News Release

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Montebello Improves Credit Rating Outlook

Montebello, CA – The City of Montebello (City) had its overall credit rating outlook improved from "negative" to "stable" as determined by Standard and Poor Global Ratings (S&P) on July 27, 2021. The S&P report revised its outlook to stable from negative and affirmed its 'A+' issuer credit rating (ICR) on the City, as well as its 'A+' long-term rating on the City's pension obligation bonds (POBs) and its 'A' long-term rating and underlying rating (SPUR) on existing lease revenue bonds issued by the Montebello Public Financing Authority on behalf of the city. S&P revised its outlook based on improved financial performance in fiscal 2021 driven by the collection of a new sales tax, and the receipt of federal stimulus funds, which they anticipate will adequately offset some of the negative impacts from the pandemic.

The revision to "stable" for the outlook is based on the City's improved financial performance in FY 2020-21 that is driven by the receipt of Federal stimulus funds (e.g., Corona Virus Aid, Relief and Economic Security Act, American Rescue Plan Act, FEMA, and others). The S&P report goes on to state that the S&P ratings team believes Montebello has "adequately addressed the structural challenges that it has faced in the past to support the existing rating level." This S&P report recognizes the improvements in the fiscal and organizational management of the City and indicates the financial outlook for Montebello is no longer "negative."

"This is yet one more sound indication of positive results being generated by the hard work of City Council and staff and the overall improvement in our financial health that we've been focused on for the last two years," said Director of Finance Michael Solorza. He added that this rating increase also improves the City's ability to secure financing and loans for major projects the City Council may consider in the future to make municipal improvements. A full copy of the S&P Global Ratings report is available at www.CityofMontebello.com.

About Montebello

Founded in 1920, Montebello is located eight miles southeast of downtown Los Angeles. Its history dates back to the days of the indigenous Tongvan peoples and Franciscan missionaries. Today it boasts a full array of civic services including parks and recreation, police, fire and one of the region's largest public transportation systems, Montebello Bus Lines. The city has a multi-cultural population of approximately 62,000 residents covering a footprint of approximately eight square miles. For more information visit www.cityofmontebello.com or follow us on Facebook, Instagram and Twitter.

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S&P Global
Ratings

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Summary:

Montebello, California; Appropriations; General Obligation

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Table Of Contents

Summary:

Montebello, California; Appropriations; General Obligation

Credit Profile		
Montebello GO (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Outlook Revised
Montebello ICR		
Long Term Rating	A+/Stable	Outlook Revised
Montebello Public Financing Authority, California		
Montebello, California		
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Outlook Revised

Rating Action

S&P Global Ratings revised its outlook to stable from negative and affirmed its 'A+' issuer credit rating (ICR) on the City of Montebello, Calif., as well as its 'A+' long-term rating on the city's pension obligation bonds (POBs) and its 'A' long-term rating and underlying rating (SPUR) on existing lease revenue bonds issued by the Montebello Public Financing Authority on behalf of the city. We are revising the outlook based on improved financial performance in fiscal 2021 driven by the collection of a new sales tax, and the receipt of federal stimulus funds, which we anticipate will adequately offset some of the negative impacts from the pandemic.

The ICR reflects our view of the city's general creditworthiness and does not incorporate the features of any particular debt instrument.

The POBs are obligations of the city and are payable from any source of legally available funds of the city, including the proceeds of a citywide property tax assessment for retirement costs, which can legally be used to pay the majority, but not all, of the debt service on the POBs. We rate the city's POBs on par with its general creditworthiness due to our view that the city's ability to pay the obligation is closely tied to its operations, and the revenue used to secure the POBs is not limited in scope and not distinct and separate from its general fund.

Under the 2019A bonds, the trustee is granted a lien on a security interest in the lease and revenue generated from the Hilton Garden Inn project. We see payment abatement risk under the lease agreement, but the leased assets meet our criteria for seismic risk and the lease requires the entity to carry 24 months of rental interruption insurance. Management reports that net project revenue from the hotel has always been sufficient to cover annual debt service on the bonds, and that projected revenue along with existing reserves are sufficient to meet debt service requirements for at least the next 18 months, particularly since the series 2019A bonds were structured with interest-only payments until fiscal year 2023.

The 2016A lease revenue bonds are secured by lease rental payments by the city similar in structure to the 2019A bonds, though the 2016A lease carries a pledge of net project revenue from the city's second hotel venture, the Montebello Home2Suites project. Furthermore, the portion of base rental payments paid from project net revenues is not subject to abatement. Management forecasts that revenue along with existing reserves are sufficient to meet debt service requirements for at least the next 18 months.

