S&P Global
Ratings

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Summary:

Oxnard Financing Authority, California
Oxnard; Appropriations; General Obligation

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Credit Profile		
US$17.25 mil lse rev bnds (Oxnard) ser 2021A dtd 03/02/2021 due 06/01/2041		
Long Term Rating	A-/Positive	New
US$6.925 mil lse rev bnds (Oxnard) ser 2019A due 06/01/2041		
Long Term Rating	A-/Positive	New
Oxnard ICR		
Long Term Rating	A/Positive	Outlook Revised
Oxnard approp (BAM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Oxnard lse ser 2011 (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Oxnard APPROP		
Long Term Rating	A-/Positive	Outlook Revised
Oxnard APPROP		
Long Term Rating	A-/Positive	Outlook Revised
California Municipal Finance Authority, California		
Oxnard, California		
California Municipal Finance Authority (Oxnard) APPROP		
Long Term Rating	A-/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised the outlook to positive from stable and affirmed its 'A' issuer credit rating (ICR) on Oxnard, Calif., and its 'A-' long-term rating and underlying rating (SPUR) on appropriation debt for which the city is obligor. At the same time, S&P Global Ratings assigned its 'A-' long-term rating, with a positive outlook, to the City of Oxnard Financing Authority's $6.9 million series 2019A taxable lease revenue bonds and $17.3 million 2021A tax-exempt lease revenue refunding bonds, both of which are obligations of the city. The city will have approximately $181 million in governmental debt outstanding at the end of fiscal 2019.

The outlook revision reflects our view that the city's refreshed management team is helping the city build on progress it has made during the past three years in addressing management deficiencies and opportunities and what appears to be fading political acrimony regarding how the city sets and use wastewater rates. We see a lack of auditor findings in the city's most recent financial statement and its willingness to address structural budgetary challenges ahead of a potential future recession by making staffing reductions for the fiscal 2020 budget as the most salient indicators of an improved organizational culture. We see potential to raise the ratings by one or more notches during the next two years should the city's new management team effectively wield and strengthen financial management policies and practices, particularly if we see gains in other areas such as a swing to strong financial performance and continued tax base growth.

Security and use of proceeds

The ICR reflects our forward-looking opinion of Oxnard's overall creditworthiness, focusing on the city's capacity and willingness to meet its financial commitments as they come due. The ICR is not specific to any financial obligation.

Lease payments made by the city, as lessee, secure the city's appropriation obligations, including the series 2019A and 2021A. These ratings are one notch below the ICR to reflect our view of appropriation risk. Lease payments, for which the city has covenanted to budget and appropriate over the life of each appropriation series, are subject to abatement, but Oxnard has agreed to maintain 24 months of rental interruption insurance to partly mitigate abatement risk, and the leased assets meet our criteria for seismic risk during the life of each series.

The city will use the proceeds of the series 2019A to finance the adoption of new enterprise resource planning software and 2021A to refund its series 2011 lease revenue refunding bonds to achieve interest expense savings to provide additional resources for the software purchase.

Credit overview

We think Oxnard is experiencing the tail end of a period of institutional stress and political conflict, with ineffective wastewater utility management earlier in the decade leading to dramatic rate increases and political conflict culminating in a recall election that saw voters turn down the opportunity to replace the mayor and three council members. Concurrently, the city identified governance shortcomings in 2014 and requested an external evaluation, to which the city responded publicly and which we think the city has substantially addressed. Turnover in the city manager, deputy city manager, and chief financial officer (CFO) roles may have slowed progress in improving governance, but city leadership has been making efforts to build confidence among stakeholders, with a recently adopted "sunshine ordinance" designed to go beyond the state's already robust transparency procedural requirements and a proposed ethics ordinance that will go before voters in March 2020. Although two lawsuits regarding the city's wastewater fees and use of wastewater resources for governmental cost recovery are still unresolved and fiscal 2018 general fund net results were negative, we see positive implications for long-term credit quality in the form of ebbing controversy over the city's multiyear wastewater rate increase plan and the city's ability to fill three senior management roles this year. We plan to continue to monitor the extent to which the city's management team stabilizes and how well the city manages cost pressures and the risk that a recession will slow or reverse tax revenue growth.

