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October 27, 2011

Summary:
California Municipal Finance Authority Sacramento Metro Fire District; Appropriations; General Obligation

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Credit Profile		
US$12.945 mil lse rev bnds (Sacramento Metro Fire Dist) ser 2011A due 05/15/2041		
Long Term Rating	AA-/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to California Municipal Finance Authority's series 2011A lease revenue bonds, issued on behalf of Sacramento Metro Fire District, and affirmed its 'AA-' rating on the district's pension obligation bonds (POBs), series 2004A, 2004B, and 2004C. The outlook is stable. The rating reflects our view of the district's:

- Location in the broad Sacramento County economy, and
- Currently strong general fund reserves and recent labor concessions that we expect will alleviate budget pressures resulting from revenue losses.

Somewhat offsetting the above strengths is our view of the district's significant other postemployment benefit (OPEB) liability, for which the unfunded actuarial accrued liability equaled almost three times the district's covered payroll for fiscal 2010.

The lease revenue bonds are payable from revenues, which are composed primarily of base rental payments made by the district to the California Municipal Finance Authority for the use of three fire stations. Under the facilities sublease, the district covenants to budget and appropriate base rental payments. To mitigate the risk of abatement, the district has covenanted to maintain rental interruption insurance equal to two years of maximum annual debt service.

Pro forma annual debt service schedule is front-loaded; annual payments total about $1.37 million between fiscal 2013 and fiscal 2016 and fall to roughly $710,000 thereafter. Management informed us that it recently leased out about 50% of its headquarters building. The base rent totals about $753,544 for the first year and will increase by 3% annually, netting the district approximately $517,444 in operating income. The lease term is five years, with three-year optional renewals.

The POBs are secured by the district's general fund pledge and absolute and unconditional obligation to make debt service payments. We understand that the series 2004B and 2004C bonds accrue interest until November 2025 and 2018, respectively, at which time the bonds will convert to auction rate mode until final maturity. The series 2004B and 2004C bonds mature on May 15, 2030, and May 15, 2034, respectively. According to board policy, management is required to annually budget and deposit with its pension funding bond trustee an amount sufficient to retire the bonds before they convert to auction rate mode in 2018 and 2025. Management informed us that it has been making the scheduled set-asides. The amount of the annual required contribution (ARC) is based on an assumed 4.5% rate of return on the fund's investments.

On average, property taxes comprise about 80% of general fund revenue. Total district property tax revenue fell 9% while assessed value (AV) declined 7% over the prior year for fiscal 2010. AV for fiscal 2011 dropped an additional 1.8%. According to management, the county has not yet released the district's final AV for fiscal 2012, but the county's current estimate calls for a 3.3% decline. We understand that the county administration is currently estimating a 3.1% decline countywide. Management reported that the budget assumes about a 3% reduction in property tax revenue. In response to declining revenue, the district has consolidated three fire stations, browned out two fire stations, and outsourced certain services. In addition, during fiscal 2011, management renegotiated compensation agreements. Concessions, including increased employee pension contributions, went into effect on April 1, 2011 and are projected by management to provide $7.4 million of savings for fiscal 2012 and $28 million over three years.

The district closed fiscal 2010 with, in our view, a very strong unreserved general fund balance equal to 22% of expenditures ($32 million). According to the notes to the audited financial statements, the unreserved designated general fund balance includes about $9.4 million and $5.7 million for pension bond retirement and OPEB, respectively. Excluding these amounts, the unreserved general fund balance would be still strong, in our view, at 11% of expenditures. Management reported that fiscal 2011 general fund expenditures exceeded revenue by about $3.9 million, excluding capital outlay. Capital outlay of $20.6 million included improvements to the district's headquarters building and the purchase of firefighting and technology equipment. About $11.3 million was offset from the proceeds of a capital lease financing. The net effect was a $13.1 million drawdown of the general fund balance to $28.5 million, or 19% of expenditures. The fiscal 2012 adopted budget shows revenues exceeding expenditures by $59,208. After a $5.5 million transfer in from the capital facilities fund for the repayment of capital outlay for the headquarters building, the general fund budget shows an increase of $5.5 million to the ending balance. Management reported that it is negotiating further compensation reductions with certain employees.

The district's management practices are considered "good" under Standard & Poor's Financial Management Assessment (FMA) methodology, indicating that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Budget assumptions tend to be conservative, such as budgeting for full employment but filling only about 85% of positions. The board can adjust the budget at any time although it has not had to historically. Financial forecasts go out three years. In addition, management has a 5% reserve policy. Investments are with a county treasurer-pooled fund and are reviewed annually by the board.

The district became the seventh-largest fire protection district in California in 2000 after the American River Fire Protection and the Sacramento County Fire Protection District merged. The district now serves a population of more than 640,000 residents. Encompassing approximately 417 square miles, the district serves a small portion of Placer County (one square mile) and predominantly the northeastern portion of Sacramento County, which accounts for 42% of the county in terms of size (square miles). Cities in the district include Citrus Heights and Rancho Cordova, as well the unincorporated communities of Arcade, Arden, Carmichael, Fair Oaks, Florin, Michigan Bar, Mills, North Highlands, Orangevale, Rio Linda, Sloughhouse, Mather Field, and McClelland Field. Prior to the recession, the Sacramento area experienced robust housing development, which has since tapered off. AV for fiscal 2010 and fiscal 2011 fell 6.9% and 1.8%, respectively, to total $52.3 billion. Based on the fiscal 2011 market value, the overall debt burden, including these bonds and overlapping debt, is moderately high, in our view, at 6.6%.

The three series of POBs totaled about $64 million for fiscal 2011, according to the district. The bonds were used to fund a portion of the district's combined accrued liability between the California Public Employees' Retirement System's (CalPERS) safety and miscellaneous plans and the Sacramento County Retirement System. For fiscal 2010, the ARC for the three defined benefit pension plans was $26.4 million. We understand that the only plan for which contribution rates are individually determined for the district is the CalPERS' safety plan, which the district reported was 79% funded as of June 30, 2009. The district also provides its employees with OPEB through a single-employer defined benefit health care plan. As of June 30, 2010, the OPEB actuarial accrued liability was $194.8 million, or about 293% of covered payroll, which the district has not yet begun to fund. The actuarial determined ARC was $18.3 million for fiscal 2010, of which the district contributed about $4.7 million. Underfunding the ARC contributed to an increase to the negative unrestricted net assets, on the governmentwide statement of net assets, to a negative $18.3 million for fiscal 2010 from a negative $4.7 million for fiscal 2009. Management reported that OPEB is not a vested benefit and can be amended through employee agreements.

Outlook

The stable outlook reflects our expectation that recent labor concessions will be sufficient to support a structurally balanced budget, following a history of repeated draws on general fund balances. If budget pressures, including the district's ability to fully fund its OPEB ARC, are not addressed and reserves weaken significantly , we could lower the rating. Given the uncertainty as to the timing of an economic recovery that would stabilize property tax revenue, and the district's retirement benefit liabilities, we do not expect to take a positive rating action during the two-year outlook period.

Related Criteria And Research

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

Ratings Detail (As Of October 27, 2011)		
Sacramento Metro Fire Dist taxable pension funding bnds (Auction Rate Securities) ser 2004B		
Long Term Rating	AA-/Stable	Affirmed
Sacramento Metro Fire Dist taxable pension funding bnds (Convertible Auction Rate Securities) ser 2004C		
Long Term Rating	AA-/Stable	Affirmed
Sacramento Metro Fire Dist taxable pension funding bnds (Fixed Rate Bnds) ser 2004A		
Long Term Rating	AA-/Stable	Affirmed

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