Although we have no reason to believe the city will falter on its commitment to support the hotel bonds if required, we could increase the separation between the hotel-related lease revenue bonds and the ICR if we believe the city's ability or willingness to support potential deficiencies in project net revenue would take a lower priority than core city functions.

The city's 2014A, 2014B, and 2014C lease revenue bonds are secured by lease rental payments by the city. The rating on the 2016A and various 2014 lease revenue bonds also reflects our view of the city's general credit quality subject to annual appropriation and are rated one notch below the ICR.

Credit overview

We believe that the city's financial performance was likely at least adequate during the past year based on the city's conservative budgeting, the first year of Measure H sales tax revenue collection, and the receipt of federal stimulus funds. We understand that the city's sales tax revenue at mid-fiscal 2021 was tracking to outperform the city's budgeted figures, which were developed at the outset of the pandemic and have proven to be very conservative although appropriate given the unpredictability of the pandemic and the related economic recession. Furthermore, the city has received or been awarded about $33 million of federal stimulus that the city prudently intends to first use to backfill any revenue losses related to the pandemic, and then apply toward unmet infrastructure and capital needs. Based on these factors as well as our review of the city's fiscal 2022 budget, we believe that the city has adequately addressed the structural challenges that it has faced in the past to support the existing rating level.

The 'A+' ICR reflects our view of the city's:

- Weak economy, with projected per capita effective buying income at 66.3% of the national level and market value per capita of $105,174, that benefits from access to a broad and diverse metropolitan statistical area, but countywide experienced high unemployment during 2020;
- Adequate management, with standard financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating results that we expect have sufficiently improved in fiscal 2021 and going forward following a deficit in fiscal 2020;
- Strong budgetary flexibility, with an available fund balance at the end of fiscal 2020 equivalent to 11% of operating expenditures;
- Very strong liquidity, with total government available cash at 50.7% of total governmental fund expenditures and 9.9x governmental debt service, and access to external liquidity we consider strong, but exposure to a nonremote contingent liability risk;
- Very weak debt and contingent liability profile, with debt service carrying charges at 5.1% of expenditures and net direct debt that is 398% of total governmental fund revenue; and

- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's ESG risks relative to its economy, management, financial measures, and debt-and-liability profile. Although the city has elevated exposure to seismic risk, we believe that strong state building codes have partly mitigated the risks. We consider the city's social and governance risks to be in line with our view of the sector standard.

Stable Outlook

Upside scenario

We could consider a positive rating action if the city is able to produce a track record of at least balanced financial results that we believe will be sustainable going forward, as well as an increase in available reserves to a level that would be consistent with the adopted reserve policy.

Downside scenario

We could consider a negative rating action if the city produces additional deficit operations, which result in further reductions in available reserves, or if audited fiscal 2021 results are materially worse than current expectations. We could also lower the rating on the lease revenue bonds if we believe that the obligor's willingness to support the hotel project financings is diminished.

Credit Opinion

Weak economy

We consider Montebello's economy to be weak. The city, with an estimated population of about 64,000, is located in Los Angeles County in the Los Angeles-Long Beach-Anaheim metropolitan statistical area, which we consider broad and diverse. The city has a projected per capita effective buying income of 66.3% of the national level and per capita market value of $105,174. The city's market value grew by 6.7% during the past year to $6.7 billion in 2021. The county unemployment rate was 12.8% in 2020, well above the 4.4% in 2019, although we expect that unemployment rates across the nation will return to pre-pandemic levels by the first quarter of 2023 based on forecasts produced by S&P Global Economics. For more information on our view of the U.S. economy, see our article "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect.

The city is primarily a residential community located approximately 10 miles east of downtown Los Angeles. Population within the city has been stable during the past five years, while assessed value grew during this period an aggregate 26.5%, or an average annual rate of 4.8%, to $6.7 billion in fiscal 2021. Local sales taxes, representing the general fund's largest revenue source at 31% in fiscal 2020 and expected to increase as a share of general fund revenue in fiscal 2021 given the collection Measure H sales tax revenue, are driven by a strong commercial presence, including the Montebello Town Center Mall. During the pandemic, sales tax revenue performed better than expected at the outset of the pandemic as federal stimulus programs offset rising unemployment rates to support consumer spending, and households subject to the county's shelter-in-place order increased spending on home improvements and consumer durables, including auto sales at the city's two auto dealerships. However, changes in shopping patterns mean that reliance on retail sales taxes may present a long-term challenge for the city. Management reports that the Montebello Hills residential development, a 1,200-unit housing development, has continued to progress during the pandemic with the tract map for the first 300 units being recorded with the county, and we expect that it will be a significant boon to the city's tax base and population given the scarcity of newly developable land in central Los Angeles County. Our view of the city's economy could improve once the high unemployment rates subside or if income or market value per capita metrics improve.

