

RatingsDirect®

Summary:

Richmond, California; Appropriations; General Obligation

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Richmond ICR		
<i>Long Term Rating</i>	A-/Positive	Upgraded
Richmond Jt Pwrs Fin Auth, California		
Richmond, California		
Richmond Jt Pwrs Fin Auth APPROP		
<i>Long Term Rating</i>	BBB+/Positive	Upgraded
Richmond Jt Pwrs Fin Auth APPROP		
<i>Long Term Rating</i>	BBB+/Positive	Upgraded
Richmond Jt Pwrs Fin Auth APPROP (ASSURED GTY)		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Positive	Upgraded
Richmond Jt Pwrs Fin Auth (Richmond) lse rev bnds (Richmond)		
<i>Long Term Rating</i>	BBB+/Positive	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its issuer credit rating (ICR) to 'A-' from 'BBB+' on Richmond, Calif. At the same time, S&P Global Ratings raised its long-term rating and underlying rating (SPUR) to 'BBB+' from 'BBB' on the city's 2009 lease revenue bonds and series 2016 lease revenue bonds. The outlook is positive.

The rating action is based upon our view of the city's recent track record of stable to positive budgetary performance, coupled with management's expectations that this will continue through the current fiscal year. As a result we no longer consider the city to be structurally imbalanced under our Local Government GO Ratings criteria. The removal of the structural imbalance criteria rating cap lifts the rating to a full rating category (three notches) above the previously amended RBC swap agreement rating termination event of lower than BBB. In addition, we anticipate that the city will increase its budgetary flexibility to a level that we view as strong, or above 8% as a percent of operating expenditures.

The positive outlook is based upon our view that there is a one-in-three chance of a further rating upgrade, of potentially by more than one notch, if the city's fiscal 2017 audit approximates the general fund net results in the unaudited actuals and if the city also maintains at least stable fiscal 2018 and 2019 results. At the same time, the rating and outlook incorporate our view that the city's large pension and other postemployment benefit liability and the lack of a credible plan to address the large obligation could represent a drag on operating performance.

Security

The rating on the bonds is one notch lower than the ICR, in accordance with our criteria, to reflect the risk associated with appropriation-backed obligations. The lease revenue bonds are payable from a pledge of lease payments made by the city, as lessee, to the Richmond Joint Powers Authority, as lessor, for the use of certain city facilities. The city has covenanted to budget and appropriate for lease payments. 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 more than 25% damage during the life of the bonds.

Credit overview

The ICR reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Weak management, with recently structurally imbalanced operations and standard financial policies and practices under our financial management assessment (FMA) methodology;
- Adequate budgetary performance, with balanced operating results in the general fund but an operating deficit at the total governmental fund level in fiscal 2016;
- Strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its fiscal 2016 level of 7.6% of operating expenditures;
- Very strong liquidity, with total government available cash at 25.5% of total governmental fund expenditures and 116.7% of governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 21.9% of expenditures and net direct debt that is 199.1% 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 performance

As a result of the city's general fund audited results in fiscals 2015 (0.6%) and 2016 (0.5%), the recently released unaudited actuals for fiscal 2017 (2.8%), the city's budget estimates for fiscal 2018 (even, or net 0% planned result), and the city's recent track record of improved budget to actual performance; we no longer consider the city to be structurally imbalanced under our Local Government GO Ratings criteria. Prior to this rating review, the general fund posted three significant years of deficits up to fiscal 2014 with the most notable deficit being negative 6.7% (\$9.5 million) in fiscal 2014. The recent stable to positive general fund performance is the result of a partly improved revenue environment related, in part, to a 2014 Measure U half-cent sales tax increase mixed with cost-control measures that include staff reductions, salary freezes, and cost-sharing measures related to healthcare expenditures.

Despite our view related to the city's budgetary performance, we note that an unforecasted economic recession, a potential inability to control personnel costs, unmanaged pension cost obligations, or a lack of deferred maintenance expenditures could move the city back to a structurally imbalanced position.

Strong flexibility

As a result of the city's recent positive budgetary performance, we now view Richmond's budgetary flexibility to be strong, as we expect the fiscal 2017 audit to show an available fund balance of at least 8% of general fund operating expenditures. The most recent available audit, for fiscal 2016, shows available fund balances of 7.6% of operating expenditures, or about \$11 million.

Very strong liquidity

In our opinion, Richmond's liquidity is very strong, with total government available cash at 25.5% of total governmental fund expenditures and 116.7% of governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

We understand that the early termination option of JPMorgan Chase Bank for the swaps related to the pension funding bonds series 2005B-1 and B-2 was triggered when the Moody's lowered its credit rating on the bonds to less than 'Baa2'. The early swap termination option contingent liability risk was eliminated through an agreement by JP Morgan Chase Bank N.A. to transfer the swaps to RBC. RBC removed Moody's rating from the termination events and lowered the rating termination event on the S&P Global Ratings' ICR to lower than 'BBB'. The RBC swap agreement added a mandatory tender in 2023, but expects the swap's fixed and floating rates will remain unchanged. In addition, the city has four swaps outstanding related to pension funding bonds series 2005B-1 and 2005B-2, variable-rate wastewater revenue refunding bonds series 2008A, and tax allocation refunding bonds (merged project areas) series 2010A, which are currently rated above the ratings termination events.

