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Ratings

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Summary:

Sanger, California; Appropriations; General Obligation

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Credit Profile		
US$21.595 mil taxable pension oblig bnds ser 2021 due 07/01/2040		
Long Term Rating	A+/Stable	New
Sanger Financing Authority, California		
Sanger, California		
Sanger Financing Authority (Sanger) lse rev bnds (Sanger) (Fire Station Expansion Project) ser 2020 dtd 09/03/2020 due 02/01/2021		
Long Term Rating	A/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A+' rating to Sanger, Calif.'s approximately $21.6 million series 2021 taxable pension obligation bonds (POBs). At the same time, we affirmed our 'A' long-term and underlying ratings on the city's outstanding lease revenue bonds. The outlook is stable.

Legally available funds secure the series 2021 POBs, which we rate on par with the city's general creditworthiness, reflecting our view that Sanger's ability to pay the obligation is closely tied to its operations, and that the revenue used to secure the city's POBs is not limited in scope, or distinct and separate from its general fund.

Proceeds from the series 2021 bonds will be used to fund all of the city's unfunded accrued actuarial liability with the California Public Employees' Retirement System (CalPERS) miscellaneous and public safety classic plans, which will increase the funded ratio of the associated plans to 100%. However, if poor investment performance or other experience changes generate new liability--particularly if it occurs earlier in the amortization period--then the city risks having to pay both the debt service costs on the bonds and higher pension contributions, eliminating potential payment savings from the transaction. Ultimately, officials are issuing the POBs to achieve savings against expected CalPERS cost increases.

The city's outstanding lease revenue bonds are secured by lease rental payments made by Sanger, as lessee, to the Sanger Financing Authority, as lessor. We rate these obligations one notch lower than the city's general creditworthiness to account for the appropriation risk associated with the lease payment. The city has pledged its best efforts to seek appropriations annually out of its operating budget and has considered the affordability of the lease payment in its long-term plans. In our view, the lease features and terms identified in our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Nov. 20, 2019) are standard, with no unusual risks regarding timely payment of debt. Under the agreements, the city can abate lease payments in the event the leased property is damaged or destroyed. To mitigate the abatement risk, the city will maintain at least two years of lease-interruption insurance as well as casualty insurance equal to the full replacement cost of the damages.

Credit overview

The rating reflects our view of the city's strong finance profile, which includes maintenance of balanced operations and available general fund reserves above 30% of operating expenditures over the past three audited years. Management reports no material influence from the COVID-19 pandemic on general fund revenues and 2021 estimates results reflect an operating surplus of $2.0 million, or 14% of operating expenditures. Additionally, in June 2021 city council approved an increase to its minimum reserve policy from 15% to 25%, which we believe further supports its strong financial position.

Offsetting the strengths of the city's financial profile are its limited economy and high debt burden. Sanger's economy is characterized by its below average income and wealth levels. However, we believe the economy is stable overall as it benefits from access to the broad and diverse Fresno metropolitan statistical area (MSA). Moreover, the city's tax base is experiencing healthy growth with a competitive housing market and new residential and commercial developments. Finally, with the issuance of the series 2021 POBs, the city is shifting its long-term liabilities from its unfunded pension obligations to long-term debt, significantly increasing its net direct debt burden with the intended benefit of a smoother payment stream and interest savings, which we view as credit neutral.

Given the city's strong financial track record, supported by good practices and policies and its growing tax base, we believe the city will maintain its financial profile in a way that will support the rating. Therefore, the outlook is stable.