The ratings reflect our view of the city's:

- Adequate economy, with projected per capita effective buying income at 68% and market value per capita of $99,500, though it benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Weak management, despite standard financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2018, which closed with operating deficits in the general fund and at the total governmental fund level;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 20% of operating expenditures;
- Very strong liquidity, with total government available cash at 98% of total governmental fund expenditures and 14x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 7% of expenditures and net direct debt that is 94% of total governmental fund revenue, as well as exposure to speculative contingent liabilities; and
- Strong institutional framework score.

Adequate economy

Oxnard serves a 27-square-mile area that continues to serve as a market and housing center for an agricultural area focused on fruit and berry production, and includes a coastal area that is a locus of second homes and maritime recreation. Although it operates just outside the city, the three-site Naval Base Ventura County is a local economic anchor, employing about 19,000 personnel. The city, with an estimated population of 209,900, is part of the Oxnard-Thousand Oaks-Ventura metropolitan statistical area, which we consider broad and diverse. The city has a projected per capita effective buying income of 68% of the national level and per capita market value of $99,500. Both of these figures are just below thresholds that, if both crossed, would result in our revising the assessment to strong, and we see the city's development pipeline and available land as pointing to a strengthening in the long term. Overall, the city's market value grew 4.6% to $20.9 billion in 2019. The county unemployment rate was 3.8% in 2018.

The city's developable land and affordability relative to its Ventura County peers has made it a primary housing development location in the western Los Angeles region. It experienced one of the state's strongest run-ups in assessed value (AV) during the 2000s, with AV nearly doubling during the five years leading up to fiscal 2009 then losing a moderate 7% for the subsequent four fiscal years. The city's AV increased by 34% during the current recovery and cleared the 2000s peak in fiscal 2015. We anticipate further AV growth through fiscal 2021 consistent with our forecast of real GDP growth for the Pacific U.S. states through 2021. Management reports that the city has approximately 673 housing units under construction, 782 units approved but yet to break ground, and 409 proposed.

Weak management

We view the city's management as weak, despite standard financial policies and practices under our financial management assessment methodology, indicating our view that the finance department maintains adequate policies in some, but not all, key areas. In our view, the city has experienced and could continue to experience leadership challenges that give it more difficultly than is typical among its peers to make decisions that support its long-term financial stability.

Chief among these challenges has been a political struggle over enterprise rates and fees. After Oxnard adopted a major rate increase in January 2016 following a sustained lack of willingness to increase wastewater rates to meet rising capital and operating costs, a citizen initiative to reverse the increase, approved by a decisive 72% margin in November 2016, again put the fund's liquidity at risk. Oxnard subsequently adopted a multiyear schedule of wastewater rate increases to achieve a similar revenue structure after five years, and we understand that the trial court denied the city's request to invalidate the initiative but also denied the complainant's request to rebate revenue that it received before the subsequent rate revision. We understand that this result is under appeal and that the city has sufficient cash in its wastewater fund to address an adverse outcome. A second legal challenge surrounds the city's multiyear practice of imposing infrastructure-use fees on municipal utilities to fund general-fund-managed costs, including administrative overhead street maintenance. This lawsuit, which has completed the discovery phase and could force the city to rebate all or a portion of previously collected fees to its utilities from the general fund and continuing fees for street projects, represents a material contingent liability risk, in our view. The city's estimate for governmental fund exposure is about $21 million (or about 10% of adjusted fiscal 2018 governmental fund expenditures), of which the general fund's exposure would be about $9 million (6% of general fund expenditures).

At the same time, we think the topic of wastewater rates and fees may be fading in its political potency. In May 2018 voters turned down an opportunity to recall the mayor and three councilmembers in a special election, and the city continues to implement its multiyear rate adjustment plan.

A lingering but diminishing credit weakness, in our view, is the city's legacy of management deficiencies, which the city started to confront publicly in 2015 upon release of a consultant study that included a list of 128 governance improvement ideas and a separate, 111-item list of findings and recommendations by its auditor, including weaknesses in internal controls and management practices. The city's audits have been unqualified since the fiscal 2017 report and were without findings in the 2018. Moreover, the auditor views the city as having addressed 91% of its previous findings and recommendations list. Management views the city's implementation of a new enterprise resource planning system as essential to institutionalizing gains in this area--recent hires have experience in implementing such systems, including the specific product the city has purchased--and we think the city's addition of two full-time equivalent employees to its finance department reduces risk of process deficiencies reemerging. We understand that the new system will also allow the city to improve cybersecurity infrastructure by simplifying systems and making it easier to identify attacks.

