S&P Global
Ratings

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Summary:

Azusa Public Finance Authority, California
Azusa; Appropriations; General Obligation

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Credit Profile		
Azusa POBs (ASSURED GTY)		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded
Azusa Pub Fin Auth, California		
Azusa, California		
Azusa 2003 lse rev rfdg certs of part dtd 12/30/2003 due 08/01/2004-2020		
Unenhanced Rating	A+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) three notches to 'A+' from 'BBB+' on the Azusa Public Finance Authority, Calif.'s existing pension obligation refunding bonds and lease revenue certificates of participation (COPs), issued for Azusa. The outlook is stable.

The upgrade reflects our view of the city's improved management score, as a result of the implementation of its recently updated financial management policies. In our view, the city's improved financial management has resulted in continuous structural general fund performance, which has boosted its general fund reserve levels, following four consecutive years of negative general fund balances through fiscal 2014.

The series 2008 pension refunding bonds are absolute and unconditional obligations of the city. The series 2003 COPs are secured by lease rental payments from the city, which it has covenanted to annually budget and appropriate.

The ratings reflect our assessment of the following factors for the city, including its:

- Adequate economy, with projected per capita effective buying income at 67.7% and market value per capita of $82,318, that is gaining advantage from 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;
- Adequate budgetary performance, with an operating surplus 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 4.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 120.4% of total governmental fund expenditures and 33.1x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 3.6% of expenditures and net direct debt that is 117.1% of total governmental fund revenue, and a large pension and other postemployment

benefit (OPEB) obligation, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Adequate economy

We consider Azusa's economy adequate. The city, with an estimated population of 51,329, is located in Los Angeles County in the Los Angeles-Long Beach-Anaheim, Calif. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 67.7% of the national level and per capita market value of $82,318. The city has experienced strong assessed value (AV) growth over the last several years as the economy rebounded from the housing downturn, and as new commercial developments have been added to the city's taxing boundaries. Overall, the city's market value grew by 6.3% over the past year to $4.2 billion in 2017. The county unemployment rate was 5.2% in 2016.

The city is located approximately 24 miles northeast of downtown Los Angeles and encompasses nine square miles. The city has significant commercial and industrial sectors as well as residential areas. Residents enjoy easy access and proximity to various employment centers within the greater Los Angeles Area. Leading employers include Azusa Pacific University, Azusa Unified School District, Northrup Grumman, and the city itself. In our view, the top 10 taxpayers make up a very diverse 7.8% of the city's tax base, with Northrup Grumman Systems Corp. as the leading taxpayer, at 2.2% of total AV in fiscal 2017.

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. We revised the city's management score to strong from adequate, as a result of a revision our assessment of the city's financial policies and practices go good from standard.

The FMA reflects our view of the following:

- The city's revenue and expenditure assumptions use historical trend analysis to project future property tax and sales tax revenues.
- Management presents budget-to-actuals to the council quarterly; previously, the city provided only mid-year updates to the board.
- The city maintains a rolling five-year financial forecast, which it shares with the board.
- The city has an investment management policy, and presents to the board monthly reports that summarize the city's investment performance.
- The city has a formal debt management policy, which provides guidelines surrounding debt issuance purpose, types of debt, debt limits, and minimum savings for refunding.
- The city has a formal, board-adopted reserve policy of maintaining 15% of expenditures. The reserve policy was recently met at the end of fiscal 2016.

Adequate budgetary performance

Azusa's budgetary performance is adequate in our opinion. The city had surplus operating results in the general fund of 8.3% of expenditures, but a deficit result across all governmental funds of 2.6% in fiscal 2016. Our assessment accounts for the fact that budgetary results could deteriorate somewhat from 2016 results in the near term, particularly with the city's total governmental fund, due to ongoing capital. General fund operating results of the city have been stable over the last three years, with a result of 9.6% in fiscal 2015 and a result of 9.0% in 2014. Management has indicated the positive general fund results are due to continued improvements in sales and property tax revenue, and close monitoring of its expenditures. To that note, we understand that the city anticipates maintaining healthy operating results, with an estimated $2.2 million general fund surplus or 5.8% of adjusted expenditures for fiscal 2017.

