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Ratings

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Summary:

Oxnard Finance Authority, California Onxard; Appropriations; General Obligation; Joint Criteria

Primary Credit Analyst:
Sarah Sullivant, San Francisco 415-371-5051; sarah.sullivant@spglobal.com

Secondary Contact:
Jenny Poree, San Francisco (1) 415-371-5044; jenny.poree@spglobal.com

Table Of Contents

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Credit Profile		
Oxnard ICR		
Long Term Rating	A/Stable	Downgraded, Removed from CreditWatch
Oxnard APPROP		
Long Term Rating	A-/Stable	Downgraded, Removed from CreditWatch

Rationale

S&P Global Ratings lowered its long-term rating to 'A-' from 'A' on the Oxnard Financing Authority, Calif.'s lease revenue project and refunding bonds issued for the City of Oxnard. In addition, S&P Global Ratings lowered its 'A' issuer credit rating (ICR) on the city. Finally, S&P Global Ratings lowered its joint support rating to 'AA/A-1' from 'AA+/A-1' on the city's variable-rate demand lease revenue bonds (LRBs), series 2003B and 2006. At the same time, S&P Global Ratings removed these ratings, where applicable, from CreditWatch with negative implications, where they had been placed on Nov. 22, 2016. The outlook, where applicable, is now stable.

The downgrade reflects our view of the city's management challenges, specifically political instability at the voter and council level, manifested in a lack of consensus building from councilmembers and consistent opposition to the city's revenue-raising ability that we believe pose a risk to its long-term financial stability.

The stable outlook reflects our view of the city's unaudited general fund performance in fiscal 2017, which we believe has stabilized, as well as our expectation that the city's general fund exposure to risks related to its wastewater and water utilities is partially mitigated by the passage of a new wastewater rate package in May, a six-month extension of letters of credit (LOCs) on variable-rate wastewater debt, and the resolution of the CreditWatch placement on its wastewater fund rating. Although we believe contingent risks related to pending litigation and outstanding swap agreements persist, we have quantified these risks and believe that the city has sufficient liquidity and market access to absorb a short-term liquidity event.

The LRBs are secured by lease payments made by the city, as lessee, to the authority under the master lease, and the rating on the LRBs reflects our view of the city's covenant to budget and appropriate lease payments annually. The rating on the variable-rate demand bonds (VRDBs) reflects the joint support of MUFG Union Bank, the LOC provider, and the city under our joint-support criteria, reflecting our view of supporting parties with low correlation.

The long-term ratings and the ICR further reflect our view of the city's:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Weak management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology, coupled with political challenges that we believe have adversely affected management's ability to make decisions that support its long-term financial stability;
- Adequate budgetary performance, with operating results that could deteriorate in the near term relative to fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 26% of operating expenditures;
- Adequate liquidity, with total government available cash at 91.8% of total governmental fund expenditures and 15.1x governmental debt service, but exposure to nonremote contingent liability risk and uncertain market access;
- Very weak debt and contingent liability position, with debt service carrying charges at 6.1% of expenditures and net direct debt that is 77.5% of total governmental fund revenue, as well as exposure to speculative contingent liabilities and 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 economy

We consider Oxnard's economy adequate. The city, with an estimated population of 209,310, is located in Ventura County in the Oxnard-Thousand Oaks-Ventura, Calif. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 70.2% of the national level and per capita market value of $87,784. Overall, the city's market value grew by 5.5% over the past year to $18.4 billion in 2016. The county unemployment rate was 5.2% in 2016.

Income levels have improved in recent years; however, they remain on the threshold of a weaker score and could be subject to volatility.

City officials report strong recent growth in both property and sales tax revenues, supported by the city's location and tourism sector, residential real estate market, and continued economic expansion. The fiscal 2018 budget anticipates 6% growth in property taxes based on preliminary assessed value (AV) estimates, and 6% growth in sales taxes. The county unemployment rate was 5.7% in 2015.

Weak management

We view the city's management as weak, characterized by political challenges that we believe have adversely affected management's ability to make decisions that support its long-term financial stability. A 2016 ballot measure challenging the city's proposed wastewater rate structure led it to the brink of a liquidity crisis stemming from its wastewater fund, which had been historically underfunded due to a lack of political willingness to increase rates before the fund's solvency was called into question. Following a decision to consider a new wastewater rate package, several members of the city's appointed Utility Ratepayers Advisory Panel proposed and voted for a rate structure that was not recommended for consideration by management, and that could have led to what the city's consultant considered to be a "catastrophic failure" of the wastewater plant. Ultimately, the panel recommended and the council approved a plan that would adequately fund the utility's capital improvement needs over the implementation period. In addition to the challenges related to strengthening the solvency of its utility funds, the city has also faced legal and political challenges with respect to infrastructure use fees (IUFs) supporting the general fund.

