

RatingsDirect®

Summary:

Barstow, California; General Obligation

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US\$21.29 mil pension oblig bnds ser 2022 dtd 04/12/2022 due 06/01/2038

Long Term Rating

A+/Stable

New

Rating Action

S&P Global Ratings assigned its 'A+' long-term rating to Barstow, Calif.'s anticipated \$21.29-million pension obligation bonds (POBs), series 2022. The outlook is stable.

Payments on the POBs are based on a pledge of legally available city funds, including the general fund, to pay debt service. We rate these obligations on par with the city's general creditworthiness given our view that the city's ability to pay is closely tied to its operations and because available revenue, including property tax revenue, is not limited in scope and not distinct and separate from its general fund. Proceeds from the series 2022 POBs will be used to increase the funding of the accrued actuarial liability with the California Public Employees' Retirement System (CalPERS) for the city's safety and miscellaneous employee plans to an estimated 100% and pay the costs of issuance.

Credit overview

The city of Barstow is connected to the Riverside-San Bernardino-Ontario Metropolitan Statistical Area (MSA) and while we believe residents have access to the MSA for employment opportunities, we note that the local economy's income and wealth indicators tend to be lower than some of its similarly rated peers. Home prices remain relatively affordable for the region, which serves as a draw for new residents, although we note that they are rising, which is contributing to continued growth in citywide assessed value (AV). While the city reported operating deficits every year from fiscal 2014 to fiscal 2020, we note that fiscal 2021 audited results reflect a strong surplus, which is a notable change in financial performance. Management attributes this surplus to a recovery in sales tax revenues in recent years, is partly due to the passage of Measure Q, which increased the general sales tax rate. General fund reserve levels have fluctuated in recent years as well. Available general fund (assigned + unassigned) reserves declined from roughly \$21.4 million (114% of general fund expenditures) in fiscal 2014 to \$3.9 million (16.6% of expenditures) in fiscal 2020. However, in fiscal 2021 the city restored reserves to levels it maintained in years prior to fiscal 2019, bringing general fund reserves back up to \$9.6 million, or 42.8% of expenditures, which we consider very strong. Going forward, management indicates they do not have plans to materially spend down reserves and expect to keep them in compliance with its policy of 25% of expenditures.

The rating further reflects our view of the city's:

- Access to the broad and diverse Riverside-San Bernardino-Ontario MSA (although, as noted above, the local economy has below-average income and wealth indicators);
- Strong management, as evidenced by what we consider a good financial management assessment;

- Maintenance of very strong budgetary flexibility and liquidity despite operating deficits reported in the years prior to fiscal 2021;
- Weak debt burden relative to governmental funds revenue (inclusive of the series 2022 POBs), with low pension and other postemployment benefit (OPEB) liabilities; and
- Strong institutional framework score.

Environmental, social, and governance

We analyzed the city's environmental, social, and governance (ESG) risks relative to its economy, management, financial measures, and debt and liability profile, and believe that its social and governance factors are in line with the sector standard. However, the city has exposure to elevated environmental risks related to drought, wildfire, and seismic activity, which could negatively affect housing demand activity over time if the frequency and severity increases.

Stable Outlook

Downside scenario

We could lower the ratings if the city were to underperform its current projections, resulting in a deterioration in its reserves to a level we no longer consider very strong and reflecting a return to recurring operating deficits in the general fund.

Upside scenario

Should the city's income and wealth metrics rise substantially and its major revenue streams continue to grow, reflecting balanced general fund operations without recurring deficits, then the rating could be raised. A higher rating would also be contingent on the Barstow Fire Protection District no longer being a financial burden on the city's general fund and the city continuing to maintain very strong general fund reserves.

Credit Opinion

A local economy that reflects below-average income and wealth indicators but with access to the Riverside-San Bernardino-Ontario MSA

Barstow has an estimated population of 24,205 and is located in the Inland Empire region of San Bernardino County, along the I-15 corridor. It is part of the Riverside-San Bernardino-Ontario MSA, which we consider broad and diverse. Barstow is located midway between Los Angeles (134 miles southwest) and Las Vegas (158 miles northeast), making it an important economic and transportation hub for the region. Wealth and income metrics for the city are below-average, although the relatively affordable price of housing is a draw for new residents. Management indicates that the housing market is strong and that home prices and new construction have risen over the past several years. The city's AV has also increased steadily, most recently by 7.4%, a trend that we expect to continue.

Strong management policies and practices

Our assessment of the city's policies and practices reflects its:

- Budget process that uses historical data related to property tax and sales tax collections, and use of an external sales

tax consultant to build revenue and expenditure assumptions;

- Historical practice of formal budget-to-actual presentations to council midway through the fiscal year; management indicates that they also present projections for major revenue streams on a more frequent basis, ranging from quarterly to monthly;
- Use of formal long-term (at least five years) forecasts for its major revenue streams, including property taxes and sales taxes;
- Long-term capital planning, including a seven-year capital improvement plan (CIP) with funding identified; management plans to update this plan annually;
- Formal investment management policy that largely restates what we consider to be conservative state rules and requires monthly updates to the council on holdings and performance;
- Formal debt management policy that includes good governance policies, although it lacks what we consider to be material quantitative constraints; and
- Policy of having a minimum reserve of 25% of expenditures to ensure continued services in the event of unanticipated financial disruptions; of this, 20% is categorized as a working capital reserve and the remaining 5% as an emergency contingency reserve.

