S&P Global
Ratings

RatingsDirect®

Summary:

Sacramento City Financing Authority, California
Sacramento; Appropriations; General Obligation

Primary Credit Analyst:
Tim Tung, San Francisco + 1 (415) 371 5041; tim.tung@spglobal.com

Secondary Contact:
Jennifer Hansen, San Francisco (1) 415-371-5035; jen.hansen@spglobal.com

Table Of Contents

Summary:

Sacramento City Financing Authority, California Sacramento; Appropriations; General Obligation

Credit Profile		
Sacramento ICR		
Long Term Rating	AA/Stable	Upgraded
Sacramento City Fincg Auth, California		
Sacramento, California		
Sacramento City Fincg Auth (Sacramento) APPROP		
Long Term Rating	AA-/Stable	Upgraded
Sacramento Pub Fincg Auth, California		
Sacramento, California		
Sacramento Pub Fincg Auth (Sacramento) APPROP		
Long Term Rating	AA-/Stable	Upgraded

Rationale

S&P Global Ratings raised its issuer credit rating (ICR) to 'AA' from 'AA-' on the City of Sacramento, Calif. At the same time, we raised our long-term rating and underlying rating (SPUR) to 'AA-' from 'A+' on Sacramento Public Financing Authority's and Sacramento City Financing Authority's existing lease revenue bonds, issued on behalf of the city. The outlook is stable.

The city had about $1.8 billion of total governmental debt outstanding at the end of fiscal year 2019.

We raised the ratings based primarily on the city's improved economic condition, as demonstrated by the steady rise in assessed values, in combination with the city's operating surpluses driving the growing reserve balances.

Security

The ICR is equivalent to our view of the city's general creditworthiness and represents our assessment of the city's capacity and willingness to meet its financial commitments as they come due without regard to the terms of a specific debt instrument.

Lease payments made by the city, as lessee, secure the lease revenue bonds. These ratings are one notch below our view of the city's general creditworthiness to reflect our view of the risk of nonappropriation. Lease payments, for which the city has covenanted to budget and appropriate over the life of each appropriation series, are subject to abatement, but Sacramento has agreed to maintain 24 months of rental interruption insurance to partly mitigate abatement risk, and the leased assets meet our criteria for seismic risk during the life of each series.

Credit overview

Sacramento has experienced an economic resurgence during the past decade that has more than offset the severe downturn during the last recession. Property values and employment opportunities have dramatically increased during the past five years, in part spurred by rising rents and housing affordability issues in coastal communities have driven some businesses and residents out of coastal areas and toward the inland metropolitan areas. In addition, the city's recovery was boosted by the passage of the Measure U half-cent sales tax in 2013, and citizens reconfirmed their desire for government services in 2018 by renewing and doubling the Measure U sales tax to a full cent without sunset. The city also completed construction of the Golden 1 Center, which has served to attract investment in its downtown area.

Despite the preceding positive developments during this period, we are also cognizant of the challenges that the city faces, particularly with respect to addressing its sizable pension and other postemployment benefit (OPEB) liabilities. Given that the carrying charges related to pension and OPEB are materially higher now than at the outset of the last recession, we are uncertain whether the city will be able to absorb a significant rise in pension and OPEB contributions if retirement system investment returns underperform actuarial assumption. In the event of an economic recession, we believe that the durability of the transformed regional economy will be tested, and we also anticipate that the city's revenue performance will be more volatile because of the increased exposure to sales tax revenues vis-à-vis Measure U.

The ratings reflect our opinion of the city's:

- Strong to very strong economy, with access to a broad and diverse metropolitan statistical area (MSA) economy;
- Strong management, with good financial policies and practices under our financial management assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund as well as at the total governmental funds level;
- Very strong budgetary flexibility, with an available fund balance at the end of fiscal year 2019 of 15.4% of operating expenditures;
- Very strong liquidity, with total government available cash of 129% of total governmental fund expenditures and 19.4x total governmental funds debt service, as well as access to external liquidity that we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges of 6.6% of expenditures and net direct debt that is 118% of total governmental fund revenue, as well as a large pension and OPEB liability and the lack of a plan to sufficiently address the obligations; and
- Strong institutional framework score.