We believe that the city's professional management has taken positive action in the direction of educating voters and ratepayers and mediating some of the most severe challenges to the city's fiscal stability. We also note that management appears to have the council's support for its fiscal recommendations. Should the city demonstrate in the future that persistent political and legal challenges to its efforts to make budget and revenue decisions that support long-term fiscal stability have receded, or that they no longer pose a significant financial risk, we could remove this adjustment.

We consider the city's financial policies and practices standard under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Following a comprehensive internal audit that revealed extensive deficiencies in internal controls, errors in fund accounting, and inappropriate management practices, the city has spent the last two years implementing the recommendations of its auditor and strengthening its financial management capabilities. Management targeted to resolve roughly half of the 111 audit findings--those that it has deemed its highest priority--by June 30, 2017, and currently anticipates that it will have all 111 findings resolved by June 30, 2018.

With recent changes in key management personnel, Oxnard is embracing a higher degree of operational transparency and internal financial controls, including adequately staffing its finance department. Budgets are adopted annually using 10-year historical data as guidance, with expenditure projections incorporating anticipated pension cost increases. Staff presents the budget semiannually to the council for review, along with updates on budget-to-actual performance. Management also prepares a long-term, five-year forecast of general fund revenues and expenses annually with the budget, in addition to a four-year capital plan with funding sources identified. The treasurer reviews investment performance monthly.

Adequate budgetary performance

Oxnard's budgetary performance is adequate in our opinion, despite positive operating results in fiscal 2016 of 8.4% of expenditures in the general fund and of 4.1% across all governmental funds. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2016 results in the near term, based on the very strong fiscal 2016 result and the city's medium-term budget projections. Further weakening our view of Oxnard's budgetary performance is the city's deferral of significant expenditures, which we think inflates the budgetary result ratios.

Fiscal 2016 revenues exceeded expenditures due primarily to the city's decision to delay expenditures on street maintenance and other projects earmarked for Measure O (sales tax) funding due to fiscal uncertainty. Although the deferral of necessary capital outlays increases the city's ability to withstand short-term liquidity risk, we believe that it overstates performance of the general fund.

In our view, the city's general fund's stability has improved in 2017, supported by stronger-than-budgeted tax revenues. Based on unaudited actual results, we expect the city's total general fund revenue (including Measure O) will exceed expenditures by roughly 3.6%. Our assessment of general fund revenue, expenditures, and fund balances includes those related to Measure O, the city's 2008 half-cent general purpose sales tax, which generated roughly $15 million in revenue in 2017.

A new wastewater rate package approved in May took effect in August and will replace the one challenged last year by Measure M. The city projects that the wastewater package, together with a separate rate increase for the water utility effective Sept. 1, 2017, will reduce deficits in both utilities and allow them to meet minimum projected capital expenditure needs, with no expected general fund subsidies to both in the future. Audited fiscal 2016 wastewater revenues provided insufficient coverage of costs, in our view.

The new wastewater rates will include a 5.25% annual increase and replace--at a lower level--the rate package challenged by Measure M last year. A ruling on the Measure M challenge to the previous wastewater rate increases has not yet been issued, although we understand that with the passage of the new rate package, the only remaining uncertainty is whether the original 35% rate increase paid by ratepayers before the new package was approved will stand.

Despite these improvements, the roughly $3 million (2% of expenditures) annual IUF to the city's general funds that has historically supported public safety has been eliminated. The loss of the IUF leaves a revenue shortfall that the city expects to offset in 2018 through increased tax revenues and a negotiated decrease in the employer-paid share of employee pension contributions. Additionally, the city expects to restore a number of critical public safety positions in 2018 that had been cut in previous years to stabilize general fund performance. Together with expected increases in California Public Employees' Retirement System (CalPERS) employer contribution rates and baseline salary and benefit costs, these expenditure pressures result in projected deficits of between 1% and 2% of expenditures beginning in 2019. The projections rely on continued growth in tax revenue of roughly 4%-5% annually, which could increase its exposure to an economic downturn.

Very strong budgetary flexibility

Oxnard's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 26% of operating expenditures (as adjusted), or $33.7 million.

We expect the city's general fund reserves to remain very strong, taking into account the presence of certain liquidity risks discussed in further detail elsewhere in this report. Our estimate of general fund expenditures is adjusted to include recurring transfers out, and may be higher than expenditure amounts reported in the audit.

The city's 2015 and 2016 audits contained qualified opinions on governmental activities (not including the general fund, which received an unmodified opinion), which were limited to the auditor's inability to obtain insufficient information to audit capital asset depreciation and construction in progress. We understand the city is working to implement an accounting system that provides adequate information on capital assets, and the existing limitations noted by the auditor do not affect our view of the city's credit quality.

Adequate liquidity

In our opinion, Oxnard's liquidity is adequate, with total government available cash at 91.8% of total governmental fund expenditures and 15.1x governmental debt service in 2016. In our view, the city's access to external liquidity may be limited in part by prior audit findings and continued exposure to nonremote contingent liability risk, as evidenced by multiple short-term extensions of its LOCs on variable-rate debt while it searches for a substitute LOC bank. Contingent liquidity risks stem from interest rate swaps on its outstanding variable rate debt as well as litigation revolving around its challenged 2016 wastewater rate package.

