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El Monte Public Financing Authority, California; Appropriations

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Long Term Rating	BBB+/Stable	Rating Assigned
El Monte Pub Fin Auth (El Monte) lse rev bnds (Taxable RZEDB) (El Monte) (City Yard Proj) ser 2010A due 02/01/2041		
Long Term Rating	BBB+/Stable	Rating Assigned

Rationale

Standard & Poor's Ratings Services assigned its 'BBB+' long-term rating and stable outlook to El Monte Public Financing Authority, Calif.'s Taxable Recovery Zone Economic Development lease revenue bonds series 2010A and lease revenue Build America Bonds (BABs) series 2010B. Both are being issued on behalf of El Monte.

The ratings reflect our view of the city's:

- Established economic base within the very large and diverse Los Angeles region;
- Standard policies and practices, including at least midyear financial updates to the city council; and
- Low-to-moderate debt burden.

Partially offsetting our view of these strengths is our assessment of:

- Merely adequate wealth and income indicators; and
- A trend of pronounced declining available balances during the prior three audited fiscal years, although unaudited fiscal 2010 results suggest an improvement.

The bonds are secured by lease payments made by the city, as lessee, to the authority, as lessor, for the use of the city hall, main police station, and public works yard. Payments are subject to abatement for damage or destruction, which we believe is partially mitigated by the city's covenant to maintain rental interruption insurance sufficient to cover rent for 24 months and the leased asset portfolio's seismic risk is consistent with our criteria. We understand that the city intends to designate series 2010A as Recovery Zone Economic Development Bonds, which will allow it to receive a subsidy from the U.S. government equal to 45% of interest, and its series 2010B as BABs, which will allow it to receive a subsidy equal to 35% of interest. However, the city will be obligated to make full debt service payments regardless of the receipt of the subsidies.

We understand that the city will use these bonds to finance the acquisition and development of a new maintenance yard facility, which is part of a larger redevelopment project known as the El Monte Gateway Project.

El Monte serves about 126,000 residents within the San Gabriel Valley in Los Angeles (LA) County, about 12 miles east of downtown Los Angeles. The city is situated at the intersection of interstates 605 and 10, providing, in our opinion, its residents with good access to the vast Los Angeles regional economy. The city also serves as a regional transit hub, with an MTA bus terminal and MetroLink commuter station. El Monte's total assessed value grew by an average annual rate of 9% during fiscals 2006-2009 to $5.9 billion before, we believe, a retrenchment in housing values, which pushed total assessed value down 0.1% and 2.1% in fiscals 2010 and 2011, respectively. We note that these declines are small relative to our experience among California cities as a whole during the past two fiscal years. The city's foreclosure rate as of October was 2.4%, which according to the LA County Assessor's Office, is average for the county. We view the city's income and wealth indicators as adequate, with a median household effective buying income of 83% of the national level and a per capita market value of $46,128.

We believe that the city's recent budget adjustments have at least temporarily improved its available general fund balance after a period in which an adverse revenue environment and interfund transfers caused the city's available general fund balance to erode to what we consider an adequate 2% of expenditures, or $1.1 million, at the end of 2009 (audited) from what we view as a very strong 40.3% of expenditures at the end of fiscal 2006. During this period, El Monte's operations were generally positive but in 2008, the city transferred a total of $5.6 million out of the general fund to a newly created self-insurance fund as well as to various non-major funds as a result of using restricted funds for their intended purposes. The city made another transfer of $4.1 million in fiscal 2009 to support the cash-flow needs of its Housing and Community Development fund and other non-major governmental funds, in addition to providing the redevelopment agency support for some of its capital projects. Combined reserved and unreserved fund balance for fiscal 2009 was about $57 million, of which $51.3 million is reserved for the redevelopment agency; however, we understand that there are currently no plans for the agency to repay the debt at present. For fiscal 2010, the city's unaudited actuals show an operating surplus that has increased El Monte's available general fund balance to about $4.3 million or 8.9% of expenditures, which we consider strong. Management attributes this increase to expenditure cuts, some—but not all—of which have continued into fiscal 2011, including 10% employee furlough days, reducing staffing levels, and decreasing employee benefits. Management has stated that it anticipates that fiscal 2011 general fund operations will be balanced due to continuing expenditure controls. However, without further cuts to expenditures or labor concessions, management has projected deficits that may result in significantly reduced general fund balances if cost-saving measures are not taken.