Oxnard's senior management team has undergone significant transitions in the past two years, with the current hierarchy responsible for financial management in place since January 2019, but we see no signs of administrative disruption. The city has refined its financial management policies and adopted its fiscal 2020 budget on a timely basis.

Elements of the city's financial policies and practices include:

- Sophisticated budget-building methodology, with an extensive analytical budget message explaining management's recommendations, although the city has sometimes underestimated public safety expenditures, and we think continuing management and political transitions add to the risk of optimistic assumptions;
- Monthly budget-to-actual updates to the council, with an analytical cover letter provided midyear to explain financial drivers;
- Five-year financial forecasting model that is in transition with the new management team but traditionally has been incorporated into the annual budget document and has tax revenue assumptions that are informed by forecasts from a third-party consultant;
- Capital planning that was reinstated in the past year with a five-year horizon and detail on timing and funding sources and, although we don't view such planning as institutionalized yet, we understand that management intends to update it every year;
- Quarterly investment holdings and performance reports to the council, with investment decisions governed by a formal comprehensive policy that was refreshed in June 2019;

- Principles-based debt management policy that lacks material numerical constraints other than a minimum refunding savings threshold and maximum general fund carrying charge ratio, and that does not update an older swap management policy, although the city reports on its debt burden relative to personal income and population debt ratios in its annual financial report; and
- Formal reserve policy of 12% of the general fund operating budget (which is a smaller denominator than our calculation of the city's adjusted general fund expenditures), which was recently reduced from 18% after a reassessment of the policy in light of liquidity needs and is designed to prepare the city for both risks such as those related to natural disasters and cash flow shortfalls, and for unexpected opportunities such as projects with a rapid payback.

Weak budgetary performance

Oxnard had operating deficits of 3.8% of expenditures in the general fund and of 8.6% across all governmental funds in fiscal 2018 following particularly strong results in fiscal years 2016 and 2017. The results are considerably weaker than our expectation at this time last year that net results would be approximately balanced. (These ratios reflect our quantitative adjustments to treat recurring general fund transfers-out as expenditures.) Management attributes the fiscal 2018 weakness to broad cost growth, with hiring in public safety (the city's largest general fund line item by far) and development services (both partly a function of human resources capacity constraints in the prior fiscal years) the largest contributors, and with weaker sales tax performance than expected. We understand that delayed sales tax distributions as a result of technical issues at the state level and mutual aid firefighting cost recoveries may help performance in fiscal years 2019 and 2020.

The city's general fund revenue structure is weighted toward property taxes, which are subject to a constitutional restriction on assessed value growth to 2% per year without a property sale (and can be lowered in a recession). This source made up 37% of general fund revenue in fiscal 2018, followed by sales taxes (21%), lodging taxes (4%), and business license taxes and fees (also 4%). Public safety dominates general fund expenditures, at 62% in fiscal 2018 (before adjustments).

We believe that our assessment could move to at least adequate in the medium term because we think the city has taken substantive measures to resolve a budgetary imbalance, although, consistent with our expectation that the risk of a recession is rising, we think the city's budgetary environment could get more challenging in the medium term. Management thinks net results are likely to improve considerably for fiscal 2019 from fiscal 2018 based on preliminary data (although publicly available figures are not yet available) and reports that the city made what we consider significant structural changes to operations for the fiscal 2020 budget to partly address a baseline general fund gap of about 7% of expenditures on a budgetary basis of accounting. For fiscal 2020, the city eliminated 26 filled and six vacant positions, along cutting back funding for visible amenities and events, such as library hours and the Independence Day fireworks display. We understand that these actions reduced the general fund's budgetary gap to about 2% of expenditures, assuming it exercises at least two-thirds of its contingencies line item. Management expects that further adjustments in fiscal 2021 or the combination of revenue growth and cost controls--the city has a measure of expenditures predictability from employee contracts that run through fiscal 2022--will lead reserves to start growing again during fiscal years 2022 to 2024.