Adequate management

We view the city's management as adequate, with 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 December 2018, the state auditor designated the city a high-risk entity under its Local High-Risk Agency Audit Program. Following the changes outlined in the succeeding paragraph, the state updated the city's risk designation to "moderate." The state auditor made its original "high-risk" determination on the basis of its findings of organizational and financial risks. Primarily, the state auditor highlighted risks from utilizing one-time resources to balance the general fund budget, financial risks associated with supporting the city-owned golf course, potential contingent liabilities associated with the ownership of its two hotels, poor contracting and procurement practices, and a lack of continuity of senior management.

Based on the city's corrective action plan and discussions with city management, many findings in the state auditor's report have been addressed, though certain challenges remain. Our views of the key remedial plans or implemented solutions are highlighted below:

- The city hired a full-time city manager in June 2019, replacing the interim manager who had been in place since 2018.
- The city hired a full-time finance director, replacing the interim director who had been in place since 2017.
- The city authorized full-time positions for key vacancies such as the deputy city clerk and the risk manager with the 2020 budget.
- The city eliminated its practice of exchanging restricted Proposition A revenue for a fraction of general-use revenue with its 2020 budget.
- The city eliminated its accrued hotel management fees.
- The city is in the process of selling its water utility and leasing the water rights, which management estimates could generate about $15 million of proceeds upon sale and water rights lease revenues during the next 10 years of about $1.9 million in aggregate.
- The city has updated its municipal code to require more stringent procurement and contracting practices.

Management reports that certain operational changes have been implemented at the golf course, including the engagement of a new management company, use of reclaimed water, and the use of an online booking system, which may result in expenditure savings and increased revenue. Furthermore, the city has entered into an agreement with

TopGolf to revitalize the golf course facility and transform its use from an 18-hole golf course to a nine-hole golf course with amenities similar to other TopGolf-operated facilities.

We understand the fiscal year 2022 budget was constructed using historical trend analysis and was informed by third-party analysis of sales tax revenue, a key general fund revenue. Formal budgetary update reports are provided to the city council, and the current management team has already demonstrated its ability and willingness to amend the budget when necessary. The city adopted a debt management policy that provides guidance and limitations beyond those delineated by the state, including limits on debt service carrying charges paid from the general fund. The city also has an adopted investment management policy that requires monthly reporting to the city council. The city adopted a reserve policy in conjunction with the fiscal year 2021 budget, but continues to lack long-term capital and financial planning.

Our view of the city's management assessment could improve if the management team is able to establish a track record of making prudent fiscal decisions that improve on the city's financial trajectory.

Adequate budgetary performance

Montebello's budgetary performance is adequate, in our opinion. Although the general fund produced a deficit in fiscal 2020, based on interim financial reports and estimates from management, we believe that the city has adequately adjusted course to produce at least balanced results for fiscal 2021 and going forward. In particular, the city completed a full year of sales tax revenue collection authorized under Measure H, and sales tax revenue performed well during fiscal 2021 despite the pandemic. For Measure H specifically, the city previously estimated that the measure would produce about $6 million annually, and we understand that this revenue was on track to outperform that level in fiscal 2021 at about $6.8 million. Furthermore, we understand that households nationally have accumulated savings during the past year, and we anticipate that those savings will be deployed as vaccination rates rise and economics reopen. We believe this will be supportive of continued strong sales tax revenue performance during the coming periods, and we do not expect a retread to prior levels.

This is in contrast to the city's past financial results that were built upon one-time revenue from the Prop A exchange in fiscal 2019 and a positive expenditure variance in fiscal 2018 driven by deferred capital spending and unfilled vacancies. For fiscal 2020, management reports that the deficit was driven primarily by $5.4 million of higher expenditures (primarily public safety salaries and overtime that were significantly over budget); lower revenues than budgeted, including a $3 million shortfall across sales tax revenue and license and permit revenue; and a budgeted $2.3 million interfund transfer to the general fund that was not made because there were insufficient funds to make the transfer.

