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Ratings

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Summary:

Larkspur, California; Appropriations; General Obligation

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Credit Profile		
US$26.5 mil lse rev bnds (Larkspur) ser 2018 due 03/01/2041		
Long Term Rating	AA+/Stable	New
US$0.0 mil ICR due 01/01/2099		
Long Term Rating	AAA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the Larkspur Public Financing Authority, Calif.'s series 2018 lease revenue bonds, issued for the City of Larkspur. In addition, S&P Global Ratings assigned its 'AAA' issuer credit rating (ICR) to the city. The outlook is stable.

Security and purpose

The series 2018 lease revenue bonds are secured by lease payments made by the city, as lessee, to the Larkspur Public Financing Authority, as lessor, for the use and possession of leased assets, through a lease-leaseback structure, whereby the city will make periodic rental payments sufficient to amortize the lease revenue bonds. The city has covenanted to budget and appropriate base rental payments for the use of the leased assets. Payments are triple net, without right of set-offs, and the city is responsible for maintenance, taxes, and utilities. The city may abate base rental payments in the event of damage to or the destruction of the assets. To mitigate abatement risk in such a case, the city has covenanted to maintain rental interruption insurance coverage equal to the maximum lease payments due in any 24-month period. In addition, we evaluated the seismic risk of each leased asset 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 leased assets include the City Hall building and Larkspur Fire Station No. 15. The city does not expect to have a debt service reserve on the bonds, but lease payment dates occur on Nov. 15 and May 15, more than 90 days after the start of the city's fiscal year, and we believe that this mitigates payment risk associated with late budget adoption. Proceeds of the 2018 lease revenue bonds will be used to finance various infrastructure improvements within the city and to pay the costs of issuance.

Credit fundamentals

Larkspur is eligible to be rated above the sovereign because we believe the city 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, U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived revenues are the source of security for the bonds, and the institutional framework in the U.S. is predictable with significant U.S. local government autonomy. In a potential sovereign default scenario, U.S. local governments would maintain financial flexibility through their ability to continue collecting locally derived revenues and their independent treasury management.

The 'AAA' ICR reflects our opinion of the following credit factors:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- 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 and at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 58% of operating expenditures;
- Very strong liquidity, with total government available cash at 125.9% of total governmental fund expenditures and 66.8x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 1.9% of expenditures and net direct debt that is 125.6% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very strong economy

We consider Larkspur's economy very strong. The city, with an estimated population of 12,755, is located in Marin County in the San Francisco-Oakland-Hayward, Calif., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 235% of the national level, which we view as extremely high and a positive credit factor, and per capita market value of $313,539. Overall, the city's market value grew by 5.7% over the past year to $4.0 billion in 2018. The county unemployment rate was 2.9% in 2017.

Larkspur is located in Marin County within the San Francisco Bay metropolitan area, approximately 15 miles north of downtown San Francisco. Given the city's participation in the San Francisco-Oakland-Hayward MSA, management reports that residents have the option of commuting to nearby San Francisco for work. In addition, the city has a large ferry terminal and an expanding commuter rail service for residents to commute throughout the MSA for employment. The largest employment industries in the area include educational and health services, professional and business services, government, and leisure and hospitality. Due to the city's historic downtown village and location near several open space areas in the county, a large component of the city's economy is tourism. The city has experienced steady year-over-year growth in population recently, with population increasing on average 1% since 2013. The city's assessed value (AV) totaled about $4.0 billion for fiscal 2018, an increase of 5.7% from fiscal 2017. The city is expecting the near-term growth trend to continue as the underlying economy improves further. Although the city is relatively built out, permit activity has continued due to existing parcels being improved or expanded. We consider the city's tax base very diverse, with the leading 10 taxpayers accounting for 13.8% of total AV.

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.

Highlights of key policies and practices of the city include the use of historical trends, economic forecasts, and other outside sources of information to help revenues and expenditures projections, with a recent trend of the city outperforming its budgets at year-end. Management presents the budget and budget-to-actual reports to the city council on a semiannual basis, along with maintaining a five-year financial forecast that is updated once a year. The city has a long-term capital plan that identifies cost estimates and that is updated annually. The city maintains a formal investment management policy, with investment holdings and earnings presented to the council monthly. The city also maintains a formal reserve policy that requires it to maintain at least 25% of expenditures (15% catastrophic reserve and 10% budget stabilization reserve) in its general fund to cover any liquidity needs or unexpected events. The city has a formally adopted debt management policy that provides qualitative guidelines for issuing debt.

Strong budgetary performance

Larkspur's budgetary performance is strong in our opinion. The city had operating surpluses of 13.3% of expenditures in the general fund and of 29.7% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2017 results in the near term.

