S&P Global Ratings

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Summary:

Montebello Public Financing Authority Montebello, California; Appropriations; General Obligation

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Table Of Contents

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Credit Profile		
US$45.0 mil gen fund lse rev bnds (Montebello) ser 2016A dtd 07/13/2016 due 06/01/2046		
Long Term Rating	A/Stable	New
Montebello ICR		
Long Term Rating	A+/Stable	Upgraded
Montebello APPROP (National)		
Unenhanced Rating	A(SPUR)/Stable	Upgraded
Montebello Public Financing Authority, California		
Montebello, California		
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Upgraded
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Upgraded
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its issuer credit rating (ICR) on the City of Montebello, Calif. to 'A+' from 'A' and its rating on the city's lease revenue bonds to 'A' from 'A-', based on our assessment of the city's management practices and policies improving to adequate from weak. The outlook is stable.

At the same time, S&P Global Ratings assigned its 'A' rating, and stable outlook, to the Montebello Public Financing Authority, Calif.'s lease revenue bonds, series 2016A (Montebello Home2 Suites by Hilton Hotel Project) issued on behalf of the City of Montebello.

The appropriation rating reflects our assessment of:

- The city's general creditworthiness; and
- A covenant to budget and appropriate lease payments for the debt.

The rating on the authority's lease revenue bonds is one notch lower than the 'A+' ICR, in accordance with our criteria, to reflect the appropriation risk associated with appropriation-backed obligations. The bonds are payable from lease payments made by the city, to which the city has pledged project net revenues of the Montebello Hilton hotel, after payment of hotel operating costs and franchise fees and city general fund appropriations. Based on our assessment of the pledged revenue streams, the rating on the bonds reflects the strongest revenue stream, which we view as the general fund appropriation pledge of the city.

If hotel net revenues are insufficient, the bonds may be paid by reimbursable advances of subordinate tax increment revenue pursuant to a project agreement between the city and its redevelopment successor agency. Under the lease agreement, the city is obligated to budget and appropriate the full amount of the base rental payments for each year, offset by the amount of project net revenues and agency advances available for such base rental payments.

We believe that payment abatement risk is present under the lease agreement; however, the leased assets meet our criteria for seismic risk, and the lease requires the entity to carry 24 months of business interruption insurance.

The rating reflects our assessment of the following factors for the city:

- Adequate economy, with projected per capita effective buying income at 69.1% and market value per capita of $83,829, though that is advantageously gaining from access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with a slight operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 15% of operating expenditures;
- Very strong liquidity, with total government available cash at 58.7% of total governmental fund expenditures and 9.4x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 6.3% of expenditures and net direct debt that is 302.5% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Adequate economy

We consider Montebello's economy adequate. The city, with an estimated population of 63,294, is located in Los Angeles County in the Los Angeles-Long Beach-Anaheim, CA MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 69.1% of the national level and per capita market value of $83,829. Overall, the city's market value grew by 3.0% over the past year to $5.3 billion in 2016. The county unemployment rate was 6.7% in 2015.

Adequate management

We view the city's management as adequate, with "standard" financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

We believe Montebello's management conditions are adequate, with "standard" financial practices under our Financial Management Assessment methodology, indicating the government, in our opinion, maintains adequate policies in some, but not all, key areas. The city uses historical revenue and expenditure trends to budget. Management prepares reports using a consultant to forecast sales and property taxes. There are monthly reviews of budget-to-actual by the finance team and quarterly updates to council. Management has made interim adjustments in the past, although given past performance, it's not clear that it would have done this as needed.

Informally, Montebello's policy is to maintain an unappropriated surplus in the general fund that is adequate to cover 8.3% of expenditures, or roughly one month of expenditures.

Weak budgetary performance

Montebello's budgetary performance is weak in our opinion. The city had slight surplus operating results in the general fund of 0.9% of expenditures, but a deficit result across all governmental funds of 4.1% in fiscal 2015. General fund operating results have been stable over the last three years, with a result of 0.9% in 2014 and a result of 0.6% in 2013. Weakening our view of Montebello's budgetary performance is the city's deferral of significant expenditures, which we think inflates the budgetary result ratios.

The fiscal 2016 budget projects a 0.6% surplus in the general fund. Historically, Montebello has relied in part on deferred cash payments and one-time revenues to balance the budget, leading to a more favorable picture of operating performance. The city's hotel enterprise in past years has deferred payments to its management company, resulting in an accumulated liability of $2.0 million in the city's hotel enterprise fund as of September 2016.

Very strong budgetary flexibility

Montebello's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 15% of operating expenditures, or $7.7 million after adjusting for certain long-term receivables from enterprise funds that we consider unavailable. We understand that the city has no plans to significantly spend down the reserves.

Very strong liquidity

In our opinion, Montebello's liquidity is very strong, with total government available cash at 58.7% of total governmental fund expenditures and 9.4x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

The city's available cash and investments represent 59% of total government funds expenditures and more than 9.4x annual debt service. The majority of the investments are in the Local Agency Investment Fund and are less than one year. The combined maximum annual debt service liability for the two hotels that the city owns is about $3.5 million, or about 7% of 2016 budgeted expenditures. Though one hotel is currently supporting itself and the second will be using its capitalized interest account for the next 18 months, should these hotels not be profitable, there could be a contingent liability risk.

Very weak debt and contingent liability profile

In our view, Montebello's debt and contingent liability profile is very weak. Total governmental fund debt service is 6.3% of total governmental fund expenditures, and net direct debt (including tax increment debt of the redevelopment successor agency) is 302.5% of total governmental fund revenue,

equal to 303% of revenues in 2015.

In our opinion, a credit weakness is Montebello's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Montebello's combined required pension and actual OPEB contributions totaled 16.3% of total governmental fund expenditures in 2015. Of that amount, 15.6% represented required contributions to pension obligations, and 0.7% represented OPEB payments. The city made its full annual required pension contribution in 2015. The funded ratio of the largest pension plan is 72.7%.

The city participates in the California Public Employees' Retirement System Miscellaneous and Safety pension plans, and contributes 100% of the annual required contribution; however, combined pension and OPEB expenditures represent 16% of total governmental funds expense, which we consider large. Montebello has a voted pension override levy, which currently provides sufficient revenue to cover its annual retirement costs. However, those costs continue to grow, and there is no assurance that the associated revenue will grow at the same pace. We do not believe that the city has a plan in place, beyond additional growth in its tax base, to stem the growth of retirement obligations. The safety pension plan is the largest plan by liability, and was 72.7% utilizing the plan's fiduciary net position as a percentage of the total liability.

Strong institutional framework

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

Outlook

The stable outlook is supported by our view of the city's still very strong available general fund balances, and very strong liquidity. We do not anticipate raising the ratings during the two-year outlook horizon, given the economy.

Upward scenario

While not likely, we could raise the ratings shouldMontebello's flexibility increase significantly and its wealth and income numbers increase; and if its debt and contingent liability profile improve.

Downward scenario

We could lower the ratings if the city's financial performance deteriorates and puts pressure on its flexibility. Should the hotels not perform, that would put significant pressure on Montebello's general fund.

Related Research

- 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

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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.