Strong budgetary flexibility

Montebello's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2020 of 11% of operating expenditures, or $6.1 million. We have adjusted the available fund balance to include about $2.1 million of restricted fund balance that represents general obligation bond proceeds that the city spent on capital projects in fiscal 2020, but had not yet reimbursed the general fund for those eligible expenditures. We understand from management that it has taken corrective action, and this issue is not anticipated to persist into the future. Furthermore, we anticipate that available fund balance could grow as the city reimburses itself from federal stimulus funds for lost revenues during the pandemic.

Very strong liquidity

In our opinion, Montebello's liquidity is very strong, with total government available cash at 50.7% of total governmental fund expenditures and 9.9x governmental debt service in fiscal 2020. In our view, the city has strong access to external liquidity if necessary. Weakening Montebello's liquidity position, in our assessment, is the city's exposure to a nonremote contingent liability that could come due within 12 months.

The majority of the investments are in the state Local Agency Investment Fund and money market funds. The combined maximum annual debt service liability for the two hotel lease revenue bonds is approximately $4.7 million, or about 11% of fiscal 2021 general fund revenue. Although we understand both hotels are self-supporting, we believe they pose a contingent liquidity risk to the city. In the event net project revenue is insufficient to cover debt service or operating expenses, the city would need to provide support from its general fund. The Hilton Garden Inn project has been in operation since 2002 and has not required support from the general fund. The Home2Suites project began operations in September 2018. The project did not require general support from the city during the construction period, and the city does not presently anticipate that the hotel projects will require general fund support.

Very weak debt and contingent liability profile

In our view, Montebello's debt and contingent liability profile is very weak. Total governmental fund debt service is 5.1% of total governmental fund expenditures, and net direct debt is 398% of total governmental fund revenue although total governmental fund debt service is expected to rise to about 25% of total governmental fund expenditures in fiscal 2021, reflecting the issuance of the POBs. Our calculation of total governmental funds debt service includes debt service paid out of the golf fund because that fund relies on operating transfers from the general fund.

Pension and other postemployment benefits (OPEB) analysis:

- The pension-funded status is high given that the city issued POBs to fully fund the unfunded actuarial liability calculated in the most recent actuarial valuation at the time.
- We believe that the issuance of POBs may exacerbate the risk of asset and contribution volatility.
- The city's OPEB plan offers a maximum benefit of $625 per month and was closed for new hires. We do not consider the OPEB plan a credit pressure.

For more information on our views of the California Public Employees' Retirement System and the pension landscape throughout California, see "Pension Spotlight: California," published July 13, 2021, on RatingsDirect.

We note that the city maintains a pension tax override, originally adopted in 1946, that allows it to levy a dedicated property tax for retirement benefits up to 49.5 cents per $100 of assessed value. The current tax rate of 19.8 cents per $100 of assessed value is budgeted to generate $13.4 million in fiscal 2021. We understand that the current tax rate was codified in 1996 through the adoption of an ordinance, and that the city has not adjusted and does not intend to adjust the tax rate for the foreseeable future. Furthermore, the proceeds of the pension tax override may only be used to pay for retirement benefits that do not exceed the benefit level that existed prior to July 1, 1978, the effective date of Proposition 13. In practice, this means that up to 94.1% of the debt service on the POBs may be paid for from the pension tax override and that the remaining 5.9% must be paid from other general fund revenues. We view the tax as positive credit factor that provides significant budgetary relief to the general fund. We also understand that the city's transit system contributes funding equal to about 27% of the city's retirement payments, and that this proportion of costs is set based on a bona fide cost allocation plan.

The city historically covered employees' share of pension contributions across both plans. Starting with the fiscal 2021 budget, employees will pay their full share of the contribution. Although this concession was accompanied with offsetting salary increases, we believe it will help the city align and manage costs.

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
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 27, 2021)		
Montebello Public Financing Authority, California		
Montebello, California		
Montebello Public Financing Authority gen fund lse rev bnds		
Long Term Rating	A/Stable	Outlook Revised
Montebello Public Financing Authority lse rev rfdg bnds (Montebello)		
Long Term Rating	A/Stable	Outlook Revised
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Outlook Revised
Montebello Public Financing Authority APPROP		
Unenhanced Rating	A(SPUR)/Stable	Outlook Revised

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.