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Ratings

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Summary:

Carson, California; General Obligation

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Credit Profile		
US$108.055 mil 2020 taxable pension obligation bnds due 01/15/2044		
Long Term Rating	AA-/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Carson, Calif.'s anticipated $108.055 million series 2020 taxable pension obligation bonds (POBs). The outlook is stable.

The POBs are obligations of the city and are payable from any source of legally available funds of the city. We rate the city's POBs on par with its general creditworthiness due to our view that the city's ability to pay the obligation is closely tied to its operations and the revenue used to secure its POBs is not limited in scope and not distinct and separate from its general fund. The proceeds will be used to prepay all of the city's current existing net pension liability (NPL) for the miscellaneous plan that is administered under CalPERs. This issuance is primarily used to recognize interest cost savings over the life of the unfunded pension liability.

Credit overview

The city's local economy has remained strong in our view with historical growth in its tax base, reflected by increases in citywide assessed value (AV) in each of the past six fiscal years. Building permits have also continued to increase, which reflects continued demand for residential and commercial property developments that will likely continue to support the city's local economy. Additionally, management indicates that current property development and construction projects have not been delayed in light of the statewide shelter-in-place order, and we believe the continued construction will likely further increase the city's taxable AV and the generation of property tax revenue in fiscal 2021.The city's general revenues are primarily funded by sales taxes (37% of total general revenues) followed by property taxes (21%), franchise taxes (13%) and utility users tax (10%). These revenue streams have been increasing during the past several years, which enabled the city to grow and maintain its very strong reserve position. However, with the current economic recession due to the COVID-19 pandemic, we believe sales tax revenues are likely to see material declines in the current and next fiscal year for municipalities across the nation. The city indicates they are currently monitoring the effects of COVID-19 within the city and have factored in any projected decreases in revenue in their financial projections (including their proposed fiscal 2021 budget) going forward.

Currently, the city is projecting a $3.5 million decrease (14.3% decline) in sales tax revenues for fiscal 2020, compared to previously budgeted 2020 figures. Like most municipalities across the state, we believe the city's largest challenge going forward is addressing the current economic recession and the potential for a prolonged period of substantially lower sales tax revenues and a high unemployment rate. However, we believe the city's very strong financial management policies and practices as well as its very strong reserve levels will enable to city to weather the downturn in the economy for the time being. The stable outlook reflects our view that the city will be able to maintain reserves at strong levels at a minimum and will make the necessary budgetary adjustments to avoid a structural imbalance in its operations. We do not expect to change the rating during our outlook period.

The rating reflects our view of the following credit factors:

- 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 methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 53% of operating expenditures;
- Very strong liquidity, with total government available cash at 79.3% of total governmental fund expenditures and 10.0x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 7.9% of expenditures and net direct debt that is 275.0% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's ESG risks relative to its economy, management, financial measures, and debt-and-liability profile. Our ratings incorporate our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's ESG risk to be in line with our view of the sector standard.

Stable Outlook

Downside scenario

The rating could be lowered if the city's reserves are depleted to strong levels or below with a projection of further declines in reserves due to an unmitigated structural imbalance in city general fund operations. We believe the current economic recession could place the city under budgetary pressure that could result in prolonged operating deficits should management fail to take steps to address the potential loss in revenue. Additionally, the rating could also be lowered if the city's budgetary performance weakens with evidence of a structural imbalance and if the city's unemployment rate rises above 10% that would result in weakened economic metrics overall.

Upside scenario

While unlikely, the rating could be raised if the city is able report general fund operating surpluses during the next two years, despite the current economic recession, resulting in the maintenance of the city's adequate economic indicators and its very strong general fund reserves.

Credit Opinion

Strong economy

We consider Carson's economy strong. The city, with an estimated population of 93,604, 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 86.3% of the national level and per capita market value of $167,980. Overall, the city's market value grew by 3.8% over the past year to $15.7 billion in 2020. The county's unemployment rate was 4.4% in 2019.