Finally, we understand that previous litigation related to a land development agreement and a petition filed by other taxing entities disputing the city's share of a property tax reimbursement paid to Chevron that we had viewed as speculative contingent liabilities were settled in the city's favor. In addition, the city's proposed program for mortgage principal reduction for residential property owners through eminent domain is no longer under active consideration.

Weak management

We view the city's management as weak, reflecting our view that the city's operations were recently structurally imbalanced and "standard" financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas. Highlights of the city's management practices include presentation of monthly reporting of investment holdings to the council and the maintenance of a five-year rolling capital plan. The five-year financial forecast for operations was recently updated through fiscal 2021. The full city council performs budget review only at midyear. The city has an investment, debt management, and swap policy. It also has a reserve policy to maintain a minimum of 7% of the next year's budgeted general fund expenditures in reserve.

Very weak debt and contingent liability profile

In our view, Richmond's debt and contingent liability profile is very weak. Total governmental fund debt service is 21.9% of total governmental fund expenditures, and net direct debt is 199.1% of total governmental fund revenue. Our calculation of the city's direct debt excludes business-type activities debt and includes debt issued by the former redevelopment agency.

In our opinion, a credit weakness is Richmond's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Richmond's combined required pension and actual OPEB contributions totaled 12.8% of total governmental fund expenditures in 2016. Of that amount, 9.4% represented required contributions to pension obligations, and 3.4% represented OPEB payments. The city made its annual required pension contribution in 2016. The funded ratio of the largest pension plan is 76.3%. For more information regarding CalPERS, please refer to our "California Pension Giants Lower Their Discount Rates To Preserve Long-Term Plan

Sustainability", published March 15, 2017, on RatingsDirect.

Strong economy

We consider Richmond's economy strong. The city is located on the western shore of Contra Costa County about 17 miles northeast of San Francisco by car. The city serves a steadily growing population of about 110,000 covering about 53 square miles. Despite the city's access to the Bay Area economy and associated metropolitan statistical areas (MSA), the city's projected per capita effective buying income (EBI) of 91.6% of the national level is notably below the Contra Costa county median household EBI of about approximately 146% of the national level.

The city's assessed value (AV) trend is positive, as the recently released AV of \$14.08 billion in fiscal 2018 is approximately 4% above the fiscal 2017 figure and is now about \$4.2 billion (or 41%) above the city's recent fiscal 2011 recession-related AV trough \$10.2 billion. The fiscal 2018 AV continues the recent trend of strong AV growth as the city has now posted four consecutive years of growth that ranges from 4% to 9% annually, with the average annual growth rate of 6.9% during that period. Finally, the city carries a per capita market value of \$124,342.

Despite the positive growth trend, we note that the city's tax base is moderately concentrated as the top 10 taxpayers account for about 28% of total AV. Of those, the top taxpayer (Chevron USA) dominates the list as it accounted \$2.99 billion or about 21% of the city's total tax base. To note, the very large AV decline in fiscal 2014 of 14.7% (\$1.86 billion) was due largely to the Chevron fire and correlated AV reassessment.

Looking ahead, we are anticipating continued AV growth at or near the historical trend. Overall, we are forecasting stable-to-positive growth for the western U.S. Pacific States as continued home-price appreciation, continued strength within the region's housing starts, and vibrant regional economies has helped boost local government tax receipts throughout much of the region, including the AV results for the city of Richmond. As a result, we expect the broader macroeconomic forces to support our view and expectation of a stable-to-positive AV result within the near-term future. For additional information, please refer to our "U.S. State And Local Government Credit Conditions Forecast", published Nov. 1, 2017, on RatingsDirect.

Strong institutional framework

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

The institutional framework score is based on the state legislative and functional environment under which these local governments operate, including a framework that encourages transparency by requiring these local governments to perform annual financial statement audits of its entire operations if it is subject to the federal single-audit requirement due to federal awards in multiple programs exceeding \$500,000 per year.

Outlook

The positive outlook reflects our view that the city's fiscal 2017 audit will reflect at least strong performance in the general fund, which could lead to greater confidence in our view of the city's structural balance during the next two years. In addition, the positive outlook reflects our expectation of an at least a stable general fund result in fiscal 2018, with all other rating factors remaining equal.

We could revise the outlook back to stable if the city's fiscal 2017 audit shows general fund performance that is below our expectations, if the city were to return to a structural imbalance, or if the city is unable to meet its budgeted performance in fiscal 2018.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Nov. 1, 2017
- 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
- California Pension Giants Lower Their Discount Rates To Preserve Long-Term Plan Sustainability, March 15, 2017

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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