In the case of the wastewater rate litigation (Measure M), we understand that up to $8 million in one-time charges paid under the challenged rate structure between January and June 2017 could be required to be repaid to ratepayers from available wastewater reserves, although such a payment could result in additional pressure on the wastewater rating. With respect to pending litigation on the city's IUFs paid to the general fund, management reports that an adverse judgment potentially totaling up to $21 million would affect the general fund, but could be structured or financed over a period that would reduce immediate liquidity pressure. City officials report that a judgment in that case is expected potentially this year.

Union Bank MUFG, the LOC provider on $28.8 million of outstanding variable-rate demand LRBs (series 2003B and 2006), as well as $16.5 million in wastewater VRDBs (the system's series 2004B), has extended its LOCs through Nov. 28, 2017, on the wastewater debt and Feb. 28, 2018, on the general fund debt. The city is in conversations with potential substitute LOC providers and reports that it expects to be able to replace Union Bank on both LOCs on or before the expiration dates. Should a remarketing fail for any reason, the rate on the VRDBs would increase to 7%, further pressuring the general fund.

The city has entered into three floating-to-fixed interest rate swaps with a notional amount totaling $47,715,000. It pays the counterparty a fixed amount on each swap agreement and receives variable payments computed as 68% of the one-month LIBOR, with the bonds coupon rate tracking the SIFMA swap index. The swap on the wastewater bonds had a negative mark-to-market of $4.6 million at June 30, 2016, and could terminate at the option of the counterparty if the rating on the wastewater bonds falls below 'BBB' (currently 'BBB' outlook negative). Although we believe the city has sufficient liquidity to make such a payment in the event of a downgrade, it would likely pressure both the wastewater and, potentially, the general fund. The general fund VRDBs also have a rating trigger for termination if the rating on the debt falls below 'BBB'.

Very weak debt and contingent liability profile

In our view, Oxnard's debt and contingent liability profile is very weak. Total governmental fund debt service is 6.1% of total governmental fund expenditures, and net direct debt is 77.5% of total governmental fund revenue. We are not aware of any plans for additional debt in the medium term; however, we consider the nature and extent of the city's contingent liabilities to be an additional burden on the debt profile.

In our opinion, a credit weakness is Oxnard's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Oxnard's combined required pension and actual OPEB contributions totaled 14.7% of total governmental fund expenditures in 2016. Of that amount, 14.1% represented required contributions to pension obligations, and 0.6% represented OPEB payments. The city made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 79.1%.

Although the city has a dedicated funding source (the Carman Override tax) to cover part of its public safety retirement costs, we believe that its combined annual contributions to cover pensions and OPEBs for both public safety and regular CalPERS employees are a significant fixed cost that will accelerate over the next six years as part of a phase-in of higher CalPERS contribution rates. The projected increases, which are included in the city's budget forecast, do not assume any further changes in the CalPERS discount rate or other funding assumptions. Management reports that its latest collective bargaining agreements include a provision requiring employees to pay the portion of annual contributions that had been previously paid by the city; however, we believe that the city's ultimate plan for accommodating rising pension costs relies primarily on continued growth in tax revenue.

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 opinion of the city's stabilizing performance in fiscal 2017, which we believe indicates a step toward long-term operating stability. The stable outlook further incorporates our expectation that the city could access the market in the event of a liquidity event without a significant reduction in long-term creditworthiness. We do not expect to change the rating within the two-year outlook horizon.

Downside scenario

Although unexpected, should current or future litigation result in an adverse judgment that threatens the city's structural balance, we could lower the rating.

Upside scenario

Should the city demonstrate in the future that persistent political and legal challenges to its efforts to make budget and revenue decisions that support long-term fiscal stability have receded, or that they no longer pose a significant financial risk, we could raise the rating. We could raise the rating by multiple notches should the above condition be met, the city's enterprise funds achieve long-term operating stability that we believe reduces its overall exposure to credit risk in those funds, and pressure on governmental funds resulting from increasing retirement obligations and other fixed operating costs be reduced.

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

Ratings Detail (As Of September 18, 2017)		
Oxnard lse rev proj and rfdg bnd		
Long Term Rating	A-/Stable	Downgraded, Removed from CreditWatch
Oxnard lse ser 2011 (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded, Removed from CreditWatch
California Municipal Finance Authority, California		
Oxnard, California		
California Municipal Finance Authority (Oxnard) APPROP		
Long Term Rating	A-/Stable	Downgraded, Removed from CreditWatch

Ratings Detail (As Of September 18, 2017) (cont.)		
Oxnard Fincg Auth, California		
Oxnard, California		
Oxnard Fincg Auth lse rev (Civic Center Phase 2 Project)		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded, Removed from CreditWatch
Long Term Rating	AA/A-1	Downgraded
Oxnard Fincg Auth lse VRDB ser 2003B		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded, Removed from CreditWatch
Long Term Rating	AA/A-1	Downgraded

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.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.