The city's finances have remained strong in recent years, evidenced by general fund surpluses in five consecutive audited years. The city has experienced growth in both property tax and sales tax revenue recently, which contributed to the net general fund result of 13.3% of operating expenditures. The city's revenue makeup is largely property and sales taxes, which account for 67% and 17% of general fund revenue, respectively. The city recently experienced a 2% increase in sales taxes during 2017, which officials attribute to continued economic activity. The larger increase from property taxes in 2017 (6% growth from the prior year) was due to the growth in AV within the city. Management expects the revenue growth to continue, as real estate trends locally remain positive and local residents recently approved a sales tax increase. In November 2017, city residents approved Measure B, which imposed a sales tax of 0.75% that also replaced an existing 0.50% sales tax set to expire in 2019. The new Measure B sales tax has no automatic sunset date. The city's general fund expenditures have increased modestly over the last several years, rising by roughly 3.6% annually since 2014.

According to officials, the city made a conscious effort to keep expenditures low and budget for limited revenue growth in order to build up fund balances. Moreover, the city intends to spend some of the savings on the Bon Air Bridge and Mitigation project. According to management, the city is responsible for about 11% of project costs, which equates to roughly $4 million. Despite some spending for the project during fiscal 2018, city officials anticipate closing out 2018 with positive operational results; they originally budgeted to end the year balanced.

Very strong budgetary flexibility

Larkspur's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 58% of operating expenditures, or $9.2 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Our calculation of available fund balance combines assigned and unassigned portions of the general fund balance as a percentage of general fund expenditures. The city increased its fund balances over the last several years to help fund the Bon Air Bridge and Mitigation project, as the city is responsible for about 11% of the project's total costs. We understand the drawdowns of reserve will likely take place within the next two years. Despite this, we believe fund balances will remain very strong, given the council-approved reserve policy of maintaining general fund reserves of at least 25% of expenditures.

Very strong liquidity

In our opinion, Larkspur's liquidity is very strong, with total government available cash at 125.9% of total governmental fund expenditures and 66.8x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

In our view, the city has strong access to external liquidity, as the city has demonstrated an ability to access capital markets. We do not consider the city's investments aggressive, as it invests primarily in the California Local Agency Investment Fund and the Investment Trust of California. The city also maintains a formal investment management policy that prohibits certain investments, while also including maturity maximums and credit quality standards. We do not expect that liquidity will weaken substantially over the next several years.

Very weak debt and contingent liability profile

In our view, Larkspur's debt and contingent liability profile is very weak. Total governmental fund debt service is 1.9% of total governmental fund expenditures, and net direct debt is 125.6% of total governmental fund revenue.

The city's direct debt profile includes a relatively small fire engine lease agreement (less than $500,000 remaining), a 2013 privately placed lease agreement, and now the series 2018 lease revenue bonds. In 2013, the city entered into a privately placed $3.1 million lease agreement with Municipal Asset Finance Corp. to help fund public capital improvements. The debt issuance includes no acceleration provisions. There is approximately $2.15 million of principal remaining on the agreement, and the city holds sufficient reserves, cash on hand, and time to tap external liquidity to handle the total amount of the privately placed debt. We consider amortization slower than average, with officials planning to retire approximately 38% of principal for all debt during the next 10 years. Management reports that the city has no official plans to issue additional debt in the next 12 to 18 months.

We do believe that Larkspur's large pension and OPEB obligation is a credit weakness; however, we note that the city is anticipating pension rate increases. Larkspur's combined required pension and actual OPEB contributions totaled 11.0% of total governmental fund expenditures in 2017. Of that amount, 6.6% represented required contributions to pension obligations, and 4.4% represented OPEB payments. The city made its full annual required pension contribution in 2017.

The city participates in the California Public Employees' Retirement System for employee pension benefits, and it made its full annual required pension contribution in 2017. The city's net pension liability was $13.6 million as of June 30, 2016, and is 74.5% funded using its fiduciary net position as a percentage of the total pension liability. We note that we expect contribution rates to rise over the medium term, which could result in budgetary pressure. The city currently funds its OPEB obligations on a pay-as-you-go basis.

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 and stable economy, with participation in the San Francisco-Oakland-Hayward MSA. The stable outlook also reflects the city's strong financial performances in the last several years, and our expectation that the city will maintain very strong general fund balances despite some planned drawdowns. In addition, the stable outlook reflects our anticipation that the city's sales and property tax collections will remain stable, providing support to the city's revenue profile. We do not expect to raise the rating within the two-year outlook horizon.

Downside scenario

If the city's budgetary performance weakens on a sustained basis, leading to a depletion of reserves below its fund balance policy-mandated minimum, we could consider lowering the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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