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Ratings

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Summary:

Santa Monica Public Financing Authority, California
Santa Monica; Appropriations; General Obligation

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Credit Profile		
US$35.0 mil lse rev bnds (Santa Monica) ser 2018 due 07/01/2048		
Long Term Rating	AA+/Stable	New
Santa Monica GO		
Long Term Rating	AAA/Stable	Affirmed
Santa Monica Pub Fincg Auth, California		
Santa Monica, California		
Santa Monica Pub Fincg Auth (Santa Monica) APPROP		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' rating to Santa Monica Public Financing Authority, Calif.'s series 2018 lease revenue bonds (Downtown Fire Station Bonds), issued on behalf of the City of Santa Monica. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the city's previously issued general obligation (GO) bonds. Lastly, S&P Global Ratings affirmed its 'AA+' long-term rating on the authority's previously issued lease revenue bonds on behalf of Santa Monica. The outlook on all ratings is stable.

The series 2018 lease revenue bonds represent an interest in lease payments made by the city, as lessee, to the Santa Monica Public Financing Authority, as lessor, for the use of the city's public safety facility in addition to the downtown fire station. The city has covenanted to budget and appropriate lease payments during the life of the obligations, subject to abatement. Payments are triple net, without right of set-offs, and the city is responsible for maintenance, taxes, and utilities. Payments may be abated in the event of damage to, or the destruction of, the leased assets. To mitigate abatement risk in such a case, the city has covenanted to maintain rental-interruption insurance coverage equal to 24 months of maximum annual debt service. We evaluated the seismic risk of the leased assets pursuant to our criteria and estimated that none of the leased assets has a greater than 5% probability of incurring 25% damage during the life of the bonds. The transaction documents do not require the city to fund a debt service reserve. In accordance with our criteria, we do not view the lack of a debt service reserve as a significant credit weakness because appropriation risk is mitigated by lease payment due dates that occur at least three months after the start of the city's fiscal year (July 1).

The GO bonds are secured by revenue from an unlimited ad valorem property tax.

The authority's lease revenue bonds are eligible to be rated above the sovereign because we believe the authority can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. local governments are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management, and no history of government intervention. The pledged revenues are also all locally derived.

The ratings reflect our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2017, which closed with a slight operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2017 of 86% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.6x total governmental fund expenditures and 71.7x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 2.2% of expenditures and net direct debt that is 82.9% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Santa Monica's economy very strong. The city, with an estimated population of 94,294, is located in Los Angeles County in the Los Angeles-Long Beach-Anaheim, Calif., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 199% of the national level and per capita market value of $363,418. Overall, the city's market value grew by 3.3% over the past year to $34.3 billion in 2018. The county unemployment rate was 4.7% in 2017.

Santa Monica covers 8.3 square miles on the Pacific Coast and is bordered on three sides by Los Angeles. Market value grew at an average annual rate of 6.7% during the past 20 years, including by 3.3% for fiscal 2018 to $34.3 billion. Tourism and entertainment have a strong economic presence. However, the five largest employers located in the city are in the local government and health care sectors: the city of Santa Monica (2,168 employees), UCLA Hospital (2,351), Santa Monica College (1,977), Saint John's Hospital Medical Center (1,750), and Santa Monica-Malibu Unified School District (1,457). Activision Publishing (872), The Rand Corp. (862), Universal Music Group (760), E.T. Whitehall (610), and Lion's Gate Entertainment Corporation (799) round out the 10 largest employers.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights include thorough revenue and expenditure assumptions that incorporate outside economic indicator projections, city council's comprehensive citywide review twice a year, a five-year financial forecast of revenues and expenses that is updated every six months, and an annually reviewed five-year capital improvement plan with funding identified and linked to its operating budget forecasts. The city has a policy of maintaining a minimum reserve of 15% of general fund annual operating and capital expenditures and subsidies to other funds, as well as a policy governing ongoing revenue and expenditure fund balances. The city adopts an investment policy annually, and it reports holdings to elected officials monthly. In addition, the city has adopted formal debt policies for all parts of operations, has limited the amount of variable-rate debt that can be issued, and requires at least 3% present value savings for refunding debt.

Strong budgetary performance

Santa Monica's budgetary performance is strong in our opinion. The city had slight deficit operating results in the general fund of 1.1% of expenditures including transfers, but a surplus result across all governmental funds of 6.6% in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could improve from 2017 results in the near term.

