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New Issue

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Santa Monica, CA

New Issue - Moody's Assigns Aa1 to Santa Monica, CA's Lease Revenue Bonds, Series 2017 (Green Bonds)

Summary Rating Rationale

Moody's Investors Service has assigned an Aa1 rating to City of Santa Monica, CA's $65.3 million Lease Revenue Bonds, Series 2017 (City Services Building Project) (Green Bonds). The city also has $6.6 million in GO debt outstanding which is rated Aaa.

The Aa1 lease revenue rating is one notch lower than Moody's Aaa rating on the city's general obligation bonds. The notching reflects a standard legal structure for a California abatement lease financing and a leased asset, that we view as "more essential." The notching also reflects the strong legal features of California general obligation bonds that are not shared by lease revenue debt.

The Aaa GO rating incorporates the strength of the city's large tax base that is poised for additional growth in the near-term and the city's above-average socioeconomic profile. The rating also incorporates the stable and strong financial profile of the city given the expectation of continued healthy performance of economically sensitive tax revenues and the city's strong financial management. The city debt burden is low and pensions, while elevated, are manageable.

Credit Strengths

» Large, diverse tax base experiencing healthy growth

» Exceptionally strong financial operations with ample reserves

» Low lease burden

» Strong resident wealth levels

Credit Challenges

» A substantial portion of General Fund revenues derived from economically sensitive tax revenues highly dependent upon tourism-related activities

» Growing pension costs facing California municipalities

Rating Outlook

The stable outlook is based on our view that the rating will not likely change in the long term given the strength of the city's economy, tax base and financial profile.

Factors that Could Lead to an Upgrade

» NA

Factors that Could Lead to a Downgrade

» Significant deterioration of the city's financial position

» Protracted decline in the city's assessed value

» Weakening of the city's socioeconomic indices

Key Indicators

Santa Monica (City of) CA	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 24,644,122	$ 25,765,605	$ 27,514,109	$ 29,046,341	$ 31,155,457
Full Value Per Capita	$ 273,799	$ 283,912	$ 300,310	$ 315,142	$ 333,989
Median Family Income (% of US Median)	171.1%	173.1%	174.1%	175.1%	175.1%
Finances					
Operating Revenue ($000)	$ 434,852	$ 337,566	$ 353,072	$ 361,583	$ 362,956
Fund Balance as a % of Revenues	82.4%	102.7%	96.3%	94.6%	97.4%
Cash Balance as a % of Revenues	98.4%	118.8%	111.4%	102.8%	97.3%
Debt/Pensions					
Net Direct Debt ($000)	$ 59,830	$ 58,375	$ 54,435	$ 50,420	$ 72,690
Net Direct Debt / Operating Revenues (x)	0.1x	0.2x	0.2x	0.1x	0.2x
Net Direct Debt / Full Value (%)	0.2%	0.2%	0.2%	0.2%	0.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.4x	2.4x	2.7x	2.8x	3.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.6%	3.1%	3.5%	3.5%	3.5%

Source: City of Santa Monica and Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Large Tax Base Continues to Benefit from Location and Proximity to Los Angeles Economy

Santa Monica's local economy should continue to benefit from its location near downtown Los Angeles and bordering the Pacific Ocean. The city is entirely integrated in the greater Los Angeles economy and continues to economically benefit from a high demand for office space, hotel lodging, and commercial activities. The city continues to serve as the heart of the "Silicon Beach and there is high demand for office space from the technology, entertainment, and media sectors with asking rents at the end of 2016 being the highest in the area. In 2016 the Expo Light-Rail line opened, which connects Downtown Los Angeles with Santa Monica and has fueled new housing, commercial and office development in the city. Two new hotels have opened adjacent to the new transit line expansion and an additional boutique hotel is under construction. We expect these continued developments will likely fuel long term economic benefit and growth to the city.

The positive economic growth of Santa Monica has driven growth in the city's assessed value (AV), which reached its highest level of $33.1 billion in fiscal 2017 after growth of a strong 6.2% over the previous year. The five year average annual growth trend has been healthy at 6.1%. Santa Monica's assessed value is the third highest of all cities in Los Angeles County, only behind the much larger cities of Los Angeles and Long Beach. Continued commercial and residential development are expected to continue to fuel AV growth in the near term. New residential and commercial development and the increasing value of local properties are expected to continue to fuel AV growth in the near term.

Wealth levels in the city are strong, although slightly lower than other national and state Aaa-rated cities. The city's per capita income (PCI) represents 206.4% of the US, while median family income represents (MFI) 175.1% of US.

The city has a diverse group of taxpayers. The ten largest taxpayers comprise 8.3% of the city's total 2017 AV. Unemployment for the city continues to trend downward and fell to 3.4% in May 2017, comparable to the national rate (4.1%) and the state rate (4.2%) for the same period.