We consider the city's management practices "standard" under our Financial Management Assessment (FMA) methodology. An FMA of "standard" indicates that in our view the finance department maintains many adequate policies in some but not all key areas. Highlights of the city's policies and practices include midyear updates to the city council on financial operations and investments performance and composition. Guiding budgeting is a detailed examination of revenue and expenditure trends, along with available third-party data, to build assumptions. El Monte does not engage in formal long-term financial planning, nor does it have a formal debt policy or a capital plan. In 2008, the city adopted a policy to maintain an available general fund balance of 15% of expenditures and an additional $5 million in working capital but we understand from management that the city is unlikely to comply with this policy until after fiscal 2011.

The city's combined direct and overlapping debt translates into $1,705 per capita, which we consider low, and 3.7% of market value, which we consider moderate. We consider the pro forma carrying charges to be moderate at 10% of government-wide, noncapital expenditures. According to a 2008 actuarial study, El Monte's other postemployment benefits (OPEB) liability is $52.6 million with an annual required contribution (ARC) of $4.4 million needed to retire the liability. The city projects that its 2011 OPEB contribution will be approximately $1.4 million. Management has indicated that it does not anticipate that the city will issue additional debt for the foreseeable future, although in our view, the El Monte Gateway Project involves complex shifts in real estate that, we believe, could generate unexpected financing needs to complete.

We understand that the city has entered into formal agreements with three component units to meet its debt service requirements associated with series 2010A and 2010B, although we note that El Monte's covenant to budget and appropriate lease payments applies to the city as a whole. Under the agreements, the city's redevelopment agency, water enterprise, and sewer enterprise will each contribute a defined share of annual debt service and we calculate based on historical data and management's projections that each unit could generate available revenues exceeding 2x its respective portion of annual debt service. The city also has agreed to maintain a debt service reserve fund that it will size to maximum annual debt service, net of federal subsidy payments.

Outlook

The stable outlook reflects our belief that the city has stabilized its operations such that it will continue to maintain at least adequate available balances as it implements its development project. While we believe that El Monte has insulated itself from the need to apply general fund resources to meet its new carrying charges under series 2010A and 2010B by formally designating component unit revenues for lease payments, we believe that it will continue to face a difficult budgeting environment due to limited revenue flexibility. If the city substantially draws on its reserves, resulting in what we consider to be an adequate level, we could lower the rating. Conversely, if El Monte were to improve financial performance, particularly if there is evidence that it has reached its minimum reserve policy, we could raise the rating.

City Will Tap Component Units To Support Debt Service

Although the 2010 series A and B lease revenue bonds will be general fund obligations, management has stated that it does not anticipated using general fund revenues to cover debt service; rather, it has established agreements with both its water and sewer enterprises, as well as with its redevelopment agency, to cover the debt service on the bonds. The enterprises and the redevelopment agency have a vested interest in the completion of this project and have, therefore, entered into these agreements. The enterprises are currently housed in the public works yard and will be moved to the new yard upon its completion. It is our understanding that under the enterprise sublease agreements, the sewer and water enterprises will pay approximately $300,000 and $200,000, respectively, in annual rent to the general fund for the next 30 years. Under this agreement, it is our understanding that the city is obligated to transfer these sublease payments to the authority for debt service payments on the bonds. El Monte has also entered into an agency cooperation agreement with the redevelopment agency, which has agreed to fund a portion of the project, given it involves some of its project areas. Although payments by the agency may be derived from any source under the agreement, it is our understanding that the agency intends to use tax increment revenues from two of its projects areas to make payments. The two project areas, Northwest and Valley-Durfee, currently have no debt outstanding and are budgeted to annually contribute approximately $245,000 and $485,000, respectively, toward debt service on the 2010 bonds. It our understanding that under the agreement all payments from the agency will be deposited into the bond fund and used for debt service on the bonds. Based on our calculations, we believe revenues generated by the water and sewer enterprises, as well as available tax increment revenues (net of pass-throughs) generated by the redevelopment agency, will be sufficient to cover their respective shares of lease payments supporting series 2010A and 2010B annual debt service.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007