The rating additionally reflects our opinion of the following credit factors:

- Very weak economy, with a high county unemployment rate exceeding 10%, yet 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;
- Strong budgetary performance, with balanced operating results in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 35% of operating expenditures;
- Very strong liquidity, with total government available cash at 128.9% of total governmental fund expenditures and 17.5x pro-forma governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with pro-forma debt service carrying charges at 7.4% of expenditures and pro-forma net direct debt that is 131.7% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's environmental and social risks relative to its economy, management, financial measures, and debt and liability profile and view them as consistent with those of the sector. We view the city as facing somewhat elevated environmental risk posed by the region's exposure to drought and, to a lesser extent, wildfires. We understand the city's water utility system has recently installed a new storage tank and is working on additional well development. Moreover, the city is receiving state grant funds for water recharge projects to mitigate drought impacts and subsidence risk.

Stable Outlook

Upside scenario

We could raise the rating if the city's resident income levels and market values per capita strengthen while maintaining very strong budgetary flexibility.

Downside scenario

Should the city experience significant budgetary pressure or structural operating imbalance, resulting in a significant drawdown on its available general fund reserves, we may lower the ratings.

Credit Opinion

Very weak economy

We consider Sanger's economy very weak. The city, with an estimated population of 26,548, is in Fresno County in the Fresno, CA MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 54.2% of the national level and per capita market value of $49,517. Overall, the city's market value grew by 4.7% over the past year to $1.3 billion in 2020.

Sanger is in California's Central Valley, about 16 miles east of the city of Fresno. While the city serves as a bedroom community to the greater Fresno region, the city contains a notable manufacturing base, providing residents employment within the city. Management reports that its main private employers (largely food processing and manufacturing businesses) continued to operate throughout the state-wide shelter-in-place orders and haven't seen significant strains.

Given the city's participation in the greater Fresno regional economy, the city is subject to seasonal employment demand that contributes to a high unemployment rate during recessions. The county unemployment rate was 11.3% in 2020, above the state and national rates. The county's unemployment rate peaked at 17.1% in April 2020, but it has since dropped to 8.8% as of May 2021 and we expect unemployment levels will remain below 10% for the remainder of 2021.

Management expects AV will continue to grow at healthy rates, which we believe given the competitive housing market trend for the area and ongoing development. Moreover, management reports that the city is in the process of annexing land from its northern boundary for commercial development. Officials expects above-ground development to begin in two to three years, after the completion of infrastructure development.

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.

Key policies and practices include:

- Well-developed and reliable budgetary assumptions based on external projections for sales and property taxes, state and county budgetary information, and historical trend analysis;

- Monthly budget-to-actuals reports to council and budget amendments;
- Lack of any formal long-term operating plan beyond the budgeted year;
- Annual updates to a capital improvement plan, with a five-year horizon that identifies all funding sources;
- An internal investment policy and biannual reporting on holdings and returns to the council;
- A debt policy that includes qualitative limitations on issuing debt, but lacks robust quantitative guidelines regarding the city's overall debt burden; and
- A minimum reserve and fund balance policy, adopted through council resolution, of 25% of general fund expenditures.

Strong budgetary performance

Sanger's budgetary performance is strong in our opinion. In assessing the city's budgetary performance, we eliminated what we consider one-time capital outlay. The city had balanced operating results in the general fund of 0.3% of expenditures, and slight surplus results across all governmental funds 1.0% in fiscal 2020. Fiscal 2020's balanced operating results represent a positive variance when compared to the adopted 2020 budget and reflect the relatively insignificant influence on the city's operating revenues from the pandemic.

Estimated fiscal 2021 results reflect a year-end operating result of $2.0 million, or 14% of operating expenditures, which management attributes in part to an increase in ambulatory services revenue and initial expenditure reductions spurred by the COVID-19 pandemic. Management reports that revenues have remained strong throughout the pandemic.

The fiscal 2022, the adopted budget includes a projected $0.6 million operating surplus. Given the city's track record of balanced operations and making necessary budgetary adjustments to address potential revenue shortfalls, we expect performance will remain stable. The city expects to receive $6.06 million in American Rescue Plan (ARP) Act funds, for which it is has established a new fund. The city is using the majority of ARP funds for water infrastructure projects.

