S&P Global Ratings

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Summary:

Malibu, California; Appropriations; General Obligation

Primary Credit Analyst:
Michael Parker, Centennial + 1 (303) 721 4701; michael.parker@spglobal.com

Secondary Contact:
Misty L Newland, San Francisco (1) 415-371-5073; misty.newland@spglobal.com

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Credit Profile		
US$23.27 mil cert of parts 2018A ser 2018A due 11/01/2048		
Long Term Rating	AA+/Stable	New
Malibu ICR		
Long Term Rating	AAA/Stable	Affirmed
Malibu APPROP		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the City of Malibu, Calif.'s series 2018A certificates of participation (COPs). At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's COPs outstanding and its 'AAA' issuer credit rating (ICR) on the city. The outlook is stable.

Security and purpose

The COPs represent interests in lease payments made by the city, as lessee, to the Malibu Public Financing Corp., as lessor. In addition, the city covenants to budget and appropriate lease payments during the life of the COPs. Late appropriation risk is mitigated by debt service payments on May 1 and Nov. 1, and lease payments due 15 days prior. The city may abate lease payments in the event of damage to or loss of use of the project, which we believe is mitigated by lease provisions to purchase two full years of rental interruption insurance to mitigate the risk of abatement. In addition, we evaluated the seismic risk of the leased asset pursuant to our criteria and estimated it does not have a greater than 5% probability of incurring 25% damage during the life of the COPs. The COPs do not have a debt service reserve. Proceeds of the 2018A COPs will be used to acquire three parcels of land within the city and to pay the costs of issuance.

Credit fundamentals

Malibu 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 COPs, 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;
- Very 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 116% of operating expenditures;
- Very strong liquidity, with total government available cash at 119.4% of total governmental fund expenditures and 10.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 11.1% of expenditures and net direct debt that is 75.4% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Adequate institutional framework score.

Very strong economy

We consider Malibu's economy very strong. The city, with an estimated population of 12,939, 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 241% of the national level, which we view as extremely high and a positive credit factor, and per capita market value of $1.2 million. Overall, the city's market value grew by 6.4% over the past year to $15.8 billion in 2018. The county unemployment rate was 4.7% in 2017.

Malibu, which has a population of 12,939, stretches along 21 miles of the Pacific Coast in the South Bay region of Los Angeles County and encompasses 20 square miles. Major thoroughfare through the city is the Pacific Coast Highway, which is owned by the state, and the local beaches are owned and operated by the county. The coastal cities of Los Angeles County, including Malibu, are fully integrated into the broader Los Angeles economic base. Los Angeles County is the largest county in the nation, by population. Meanwhile, population, income, and consumer spending continue to rise, while the county's unemployment rate has flattened out at just 4.7% after falling from a peak above 10.0% in fiscal 2012. The city is located just 25 miles west of downtown Los Angeles, and residents can commute to the city via Highway 10. Because the city is predominantly residential, most residents find employment opportunities outside the city. However, due to its 21 miles of beaches, the area receives a significant amount of tourists each year. The city's assessed value (AV) totaled about $15.8 billion for fiscal 2018, an increase of 6.4% from fiscal 2017. We consider the city's tax base very diverse, with the leading 10 taxpayers accounting for 5.6% 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 the city's approach to financial management include:

- A budget formation process that incorporates historical revenue and expenditure trends;
- An annual budget process with formal quarterly monitoring by city council of budget-to-actuals;

- A lack of a formal financial forecast beyond the budgeted year;
- An annually updated five-year capital improvement plan that identifies cost estimates and sources of funding;
- A formal investment policy that details permitted instruments and portfolio objectives and includes monitoring requirements with quarterly presentation to council;
- A formal debt policy that includes certain restrictions on debt capacity; and
- A minimum reserve and fund balance policy of 50% of general fund revenue, based on cash flow considerations of natural disaster costs.

Very strong budgetary performance

Malibu's budgetary performance is very strong in our opinion. The city had operating surpluses of 11.5% of expenditures in the general fund and of 11.3% across all governmental funds in fiscal 2017. General fund operating results of the city have been stable over the last three years, with a result of 11.2% in 2016 and a result of 10.2% in 2015.