Carson is located in the South Bay region of the county along the Interstate 405. The 19.2-square-mile city is located approximately 17 miles south of downtown Los Angeles. Residents have access to employment throughout Los Angeles County, including major South Bay employers such as Northrop Grumman, Raytheon, Boeing, Lockheed Martin, Alcoa, and the Port of Los Angeles. The city's tax base is primarily industrial, given the large number of light industry, warehouse, and distribution properties within city boundaries. Management indicates that the city's location makes it ideal for these types of properties, given its close proximity to Los Angeles International Airport (LAX), the Port of Los Angeles, and the Port of Long Beach. Included within the city are two large oil refineries that also reflect the top two property taxpayers within the city. The top taxpayer is Tesoro Refining (now known as Marathon) (9.5% of total AV in fiscal 2019) and the second-highest taxpayer is Phillips 66 (4% of total AV in fiscal 2019). Citywide AV has grown in each of the past six fiscal years, most recently growing by 3.8% in fiscal 2020, bringing total AV up to $15.7 billion. Management indicates that the city has completed or plans to complete several residential and industrial property development projects in calendar year 2019, which will add to future AV figures for fiscal 2021. However due to the recession as well as the decline in oil prices, which affects the AV for the two oil refineries within the city, we believe that future growth in citywide AV may be tempered or even decline for fiscal 2022.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment 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 revenue and expenditure 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 quarterly, along with maintaining a five-year financial forecast that is updated annually. The city also annually updates a five-year long-term capital plan that identifies cost estimates. 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 20% of annual operating expenses in its general fund. The city also has a formally adopted debt management policy that provides qualitative guidelines for issuing debt.

Adequate budgetary performance

Carson's budgetary performance is adequate in our opinion. The city had operating surpluses of 11.5% of expenditures in the general fund and of 20.7% across all governmental funds in fiscal 2019. Although recent budgetary performance has generated relatively stable results in the past three fiscal years, we believe the uncertainty due to the unknown duration of the pandemic and economic challenges stemming from the current recession could pose budgetary challenges in the near term. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2019 results in the near term.

The city has reported positive general fund operating results during the past three years, primarily due to growth in the city's major revenue streams that include both sales tax revenue and property tax revenue. These revenue streams have been increasing during the past several years, which enabled the city to grow and maintain its very strong reserve position. However, with the current economic recession due to the COVID-19 pandemic, we believe sales tax revenues are likely to see material declines in the current and next fiscal year for municipalities across the nation. The city indicates they are currently monitoring the effects of COVID-19 within the city and have factored in any projected decreases in revenue in their financial projections (including their proposed fiscal 2021 budget) going forward. Currently, the city is projecting a $3.5 million decrease (14.3% decline from the fiscal 2020 budget) in sales tax revenues for fiscal 2020 compared to previously budgeted 2020 figures. Other projected declines include a $2 million reduction in license and permit revenue for fiscal 2021.

In order to adjust its operations and reduce expenditures, the city plans on implementing a limited hiring freeze, reducing non-personnel related expenditures across most city departments, suspending certain city programs and cancelling certain large-scale special events for the remainder of the calendar year. We note that the city does not anticipate needing to reduce staffing levels either through temporary furloughs or permanent layoffs. Rather, the city plans on drawing down its sizeable reserves with a projected use of $8.1 million in fiscal 2020, which would bring total available general fund reserves down to $36.1 million or a very strong 41.9% of expenditures. The proposed budget for fiscal 2021 shows another drawdown of about $3.4 million with a projected ending reserve balance of $32.7 million or 39% of expenditures, which we consider very strong.

Very strong budgetary flexibility

Carson's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 53% of operating expenditures, or $44.1 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.

The city maintains a large amount of general fund reserves that have grown to very strong levels in recent years. At the end of fiscal 2019, the city reported an available general fund balance of $44.1 million or 53% of expenditures. Included in this figure is an economic uncertainties reserve in the amount of $15.2 million categorized as committed in the general fund. Going forward, we understand the city has plans to draw down portions of the general fund, although we believe reserves will remain very strong despite these planned drawdowns. The proposed budget for fiscal 2021 shows a drawdown of about $3.4 million with a projected ending general fund reserve balance of $32.7 million or a very strong 39% of expenditures in our view.