Oxnard continues to benefit from two taxes unusual among its peers in the state. The first, known as Measure O, is a special sales tax approved by voters in 2008 that generated the equivalent of about 11% of adjusted general fund expenditures in fiscal 2018. The second, known as the Carman Override, is a property tax for public safety pension costs that generates approximately 6% of total governmental fund expenditures, thereby freeing up unrestricted governmental fund revenue for other purposes.

Very strong budgetary flexibility

Oxnard's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 20% of operating expenditures, or $29.9 million. Our calculation of the city's available general fund balance includes quantitative adjustments to treat recurring transfers out as expenditures, and we note that the fiscal 2018 ratio is down substantially from 34% at the end of fiscal 2017 given the combination of negative results and what we understand was reclassification of reserves for capital to restricted (and therefore generally excluded from our calculation of budgetary flexibility) from assigned. These changes, if repeated, for fiscal years 2019 or 2020 could lead us to revise our budgetary flexibility assessment to strong, and the city's recent revision of its reserve policy to 12% of expenditures from 18% using a different calculation than ours points to the potential for long-term weakening. However, based on our expectation that general fund performance will prove only modestly negative in fiscal years 2019 and 2020, we anticipate that the city's available general fund balance will remain equal to or above 15% of adjusted expenditures in the medium term and that our assessment will remain very strong.

Strong liquidity

In our opinion, Oxnard's liquidity is very strong, with total government available cash at 98% of total governmental fund expenditures and 14x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary given the resolution of conditions that led to auditor's findings and demonstrated market access in the past year.

Our assessment includes an adjustment to reflect our view that the city is exposed to three nonremote contingent liquidity risks that could come due in the next 12 months:

- The first relates to a trial court result under appeal in which the city did not successfully convince the court to invalidate a voter-approved ballot measure that rescinded a major wastewater rate increase adopted in January 2016. Management reports that the complainant has appealed to request the city rebate certain revenues collected before the ballot measure passed. We understand that this would result a liability of about $5.9 million, all of which would likely be paid for with cash on hand in the wastewater fund, which totals $25 million, rather than the general fund.
- The second concerns the city's multiyear use of infrastructure-use fees on city utilities that funded operations and maintenance managed in the general fund. The trial for a lawsuit against the city has yet to begin but has completed the discovery phase. Management calculates a liability of as much as $21 million in the form of accumulated fee revenue that the city could be forced to rebate to its utilities from the general fund and street fund, with the general fund's direct exposure about $9 million. The figure could grow further based on fees that the city is still collecting for street projects.
- The third concerns $7.7 million in capital lease principal outstanding under a master lease that the city entered into in 2018 to finance vehicle and other equipment purchases. The loans are subject to what we consider nonremote events of default and allow for acceleration of payments as a remedy, although we understand that acceleration beyond a given semiannual payment period may not be enforceable in the state.

Combined, these liabilities total the equivalent of 24% of general fund revenue, which we view as large, but we believe that these potential liquidity events individually or in combination would be unlikely to materially impair the general fund. We anticipate that the city could draw on pooled cash that totaling $206 million at the end of fiscal 2018 for any immediate needs and, based on experience with its peers in the state, we think it could tap capital markets for judgment obligation bond financing to amortize a liability it could not immediately resolve.

Weak debt and contingent liability profile

Our weak assessment reflects total governmental fund debt service at 7% of total governmental fund expenditures, net direct debt at 94% of total governmental fund revenue, and the presence of what we consider speculative contingent liabilities. Our net direct debt calculation includes tax increment and special assessment debt associated with entities we consider institutionally linked to the city but deducts for revenue-secured debt associated with the city's utilities. We no longer consider the city's pension and other postemployment benefit (OPEB) liability large after considering the proportion of payments attributable to its water, wastewater, and solid waste enterprises.

We consider legal proceedings related to wastewater rates and municipal utility support to the general fund to be material speculative contingent liabilities that negatively affect the city's debt profile. The city has alternative financing with principal acceleration provisions in the form of a master lease program to facilitate borrowing for equipment leases that has $7.7 million outstanding, and we anticipate that the city will add additional leases from time to time.

