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City of Santa Monica, CA

Update to Credit Analysis

Summary

The City of Santa Monica (Aaa, stable) benefits from a large and diverse tax base, strong resident wealth levels and an exceptionally strong financial position that is supported by healthy reserves and liquidity. The city has low debt and OPEB burdens. Rising pension costs are ongoing budget pressures, however the city is well positioned to afford these costs given its robust financial position and management's prudent fiscal practices.

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 reflects the city's large and diverse tax base, which is expected to experience ongoing moderate growth, and the city's reserves and liquidity that will remain exceptionally healthy.

Factors that could lead to an upgrade

» Not applicable

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

Exhibit 1

Santa Monica (City of) CA	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$25,765,605	$27,514,109	$29,046,341	$31,155,457	$33,159,981
Population	90,752	91,619	92,169	92,247	93,640
Full Value Per Capita	$283,912	$300,310	$315,142	$337,740	$354,122
Median Family Income (% of US Median)	173.1%	174.1%	175.1%	172.8%	172.8%
Finances					
Operating Revenue ($000)	$337,566	$353,072	$361,583	$362,956	$376,869
Fund Balance ($000)	$346,843	$340,057	$342,066	$353,613	$333,751
Cash Balance ($000)	$401,183	$393,269	$371,843	$353,318	$335,867
Fund Balance as a % of Revenues	102.7%	96.3%	94.6%	97.4%	88.6%
Cash Balance as a % of Revenues	118.8%	111.4%	102.8%	97.3%	89.1%
Debt/Pensions					
Net Direct Debt ($000)	$58,375	$54,435	$50,420	$72,690	$67,520
3-Year Average of Moody's ANPL ($000)	$793,516	$950,556	$1,017,882	$1,100,815	$1,282,308
Net Direct Debt / Operating Revenues (x)	0.2x	0.2x	0.1x	0.2x	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)	2.4x	2.7x	2.8x	3.0x	3.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.1%	3.5%	3.5%	3.5%	3.9%

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

Profile

Santa Monica is situated on the western side of Los Angeles County (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. The city's current population is 93,640, and it has been relatively stable over the past five years.

Detailed credit considerations

Economy and Tax Base: Large tax base continues to benefit from location and proximity to Los Angeles economy

Santa Monica's local economy will 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 2017 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. The positive economic growth of Santa Monica has driven growth in the city's assessed value (AV), which reached its highest level of $34.4 billion in fiscal 2018 after solid growth of 3.8% over the previous year. The five year average annual growth trend has been healthy at 5.8%. 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. 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 210.8% of the US, while median family income represents (MFI) 172.8% of US.

The city has a diverse group of taxpayers. The ten largest taxpayers comprise 8.3% of the city's total 2018 AV. Unemployment for the city is in-line with the state and U.S. at 4.6% as of January 2018.

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 management's prudent fiscal practices and formal financial policies. 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 general fund balance at fiscal year 2017 year end was $328.9 million, or an ample 85.2% of revenues, despite the city making a one-time prepayment to CalPERs of $36.7 million and funding $22.6 million in capital expenditures. The fiscal 2017 operating available fund balance, which includes the general fund and debt service fund was $333.7 million or an exceptionally strong 88.6% of operating revenues. We expect audited results in FY 2018 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 17% 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 (14% of general fund revenues) continue to grow given continued development and property appreciation. Sales tax revenues (17% of general fund revenues) have grown approximately 3.5% each year since 2010, yet management sets the budget at 2%. 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. 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 under construction will likely continue to fuel growth of this tax revenue.

LIQUIDITY

The city continues to maintain an exceptionally strong liquidity position. General fund and operating fund cash balances were $331.0 million (85.8% of general fund revenues) and $335.8 million (89.1% of operating fund revenues), respectively. Liquidity will continue to be strong given the anticipated growth in city tax revenues and management's prudent fiscal practices.

Debt and Pensions: Debt burden will remain low; moderate pension burden

The city has a low net direct debt burden (0.5% of AV) that should remain low in the long-term given the high level of cash funding the city sets aside for capital projects and our expectation that AV will continue to grow at a moderate rate.

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 2017 was a low 1.9% of revenues, not including self-supporting debt service. Future debt plans include two large capital projects; New City Yards ($114 million project) and city-wide park improvements ($200 million project). The funding sources for the New City Yards are still being determined and the city-wide park improvements are expected to be financed with GO bonds.

DEBT STRUCTURE

The city has approximately $5.5 million of general obligation bonds outstanding, which are rated Aaa by Moody's. The city will have $112.0 million in lease revenue bonds outstanding after the Lease Revenue Bonds Series 2018 issuance. Essential asset backed lease revenue debt is rated Aa1 and less essential asset backed lease revenue debt is rated Aa2.

DEBT-RELATED DERIVATIVES

The city has no debt-related derivatives.

PENSIONS AND OPEB

Pension-driven budgetary pressures will be manageable for the city. The city has fully funded its pension contribution requirement every year and in 2015 formalized policy to set a goal of paying a minimum of $1 million above its annual contribution until the unfunded liability is eliminated.

Since fiscal 2011, the city has used budgetary savings to pay down the pension liability with a cumulative pay down of $76.3 million to date. The pay down provides more than $6.3 million a year in ongoing savings. Management has made meaningful actions to address its unfunded pension liability, which is credit positive.

Moody's three-year average adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $1.3 billion, or an above average 3.4 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 actuarial accrued liability for OPEB at $27.9 million or 16.9% of payroll. The city has funded the full OPEB ARC since 2015 and the contribution made in fiscal year 2017 was $2.6 million.

Management and Governance

California cities have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. California cities' major revenue sources can only be raised with voter approval, or, in the case of ad valorem property taxes, cannot be raised except to meet GO bond payments. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, California has strong public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

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