The city's general revenues are sourced primarily through a combination of property taxes, sales taxes, and franchise taxes. All three revenue streams have increased in each of the last three audited years, which has aided the city's strong budgetary results. The city recently created a Budget Sustainability and Operational Efficiency Committee, which comprises various representatives throughout the city's departments, and has continuously aimed to achieve certain cost reductions in its budget. Inclusive of pension cost increases, the city is budgeting for a $1.5 million general fund surplus, or 3.7% of adjusted expenditures. While the city may experience budgetary pressure due to increased pension costs and ongoing capital needs, we do not expect general fund performance to weaken.

Strong budgetary flexibility

Azusa's budgetary flexibility is strong, in our view. The city reported its second consecutive year of positive available general fund balances in fiscal 2016, after reporting four consecutive years of negative general fund balances. While the city reported an available general fund balance of $5.8 million or 18.0% of expenditures in fiscal 2016, approximately $4 million of that balance was attributed to funds received through an advance made from the city's water fund into the general fund, which the city will eventually need to repay. To its expectations, the city met its 15% reserve requirement at the end of fiscal 2016, and will begin evaluating the timing for repaying the water loan while maintaining its reserve requirement level. After adjusting out the advance from its water fund, the city's available general fund balance was $1.8 million or 4.9% of expenditures for fiscal 2016, a level we still consider good.

Our assessment accounts for the fact that we expect budgetary flexibility could improve in the near term from the fiscal 2016 results. With the city's anticipated general fund surplus for fiscal 2017, management estimates ending the year with an available general fund balance of about $4.0 million (excluding funds from the water fund) or 10.7% of expenditures, a level we consider strong. Furthermore, the city anticipates another surplus for fiscal 2018, resulting in a further increase to the city's reserve levels. Given management's prudent financial practices and recently implemented reserve policy, we do not expect anticipate any significant deterioration in the district's reserves in the near term.

Very strong liquidity

In our opinion, Azusa's liquidity is very strong, with total government available cash at 120.1% of total governmental fund expenditures and 33.1x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

The city has had strong access to the capital markets, as demonstrated by its COP and pension obligation bond issuances. While the city had previously borrowed from its enterprise fund for liquidity purposes, management does not expect to deplete its liquidity, given its recent and continued improvements to its general fund results. We do not consider the city's investments aggressive, as it invests primarily in U.S. government securities with short-term maturity schedules. The city also does not have any variable-rate debt that could weaken the city's liquidity.

Weak debt and contingent liability profile

In our view, Azusa's debt and contingent liability profile is weak. Total governmental fund debt service is 3.6% of total governmental fund expenditures, and net direct debt is 117.1% of total governmental fund revenue. Overall net debt is low at 2.6% of market value, which is in our view a positive credit factor. We consider amortization slower than average, with officials planning to retire approximately 49% of principal during the next 10 years. We understand that the city has no plans to issue new-money debt in the near term. The city indicates that it does not have any outstanding direct purchase or private placement general fund debt.

In our opinion, a credit weakness is Azusa's large pension and OPEB obligation. Azusa's combined required pension and actual OPEB contributions totaled 12.0% of total governmental fund expenditures in 2016. Of that amount, 10.7% represented required contributions to pension obligations, and 1.3% represented OPEB payments. The city made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 67.6%.

The city participates in the California Public Employees' Retirement System, a multiple employer defined benefit plan for employee pension benefits, and has consistently made its full required contribution. Additionally, the city contributes to the Public Agency Retirement System, a defined contribution pension plan. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's net pension liability was $40.0 million as of June 30, 2016. The city's OPEB provides health care benefits to qualified retirees, and is funded on a pay-as-you-go basis. We understand that the city may seek authorization from council this fall to establish pension and OPEB trusts, in order to reduce its future pension liabilities.

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 that the city's good financial management policies and practices will continue to guide the city's strong operating results and allow the city to maintain reserves at a level we consider at least good. We also do not expect any major changes to the economy which may affect revenues. We do not expect to change the ratings within our two-year outlook horizon.

Upside scenario

Should the city's local economy and debt profile improve while the city maintains strong operating results and increases its available fund balance significantly, we could raise the ratings.

Downside scenario

Should the city experience structural operating imbalance, resulting in a significant drawdown on its available reserves, we could lower the ratings.

Related Research

- 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
- 2016 Update Of Institutional Framework For U.S. Local Governments

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.