Pension and OPEB highlights:

- In our view, the city does not have a large pension and OPEB liability after taking into account the presence of a dedicated property tax for a portion of its public safety liability and after adjustment to remove the portion attributable to its water and wastewater enterprises.
- The city's pension plans' funded status, combined with recent changes to assumed discount rate and amortization methods, will likely lead to accelerating costs in the medium term; however, we believe this approach will help the city make timely progress reducing pension liabilities.
- While the city is not making full actuarially determined contributions toward its OPEB liability, the city's legal flexibility to alter OPEB benefits limits adverse credit impacts from its OPEB liability.

The city participated in the following plans funded as of June 30, 2017:

- California Public Employees' Retirement System (CalPERS) agent multiple-employer plan for miscellaneous employees: $123 million in net liability, and 73% funded;
- CalPERS agent multiple-employer plan for police: $105 million in net liability, and 71% funded;
- CalPERS agent multiple-employer plan for police safety plan for firefighters: $51 million in net liability, and 73% funded;
- Single-employer Public Agency Retirement System Retirement Enhancement Plan (PARS): $21 million in net liability, and 77% funded; and
- Single-employer OPEB plan: $36 million in net liability, and 0% funded.

Oxnard's required pension and actual OPEB contributions totaled 15.0% of total governmental fund expenditures in

2018, with 14.5% representing required contributions to pension obligations and 0.4% representing OPEB payments. We think the more comparable ratio aggregate is about 5% after taking into account a dedicated property tax--known as the Carman Override--that the city can use for a portion of its police and fire liabilities and by excluding the proportion of contributions attributable to its water and wastewater enterprises, which are not included in our government fund expenditures denominator of our pension and OPEB carrying charge ratio. We note that the Carman Override is subject to a levy rate cap and complex state case-law restrictions related to overrides of this type. We anticipate that such revenue will slowly decline over the next five fiscal years as a proportion of the city's annual pension contributions and relative to total governmental funds expenditures given the restrictions. This could lead us eventually to consider the city's pension liability large.

The city's 2018 actuarially determined contributions for both CalPERS plans fell short of both static funding and minimum funding progress, indicating no funding progress was made and liabilities increased. We see CalPERS' recent adoption of a 20-year, level dollar amortization approach for new gains and losses as a turning point in that contribution increases from a shorter amortization period will provide a faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability, which we view favorably. However, we believe costs will continue to increase for the next several years to retire existing unfunded liability, much of which is amortized over 30-year periods using a level percent of payroll approach. In our view, the discount rate of 7.15% could lead to contribution volatility. Oxnard has planned for higher contribution rates in its multiyear projections but does not have plans, such as a substantial funding of a side fund for either its pension or OPEB liabilities, that we think would give it more flexibility in managing upcoming contribution increases.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit is strong. Oxnard must file single audits because it receives federal awards across multiple programs that collectively exceed $750,000 annually. These two conditions trigger enhanced financial reporting requirements under state law.

Outlook

The positive outlook reflects our view that the city continues to make progress fortifying its organizational culture and that investments in a new enterprise resource planning system could facilitate efficiency and transparency improvements. Accordingly, we could raise our rating during the next two years if we saw evidence that the city were consolidating management gains and potentially by more than one notch if we saw concurrent improvement in other factors that we view as important to credit quality, such as a swing to strong financial performance, strengthening in key economic ratios, or a formal plan to accelerate amortization of its pension liability.

Consistent with our assessment of weak financial performance, we could revise the outlook back to stable if we thought the city was having difficulty using its financial monitoring and planning tools to bring its operations back to balance in the medium term, or if we see signs that organizational improvement had stalled such as from additional senior management turnover. We could also revise the outlook to stable if we saw a reemergence of wastewater rates as a source of political controversy that was making more difficult for the city to find consensus on budgeting decisions generally, or if we thought it was having difficulty managing contingent liabilities, such as an adverse outcome from utility user fee lawsuit.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 31, 2019
- SeismiCat Earthquake Model, May 4, 2018
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 2019 Update Of Institutional Framework For U.S. Local Governments