Very strong liquidity

In our opinion, Carson's liquidity is very strong, with total government available cash at 79.3% of total governmental fund expenditures and 10.0x governmental debt service in 2019. In our view, the city has strong access to external liquidity, if necessary.

The city has issued bonds in the past 20 years, indicating it has a record of sufficient access to external liquidity through the capital markets, 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 the state and county investment pools. Some portion of investments has been made in money market funds, most of them are rated AAAm.

Very weak debt and contingent liability profile

In our view, Carson's debt and contingent liability profile is very weak. Total governmental fund debt service is 7.9% of total governmental fund expenditures, and net direct debt is 275.0% of total governmental fund revenue. These calculations include the issuance of the series 2020 pension obligation bonds and uses an annual debt service payment of $7.9 million for the POBs.

Included in the debt ratio calculations above are tax increment debt issued by the Successor Agency of the Carson Redevelopment Agency and special assessment district debt. The debt calculations also factor into the series 2020 taxable POBs that will begin debt service payments in fiscal 2021.

Pensions and other postemployment benefits (OPEBs)

Prior to the issuance of the series 2020 POBs, Carson's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 11.0% of total governmental fund expenditures in 2019. Of that amount, 8.4% represented required contributions to pension obligations, and 2.6% represented OPEB payments. The city made its full annual required pension contribution in 2019.

Highlights:

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for the city, given that the POB will refinance a majority of the city's pension liability into a fixed-debt obligation to recognize interest cost savings. We understand the POB issuance will not defer any ongoing pension liabilities and will not extend the term of the city's current pension liabilities. However, if poor investment performance or other experience changes generate new liabilities that are greater than previously projected--particularly if it occurs earlier in the amortization period--then the city risks having to pay both the debt service costs on the bonds and higher-than-expected pension contributions, which would result in eliminating potential payment savings from the transaction.
- The issuance of the POBs is expected to reduce the annual pension costs to CalPERS and recognize savings of an average $2.5 million annually during the first 15 years.
- The city offers a very limited OPEB benefit, which does not pose any credit risk, in our view. As of June 30, 2018, the total net OPEB liability reached $51.4 million.

The city of Carson participates in the CalPERS miscellaneous pension plan. As of a June 30, 2018 measurement date, this plan is 64.8% funded with an UAAL of $105 million.

In our view, a discount rate of 7.15% (on a GASB basis) for the miscellaneous plan could lead to contribution volatility. While CalPERS' recent adoption of a 20-year, level dollar amortization approach for new gains and losses will lead to more rapid contribution increases and increased payment volatility, a shorter amortization period will provide a faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability, which we view favorably from a credit perspective.

In fiscal 2019 (prior to the issuance of the series 2020 POBs), the city's combined required pension and actual OPEB contributions totaled 11% of total governmental fund expenditures in fiscal 2019. Of that amount, 8.4% represented required contributions to pension obligations, and only 2.6% represented OPEB payments. The city made its full annual required pension contribution in 2019 and has always done so. After the issuance of the series 2020 POBs, we calculate that the required pension contribution cost will fall down to a projected 3.1% in fiscal 2021. This 3.1% pension contribution cost primarily reflects the employer normal cost that the city is projected by CalPERS to pay in fiscal 2021. Total governmental fund debt service would increase from 0% to 7.9% of total governmental fund expenditures, and net direct debt would increase to 185% from 275% of total governmental fund revenue. Additionally, the funding ratio for the miscellaneous plan would increase to 100% in fiscal 2021.

We also note that the city has structured the POB principal payments proportional to existing liabilities that will provide debt service savings of roughly $2.5 million average annually during the first 15 years. We note that the 2020 POBs will not defer any pension payments or extend the term for the city's existing pension liabilities. For more on our view of POBs, please see our report "Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers," published Dec. 6, 2017.

Strong institutional framework

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