We have adjusted general fund revenues and expenditures upward to account for recurring transfers that we believe function like ongoing general fund activity. In addition, we have adjusted the county's general fund and total governmental fund expenditures to reflect some one-time capital costs associated with the acquisition of the Trancas Field property in 2017. The city's finances have remained very strong in recent years, evidenced by general fund surpluses in five consecutive audited years. Property taxes, local sales and use taxes, transient occupancy taxes (TOT), and to a lesser extent, charges for services account for most of the city's general fund revenue. The city's recent positive operational results are largely due to continued growth in several tax categories, especially TOT taxes, as new motels and short-term rentals of private homes within the city have grown. The city's general fund expenditures have increased steadily over the last several years, rising by roughly 6.7% annually since 2014, largely attributed to increases from general government and public safety (contracts with the county for police, fire, and lifeguard services).

Based on unaudited actuals for fiscal 2018, the city expects to close out the year with a surplus of $3.1 million, or 10.6% of operating expenditures. 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 to help pay for the land acquisition. According to management, the city will put $13 million of unrestricted reserves towards the purchase in 2019. Excluding the one-time acquisition expense, the city expects to end close out fiscal 2019 balanced.

Very strong budgetary flexibility

Malibu's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 116% of operating expenditures, or $32.8 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, unassigned, and some committed portions of the general fund balance as a percentage of general fund expenditures. The city has held reserves above 75% of expenditures for the last several years, and the city's estimated available reserves for fiscal 2018 total $36.1 million, or 123% of estimated expenditures. In anticipation of the one-time spending associated with the land acquisition, we estimate reserves could fall below 75% in fiscal 2019. Despite this, we believe fund balances will remain very strong, given the council-approved reserve policy of maintaining general fund reserves of at least 50% of general fund revenue. We understand that the city has some available fund balances through a commercial real estate fund, which is used for collecting rental income and providing corresponding property expenses of three local commercial properties, although it is not considered in our calculations.

Very strong liquidity

In our opinion, Malibu's liquidity is very strong, with total government available cash at 119.4% of total governmental fund expenditures and 10.8x 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. We believe the city's investment policy restricts its ability to maintain an aggressive investment portfolio, and we have not identified any contingent risks that would jeopardize the city's liquidity. We do not expect the city's liquidity position to deteriorate over the medium term.

Adequate debt and contingent liability profile

In our view, Malibu's debt and contingent liability profile is adequate. Total governmental fund debt service is 11.1% of total governmental fund expenditures, and net direct debt is 75.4% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, which is in our view a positive credit factor.

The city has issued appropriation-backed debt regularly in the past 10 years. Management has confirmed that the city has no alternative financing obligations. We consider amortization slow, with officials planning to retire approximately 26% of principal for all debt during the next 10 years. According to management, the city has no authorized but unissued debt outstanding, nor does it anticipate issuing additional long-term debt in the medium term.

Malibu's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.9% of total governmental fund expenditures in 2017. Of that amount, 2.2% represented required contributions to pension obligations, and 1.7% represented OPEB payments. The city made its full annual required pension contribution in 2017.

The city participates in defined-benefit pension plans managed by the Public Employees' Retirement System (CalPERS) and it made its full annual required pension contribution in 2017. Using reporting standards in accordance with Governmental Accounting Standard Board (GASB) Statement No. 67 and 68, the city's net pension liability as of June 30, 2017, was $4.6 million. As of the same date, CalPERS maintained a funded level of 74.1%, using its fiduciary net position as a percentage of the total pension liability. We understand that the city is considering establishing an irrevocable pension trust in the next several years, in anticipation of contribution rates increasing. The city has a policy of contributing 100% of its annual required OPEB contribution.

Adequate institutional framework

The institutional framework score for California municipalities not required to submit a federal single audit is adequate.

Outlook

The stable outlook reflects our view of the city's very strong and stable economy, with participation in the Los Angeles-Long Beach-Anaheim MSA. The stable outlook also reflects the city's very 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 anticipate changing the ratings during the two-year outlook period.

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 ratings.

Related Research

2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 26, 2018)		
Malibu rfdg certs of part		
Long Term Rating	AA+/Stable	Affirmed
Malibu COPS		
Long Term Rating	AA+/Stable	Affirmed
Malibu APPROP		
Long Term Rating	AA+/Stable	Affirmed
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