As of unaudited fiscal 2021 (June 30), the city's primary sources of revenue include property taxes (34%), charges for services (24%), and sales taxes (22%). The city benefits from revenue received through federal government reimbursements for the ambulatory services the city's fire department provides throughout a large section of the county, which is referred to as intergovernmental transfer revenue, or IGT.

Very strong budgetary flexibility

Sanger's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 35% of operating expenditures, or $4.8 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.

The city has seen its reserves grow consistently over the last decade. Based on the city's fiscal 2021 estimated actuals, the city finished the year with an available general fund balance of about $6.0 million, or 40.5% of estimated expenditures (including its 25% emergency reserve in addition to its assigned and unassigned fund balances). We expect reserves to remain stable given fiscal 2022 projections and management reports no plans to significantly draw down on reserves. Moreover, the city council approved a general fund reserve policy of 25% operating expenditures in June 2021.

Very strong liquidity

In our opinion, Sanger's liquidity is very strong, with total government available cash at 128.9% of total governmental fund expenditures and 17.5x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary due to its track record in the past 20 years of issuing bonds. The majority of the city's excess cash and investments are held in the state Local Agency Investment Fund and certificates of deposit as regulated by the city's investment policy, and we do not consider its investment exposure aggressive. Finally, we understand that the city does not have any direct purchase or private placement debt outstanding.

Weak debt and contingent liability profile

In our view, Sanger's debt and contingent liability profile is weak. Pro-forma total governmental fund debt service is 7.4% of total governmental fund expenditures, and pro-forma net direct debt is 131.7% of total governmental fund revenue.

Pension and other post-employment benefits (OPEB)

With the issuance of these POBs, the city shifts its long-term liabilities from its unfunded pension obligations to long-term debt to recognize interest cost savings. The issuance will increase pension funding to 100% in both its CalPERS Safety and Miscellaneous plans, on an actuarial basis, while increasing net direct debt to $30.3 million from about $8.8 million. Total governmental fund debt service would increase to 7.4% from 0.3% of total governmental fund expenditures, based on fiscal 2023 estimated debt service. Amortization on the POBs is four years shorter than the amortization length of CalPERS obligations, which we view as credit neutral in that it doesn't push out these obligations. The city does not have additional debt plans following this issuance.

Following this issuance, we do not view pension obligations as a source of budgetary pressure given that these benefits will now be fully funded, and we expect contribution volatility will be alleviated. Furthermore, we note that CalPERS discount rate of 7% is above our guideline, which could lead to a return to contribution volatility if actuarily determined contribution do not keep pace with normal costs or if the plan experiences significant market losses. Sanger has a comprehensive policy for managing its unfunded pension liabilities, including establishing and funding a dedicated trust to offset any rise in contributions, which it will present to city council for adoption in July 2021. The issuance of the POBs is expected to reduce the annual pension costs to CalPERS and recognize total general fund savings of approximately $5.3 million during the next 24 years. For more on our view of POBs, please see our report "Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers", published Dec. 6, 2017, on RatingsDirect.

Sanger participates in three plans with the following funding status as of June 30, 2019:

- CalPERS Safety - Police: 78.6% funded, with an unfunded accrued liability (UAL) of $4.95 million
- CalPERS Safety - Fire: 71.3% funded, with a UAL of $7.02 million
- CalPERS Miscellaneous: 68.3%, with a UAL of $10.74 million

Sanger's combined required pension totaled 14.1% of total governmental fund expenditures in 2020. The city made its full actuarially determined contribution to its pension plans in 2020. Sanger does not have an OPEB plan. After the issuance of the POBs, we calculate that the combined required pension contribution cost will fall substantially to 3.4%, which primarily reflects the remaining service cost for the city's pension plans expense.

Strong institutional framework

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

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

Ratings Detail (As Of July 9, 2021)		
Sanger Financing Authority, California		
Sanger, California		
Sanger Financing Auth (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.