Financial Operations and Reserves: Conservative Management Continues to Produce Strong Financial Results Despite Exposure to Volatile Revenue Sources

We expect the city will continue to maintain exceptionally large fund balance levels given a history of significant operating surpluses and the implementation of formal financial policy to strengthen healthy financial position. The city's high fund balances continue to provide extraordinary financial flexibility, including significant use of surplus revenues on cash for capital spending. Operating revenues have consistently exceeded operating expenditures. Any operating surpluses are strategically allocated by city management for one-time projects, including capital and pension or OPEB obligations, to ensure long-term viability of the city's infrastructure and obligations. Available fund balance at fiscal year 2016 year end was $347.7 million, or an ample 94.9% of revenues. We expect audited results in FY 2017 to be equally strong given the city's conservative approach to finances.

The city's tax revenues are highly diverse and no single revenue source accounts for more than 15% of general fund revenues. Positively, most of the city's economically sensitive tax revenues are poised for additional growth. The city's property tax revenues (15% of general fund revenues) continue to grow given continued development and property appreciation. Sales tax revenues (18% of general fund revenues) are projected to increase by 3% in both fiscal 2018 and fiscal 2019. Sales tax revenues are derived from a diverse array of economic activities and are not dependent on one source of industry. The city's transient occupancy tax (15% of general fund revenues) continues to increase and will likely fuel a larger portion of the city's revenue growth in the near-term with 5% growth projected in fiscal 2017. The city collects a 14% tax on hotel stays, and average room rates are one of the highest in Southern California. Two new hotels near the Expo Light-Rail and an additional hotel currently underconstruction will likely continue to fuel growth of this tax revenue.

LIQUIDITY

The city continues to maintain exceptionally strong General Fund liquidity. General Fund cash was $347.4 million or an exceptionally strong 94.8% of fiscal 2016 revenues. Liquidity will likely continue to be strong given the anticipated growth in city tax revenues.

Debt and Pensions: Manageable Debt and Pension Burdens

The city has a low net direct debt burden that should remain low in the long-term given the cash funding the city sets aside for capital projects. The city had a low 0.4% net direct debt burden as a percentage of AV in fiscal 2016.

The city's General Fund-supported lease burden is also low and manageable given the strength of the city's financial profile. The city's lease burden in fiscal year 2016 was a low 1.9% of revenues, not including self-supporting debt service. This low burden as a percentage of revenues will likely decline as revenues increase and the amortization of the outstanding lease revenue bonds declines.

DEBT STRUCTURE

The city has approximately $6.6 million of general obligation bonds outstanding, which are rated Aaa by Moody's. The city will have $125.8 million in lease revenue bonds outstanding after the current issue. Essential asset backed lease revenue debt is rated Aa1 and less essential asset backed lease revenue debt is rated Aa2.

The Lease Revenue Bonds, Series 2017 are standard California abatement lease obligations, including a covenant to budget and appropriate rental payments through maturity of the bonds. The assets securing the lease payments during construction are the existing City Hall and Main Library with a combined value of $76.8 million. Once the City Services Building (CSB) is constructed and the city is able to occupy the facility the lease payments will be made from the use and occupancy of the CSB.

Insurance requirements include title insurance, fire/lightning/special extended coverage, and rental interruption insurance. There will be no debt service reserve fund for the Series 2017 bonds, because of the strong city fund balances available for debt service payments.

DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives.

PENSIONS AND OPEB

Pension-driven budgetary pressures for the city are stable, and pension rate increases by CalPERS will likely be manageable for the city. The city's annual pension costs (ARC) to the state's retirement system in fiscal 2016 was $44.9 million and the city contributed $46.2 milion. The city has fully funded its actuarially required contribution every year and in 2015 formalized polity to set a goal of paying a minimum of $1 million above its ARC until the unfunded liability is eliminated.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $1.18 billion, or an above average 3.25 times operating revenues. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city has a relatively small unfunded OPEB liability of with a $10.4 million net OPEB oligation at the end of fiscal year 2016. The city has funded the full OPEB ARC since 2015 and the contribution made in fiscal year 2016 was $2.6 million.

Management and Governance

California cities have an institutional framework score of “A,” or moderate. Revenue predictability is moderate, because the primary sources are property taxes and sales taxes. Property taxes are very predictable, given the state’s constitutional formula established by Proposition 13 in 1978, while sales taxes are economically sensitive. Revenue-raising ability is moderate because increases almost always require voter approval. Expenditure reduction ability is moderate, because of collective bargaining and growing pension and OPEB pressures. Expenditure predictability is high, as police and fire typically make up 60% of discretionary spending in full-service cities.

Legal Security

The Series 2017 lease revenue bonds are secured by rental payments and other available funds paid by the city to the authority under a facilities abatement lease.

Use of Proceeds

Proceeds from the current issue will fund the new construction of the City Services Building.

Obligor Profile

Santa Monica is situated on the western side of Los Angeles County (Issuer Rating Aa1 stable), bordered by the City of Los Angeles (Aa2 stable) on three sides and by the Pacific Ocean to the west. Notable sectors within the city's economy are tourism, entertainment, and technology.

Methodology

The principal methodology used in this rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Santa Monica (City of) CA

Issue	Rating
Lease Revenue Bonds, Series 2017 (City Services Building Project) (Green Bonds)	Aa1
Rating Type	Underlying LT
Sale Amount	$65,285,000
Expected Sale Date	08/01/2017
Rating Description	Lease: Abatement

Source: Moody’s Investors Service

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