Strong to very strong economy

We consider Sacramento's economy strong to very strong. The city, with an estimated population of 508,172 for 2019, is located in Sacramento County in the Sacramento--Roseville--Arden-Arcade, MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 90% of the national level and per capita market value of $108,415. The city's market value grew in aggregate by 39% during the past six years to $55.1 billion for 2020. The county unemployment rate was 3.8% for 2018.

Sacramento is located in Sacramento County in the northern section of California's Central Valley at the confluence of the Sacramento and American rivers. Because Sacramento is the state's capital, its employment base centers on government, with roughly a quarter of jobs in the area in the government sector. The city's tax base is very diverse with the top 10 taxpayers accounting for only 3.3% of assessed value.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

The city's financial policies and practices include the following:

- To plan for revenue growth, management works closely with the county assessor to determine property tax revenue and with an outside consultant to project sales tax revenue.
- On a formal basis, the budget is adjusted during a midyear review, although it can be adjusted more often if necessary. The budget is monitored on an informal basis continuously throughout the fiscal year. The midyear review focuses on structural balance and meeting financial targets such as funding reserve levels.
- In addition, the city maintains a five-year general fund forecast with a focus on balancing operations, and the forecast is updated annually.
- The city maintains a five-year capital improvement plan, which it updates annually and which identifies funding sources.
- The city's investment management policy and practices include at least quarterly reporting to the city council, which reviews the portfolio for performance and compliance with state law.
- The city has a debt management policy with a stated limitation for general fund and lease debt service of 6% of net general fund revenues.
- Finally, the city has a general fund economic uncertainty reserve policy with a minimum level of 10% of budgeted general fund revenues and a target of 17% of general fund expenditures.

We understand the city has procured insurance to mitigate some of the risk related to cybersecurity attacks.

In February 2012, the city council adopted the Sacramento Climate Action Plan (CAP), which included targets for reducing greenhouse gases through specific strategies and actions. Further embedding these policies, the city integrated the CAP into the general plan when it was last updated in 2015.

Strong budgetary performance

Sacramento's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 6.2% of expenditures and across all governmental funds of 9.3% in fiscal year 2019. However, the city's general fund operating results have varied widely during the past three years, with more modest surpluses of 0.9% and 1.5% in fiscal years 2017 and 2018, respectively, and we do not anticipate that general fund operating surpluses in excess of 5% are sustainable for the city.

The city expects to post another surplus in fiscal year 2020 based on the expansion of the Measure U sales tax as well as generally strong sales tax and property tax revenue performance, and we expect that this trend will continue over the near term, as revenue growth has outpaced expenditure growth as the city fills Measure U-funded positions. Although Measure U was originally scheduled to sunset in 2019, voters in November 2018 approved an extension without a sunset date, which eliminated the previous renewal risk. While the expansion of the Measure U revenue stream to a full cent from a half cent provides substantial new revenue to the city, we note that this significantly increases the city's exposure to economically sensitive revenues.

Strong budgetary flexibility

Sacramento's budgetary flexibility is strong, in our view, with an available fund balance at the end of fiscal year 2019 of 15.4% of operating expenditures, or $88.5 million. In our calculation of available fund balance, we include the economic uncertainty reserve that the city reports as committed in its audited financial statements. We do not expect that budgetary flexibility will decrease in the next few years given the city's continued budgeted surpluses, but also do not anticipate that the city will significantly increase reserves given the size of surpluses relative to total expenditures.

Very strong liquidity

In our opinion, Sacramento's liquidity is very strong, with total government available cash at 129% of total governmental fund expenditures and 19.4x governmental debt service in fiscal year 2019. In our view, the city has strong access to external liquidity, if necessary. The city has issued lease revenue bonds and water and sewer debt during the past 20 years, demonstrating its strong access to capital market for external liquidity. The city has a diversified investment portfolio, which we do not consider to be aggressively invested. The majority of investments are in corporate bonds (25%), commercial paper (16%), and U.S. agency securities (15%). The city does have some investments in equities, but this position represents less than 2% of total investments.