The fiscal 2018 proposed budget also includes positive general fund results, as does the five-year forecast through fiscal 2021; the city projects a modest deficit for fiscal 2022. The drawdown in fiscal 2017 includeda one-time payment of $35.6 million from the general fund to the California Public Employees' Retirement System (CalPERS) to reduce the city's pension liabilities. This payment is in addition to the city's required annual contribution.

The city benefits from diversified sources of tax revenue that include property taxes, utility user's taxes, sales taxes, business license taxes, and transient occupancy taxes (TOT). Sales and use tax revenues are the largest general fund revenue stream, accounting for about 18% of general fund revenue, and have increased by 3.5% annually since fiscal 2010. Strengthening the sales tax revenues, voters have approved two 0.5% sales tax increases in the last several years, one in 2011 and the other in 2016. Property tax revenue, which has grown during the last several years, accounts for 15% of general fund tax revenue. The city's TOT, which are imposed on hotel stays, account for another 15% of general fund revenue; they increased 7% in fiscal 2017 and are projected to increase another 5% in fiscal 2018. The city is projecting in its five-year forecast continued growth in its major tax revenues.

Very strong budgetary flexibility

Santa Monica's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2017 of 86% of operating expenditures, or $324.1 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The available fund balance is composed of the combined assigned and unassigned general fund balance. For fiscal 2017, included within the unassigned fund general fund balance are city's reserve policy of 15% and a $9.7 million economic uncertainty reserve. While the fund balance decreased in fiscal 2017 due to the large one-time payment to CalPERS, we do not expect that the city will significantly reduce its fund balance over the near term.

Very strong liquidity

In our opinion, Santa Monica's liquidity is very strong, with total government available cash at 1.6x total governmental fund expenditures and 71.7x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

The city has issued GO, utility revenue, and lease revenue bonds in the past 10 years, indicating strong access to external liquidity, in our view. We expect the current liquidity levels will not likely fall below the threshold levels in coming years. The city's investments are primarily in federal agency securities and the state investment pool, which we do not consider to be aggressive.

Adequate debt and contingent liability profile

In our view, Santa Monica's debt and contingent liability profile is adequate. Total governmental fund debt service is 2.2% of total governmental fund expenditures, and net direct debt is 82.9% of total governmental fund revenue. Overall net debt is low at 2.9% of market value, which is in our view a positive credit factor.

Following this issuance, the city does not have plans to issue additional debt over the next few years, and we expect debt and liabilities will remain adequate.

In our opinion, a credit weakness is Santa Monica's large pension and OPEB obligation. Santa Monica's combined required pension and actual OPEB contributions totaled 12.1% of total governmental fund expenditures in 2017. Of that amount, 11.4% represented required contributions to pension obligations, and 0.6% represented OPEB payments. The city made 193% of its annual required pension contribution in 2017. The funded ratio of the largest pension plan is 73.1%.

The city participates in the CalPERS for the administration of its retirement plan. The city also provides OPEBs. The combined pension actuarial required contribution (ARC) and OPEB pay-as-you-go contribution for fiscal 2016 represented 12.1% of total governmental fund expenditures. We understand that the city has a policy of paying a minimum of $1 million above the pension ARC annually until there is no unfunded retirement liability. For fiscal 2017, the city contributed $45 million above its pension ARC. We understand the city had traditionally funded its OPEB on a pay-as-you-go basis, but began funding its OPEB ARC ($2.5 million) in fiscal 2015. The majority of the city's OPEB liability is in the form of an implicit rate subsidy for retirees who are allowed to purchase the city's health plan (68% of the liability), while police safety employees are eligible for health care benefit program administered by CalPERS (24%) and the remainder of eligible employees receive postretirement health care benefits paid by the city (8%).

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit is strong.

Outlook

The stable outlook reflects our view of the city's very strong budgetary flexibility and strong budgetary performance, supported by very strong financial practices. The city's very strong economy and participation in a broad and diverse metropolitan area enhance stability. We do not expect to change the ratings during the current two-year outlook period. However, we could consider lowering the ratings if budgetary performance and budgetary flexibility were to consistently generate results we consider weak.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 26, 2018
- Standard & Poor's Earthquake Model, Oct. 25, 2012
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 9, 2018)		
Santa Monica Pub Fincg Auth, California		
Santa Monica, California		
Santa Monica Pub Fincg Auth (Santa Monica) lse rev bnds (Santa Monica) (City Services Building Project, Green Bonds) ser 2017 due 07/01/2047		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica Pub Fincg Auth (Santa Monica) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica Pub Fincg Auth (Santa Monica) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica Pub Fincg Auth (Santa Monica) APPROP		
Long Term Rating	AA+/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.