in the economic base and the revenue structure's ability to capture economic activity.

The city has satisfactory independent legal ability to raise revenues relative to its limited revenue volatility. State tax limitations prohibit increases in the operating property tax levy, and other taxes can only be increased with voter approval. Policymakers' independent revenue-raising flexibility is limited to fees and fines, which make up a moderate portion of total general fund revenues. Fee increases are likely to offset typical cyclical variations in revenues because revenue volatility is low, not because revenue flexibility is particularly strong. While the city lacks the independent ability to increase tax revenues, local voters have proven willing to approve additional taxes as needed to provide a high level of government services.

Expenditure Framework

Santa Monica is a full service city, providing fire, police, library, parks and recreation, and other typical municipal services. Public safety is the largest individual category of expenditure, but it does not dominate the way it does in other California communities with narrower service offerings.

The city faces a degree of expenditure growth pressure as pension, workers' compensation and healthcare costs are rising faster than inflation and overall spending. However, the city's overall pace of spending growth is likely to trail the rate of revenue growth, which is unusually high and lessens the pressure to make ongoing service reductions to make room for rising fixed costs.

Expenditure flexibility is solid. Fixed carrying costs of debt, pensions and OPEB were moderate at 14.3% of governmental spending in fiscal 2017. Fitch expects pension contributions to climb given current pension funded levels and rate of return assumptions but Fitch expects these costs to remain manageable. Fitch's supplemental pension metric, which assumes a 20-year level payoff of the Fitch-adjusted liability, indicates that contributions at the actuarial level would likely be insufficient to reduce pension liabilities. For more information see "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)," dated May 31, 2017.

The labor negotiating framework is typical for California cities, with a requirement to meet and confer with the public employee unions, but the city council retains the right to impose terms in the rare instances where the sides cannot reach an agreement. The city also benefits from significant spending flexibility related to its ongoing pay-as-you-go capital program, which can expand and contract with the availability of funds.

Long-Term Liability Burden

The long-term liability burden is moderate relative to the city's significant economic resource base, with unfunded pension liabilities, and direct and overlapping debt totaling approximately 16% of personal income. The city's direct debt burden is roughly $165.8 million after the current offering and largely comprises fully amortizing, fixed-rate lease revenue bonds. Overlapping debt makes up about one-half of the liability burden.

The city has been working proactively to address its increasing pension liability by paying additional pension contributions since fiscal 2011 to reduce the liability. In 2015, the city council adopted a goal to contribute an additional $1 million minimum above each year's actuarially determined contribution to reduce the unfunded pension liability. Adjusted for Fitch's standard 6% rate of return assumption, the city's fiscal 2017 estimated net pension liability was approximately $842.5 million, with assets covering just shy of 60% of the total liability.

The city may consider seeking voter authorization for up to $200 million in GO parks improvement bonds in 2020. Management is also researching funding mechanisms for a $114 million capital project to improve its maintenance facility. Funding sources for this project will likely be a combination of reserve funding and borrowing.

Operating Performance

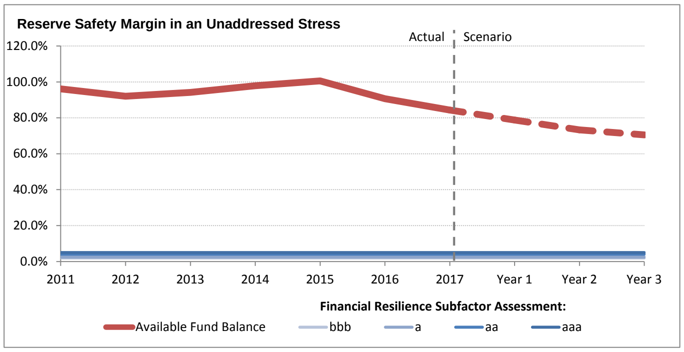
The city has exceptionally strong gap-closing capacity, with reserves equal to about a year of spending, which is very high relative to revenue volatility. For details, see Scenario Analysis, page 4.

Budget management in times of recovery is very strong. The city makes consistent efforts to maintain structural budgetary balance through the use of conservative long-range financial forecasts. Management regularly updates capital improvement plans and provides cash funding to priority projects. The recent decision to more aggressively address unfunded pension liabilities should gradually improve funded ratios.

Santa Monica (CA)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

The city has exceptionally strong gap closing capacity with reserves equal to about one year of spending and very high relative to revenue volatility. The Fitch Analytical Sensitivity Tool (FAST) suggests the city would experience very modest revenue losses in a moderate recession scenario of a 1% decline in U.S. GDP. The city is likely to draw down reserves from the current level to fund capital projects and one-time expenditures over time, but is likely to maintain substantial reserves across business cycles. In a typical downturn, Fitch expects the city to enact modest spending reductions and to spend manageable amounts of reserves, but fundamental financial flexibility and reserves are likely to remain well above the level that Fitch believes is consistent with a 'aaa' financial resilience assessment.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.1%	4.7%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	266,325	434,801	332,245	337,948	352,679	362,581	376,817	373,048	380,759	398,697
% Change in Revenues	-	63.3%	(23.6%)	1.7%	4.4%	2.8%	3.9%	(1.0%)	2.1%	4.7%
Total Expenditures	270,917	334,089	346,639	327,984	321,102	343,003	358,205	365,369	372,676	380,130
% Change in Expenditures	-	23.3%	3.8%	(5.4%)	(2.1%)	6.8%	4.4%	2.0%	2.0%	2.0%
Transfers In and Other Sources	92,949	67,744	9,214	15,709	9,358	31,964	9,101	9,010	9,196	9,630
Transfers Out and Other Uses	8,552	47,475	12,640	10,557	10,358	40,710	31,750	32,385	33,033	33,693
Net Transfers	84,397	20,269	(3,426)	5,152	(1,000)	(8,746)	(22,649)	(23,375)	(23,836)	(24,064)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	79,805	120,981	(17,820)	15,116	30,577	10,832	(4,037)	(15,695)	(15,753)	(5,496)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	28.6%	31.7%	(5.0%)	4.5%	9.2%	2.8%	(1.0%)	(3.9%)	(3.9%)	(1.3%)
Unrestricted/Unreserved Fund Balance (General Fund)	268,523	351,019	338,253	331,382	333,347	347,682	328,903	313,208	297,455	291,958
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	268,523	351,019	338,253	331,382	333,347	347,682	328,903	313,208	297,455	291,958
Combined Available Fund Bal. (% of Expend. and Transfers Out)	96.1%	92.0%	94.1%	97.9%	100.6%	90.6%	84.3%	78.7%	73.3%	70.6%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.