Very weak debt and contingent liability profile

In our view, Sacramento's debt and contingent liability profile is very weak. Total governmental fund debt service is 6.6% of total governmental fund expenditures, and net direct debt is 117.7% of total governmental fund revenue. We understand that the city is considering an additional issuance of lease revenue bonds to fund capital improvements related to affordable housing and inclusive economic development. The general fund does not have any privately placed debt aside from small equipment capital leases, and we do not believe these leases to be a material credit risk.

Pension and OPEB highlights:

- In our view, the city has a large pension and OPEB liability that could have a negative effect on financial performance in the coming years.
- The city's pension plans' funded status, combined with recent changes to assumed discount rate and amortization methods, will likely lead to accelerating costs in the medium term, but we believe this approach will help the city make timely progress reducing pension liabilities.
- While the city is not making full actuarially determined contributions toward its OPEB liability, the city's legal flexibility to alter OPEB benefits limits adverse credit impacts from its OPEB liability, and the city's recent labor negotiations to eliminate OPEB benefits for all future employees--this benefit was eliminated for most bargaining groups in 2015--will reduce the city's exposure to liability growth over the long-term horizon.

The city participated in the following plans funded as of June 30, 2018:

- California Public Employees' Retirement System (CalPERS) agent multiple-employer plan for safety employees: $582 million in net liability, and 69% funded;
- CalPERS agent multiple-employer plan for miscellaneous employees: $352 million in net liability, and 74% funded;
- Sacramento City Employees' Retirement System: $32 million in net liability, and 90% funded; and
- CalPERS agent multiple-employer defined benefit OPEB plan: $362 million in net liability, and 9% funded.

Sacramento's required pension and actual OPEB contributions totaled 14.8% of total governmental fund expenditures in fiscal year 2019, with 12.4% representing required contributions to pension obligations and 2.4% representing OPEB payments. The city's fiscal 2019 actuarially determined contributions for both CalPERS plans fell short of both static funding and minimum funding progress, indicating no funding progress and an increase in liabilities. We see CalPERS' recent adoption of a 20-year, level dollar amortization approach for new gains and losses as a turning point in that contribution increases from a shorter amortization period will provide faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability, which we view favorably. However, we believe costs will continue to increase for the next several years to retire existing unfunded liability, much of which is amortized over 30-year periods using a level-percent-of-payroll approach. In our view, the discount rate of 7.15% could lead to contribution volatility. Sacramento has planned for higher contribution rates in its multiyear projections; however, it does not have plans, such as a substantial funding of a side fund for either its pension or OPEB liabilities, that we think would give it more flexibility in managing upcoming contribution increases.

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 strong budgetary flexibility, with small surpluses projected over the next few years. Further strengthening the ratings is our view of the city's strong management practices and good financial policies. We do not expect to change the ratings within our two-year outlook horizon due to our anticipation that the city will continue to have a very weak debt profile with high pension and OPEB costs.

Upside scenario

Should the city be able to improve its debt and liabilities position, including reducing pension and OPEB costs, we could consider raising the ratings.

Downside scenario

Should the city management be unable to maintain balanced operations and significantly draw on reserves, we could consider lowering the ratings.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019
- 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
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017
- Looking Forward: The Application Of The Discount Rate In Funding U.S. Government Pensions, Sept. 13, 2018
- The Increasing Cost Of Governmental Pensions: Discount Rate And Contribution Practices, Sept. 27, 2018
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of March 2, 2020)		
Sacramento City Fincg Auth, California		
Sacramento, California		
Sacramento City Fincg Auth (Sacramento) APPROP		
Long Term Rating	AA-/Stable	Upgraded
Sacramento City Fincg Auth (Sacramento) APPROP (AMBAC)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Sacramento City Fincg Auth (Sacramento) APPROP (National) (MBIA) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Sacramento City Fincg Auth (Sacramento) (Master Lse Prog Facs)		
Long Term Rating	AA-/Stable	Upgraded
Sacramento City Fincg Auth (Sacramento) (Master Lse Prog Facs) (AMBAC)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Sacramento City Fincg Auth (Sacramento) (Master Lse Prog Facs) (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

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.