Maintenance of a very strong reserve position despite a history of consecutive operating deficits prior to 2021

The city has historically maintained very strong general fund reserves, although these have been steadily spent down in each year since 2014. General fund reserves in fiscal 2014 were approximately \$21.4 million (114% of general fund expenditures) but fell to \$3.9 million (16.6% of expenditures) in fiscal 2020. However, in fiscal 2021 the city restored reserves to levels it maintained prior to fiscal 2019 and raised general fund reserves to \$9.6 million, or 42.8% of expenditures, a level we consider very strong. Management indicates that the prior deficits in the general fund were related to the need to support operations for the Barstow Fire Protection District, which became part of the city in 2010. Fiscal 2021 results reflect a strong operating surplus that management indicates is due to a substantial recovery in sales tax revenues that began in fiscal 2019. Going forward, management does not anticipate a return to deficit spending but expects to report stable financial performance and keep its general fund reserves in compliance with its reserve policy of 25% of expenditures at a minimum. We consider reserves above 15% of expenditures to be very strong.

The city receives the majority of its general fund revenues from sales tax, followed by transient occupancy tax (TOT) and property tax. Management reports that the ongoing COVID-19 pandemic did not have a negative effect on the city and that its revenue streams continue to grow going into fiscal 2022. Sales tax revenues are projected to increase going forward, supported in part by continued demand and higher prices for gasoline. We do not expect the city's financial position to weaken substantially during the next two years.

City continues to support fire district operations with regular transfers from the general fund although city reserves remain very strong

We note that the Barstow Fire Protection District became part of the city on Nov. 17, 2010. Historically, the fire district was financially challenged, with operating deficits reported for several years due to rising operational costs from both salary and benefit expenses as well as pension-related costs under the San Bernardino County Employees' Retirement

Association (SBCERA). We note that only fire district employees participate in SBCERA. The continued deficits in the fire district required the city of Barstow to loan general fund money to the district in fiscal 2015 in order to support its operations. This outstanding loan totaled approximately \$5.3 million as of fiscal 2021 and is categorized as non-spendable; it is therefore not factored into any of our general fund reserve calculations for the city. We understand that the city has taken steps to restore balance to the fire district's operations, including the passing of Measure Q, a general sales tax revenue increase that is used to pay back the loan from the district to the city and sustain its operations.

Management indicates that, with the passage of Measure Q, the city is able to regularly transfer funds to the fire district in order to support its operations. It expects the fire district to stabilize operations and begin paying back the outstanding loan to the city. The Barstow Fire Protection District fund ended fiscal 2021 with a deficit reduction of \$1.3 million from fiscal 2020, resulting in an ending negative fund balance of \$5.0 million, which primarily reflects the loan to the city.

Higher debt burden due to the recently issued POBs, which are estimated to reduce total pension costs and result in savings

We note that we expect total governmental fund debt service to materially increase due to the city's issuance of POBs, while the city's required pension and actual other post-employment benefit (OPEB) contributions decrease. Including the issuance of the series 2022 POBs, total governmental fund debt service is 11% of total governmental fund expenditures, and net direct debt is 83% of total governmental fund revenue.

We note that the city entered into a lease financing that was privately placed in the original par amount of \$8.485 million. On review of the legal requirements, we do not consider this lease as a contingent liquidity risk as there are in our view no permissive covenants, acceleration provisions, or cross-default provisions that could result in an unanticipated call on liquidity.

Pension and OPEB liabilities

In fiscal 2021 (prior to the issuance of the series 2022 POBs), we calculate that the city's combined required pension and actual OPEB contributions totaled 12% of total governmental fund expenditures. We note that this figure includes only the pension liabilities related to CalPERS. Of that amount, nearly all are required contributions to pension obligations, and only 2.4% represented OPEB payments. The city made its full annual required pension contribution in 2021. We note also that after the issuance of the series 2022 POBs, we estimate that the city's combined required pension and OPEB contributions will fall to 5.9% of total governmental expenditures.

The pension contributions and funded ratios used in our analysis reflect pro forma figures following the issuance of the POBs. We do not view pension and OPEB liabilities as an immediate source of credit pressure for the county, given that the POBs are estimated to refinance its safety and miscellaneous pension liabilities into a fixed-debt obligation. However, if poor investment performance or other changes generate a new liability, especially 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 the potential payment savings from the transaction.

We do not view pension and OPEB liabilities as an immediate source of credit pressure for the city, given that the 2022 POBs are estimated to refinance all the city's pension liability outstanding under CalPERS into a fixed-debt obligation

to recognize interest-cost savings.

The city offers an OPEB benefit that is currently funded on a pay-as-you-go basis.

The city participates in the following plans (we note that this data reflects a measurement date of June 30, 2020):

- CalPERS safety and miscellaneous plans: 77.87% funded with a net pension liability of \$29.8 million; we note that the funded ratio is projected to rise to approximately 100% after the 2022 POBs.
- Single-employer defined post-employment healthcare plan benefits: \$20.2 million in net liability, and 6% funded as of June 30, 2020.

We note that the Barstow Fire Protection District is a component unit of the city and that its employees participate under SBCERA. The previous pension calculations included in this report do not include SBCERA liabilities.

CalPERS has lowered its discount rate to 6.8% from 7.0% in fiscal 2022 with the aim of reducing market risk. We believe a discount rate above our pension guideline of 6% could lead to contribution volatility. For more information on our view of California pensions, see our report "Pension Spotlight: California" (published July 13, 2021 on Ratings Direct).

Barstow, Calif.: Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
Weak economy				
Projected per capita EBI % of U.S.	54.62			
Market value per capita (\$)	66,868.17			
Population		24,205	23,732	23,798
County unemployment rate(%)			9.4	
Market value (\$000)	1,618,544	1,507,229	1,461,422	
Ten largest taxpayers % of taxable value	20.42			
Adequate budgetary performance				
Operating fund result % of expenditures		16.16	(5.75)	(5.05)
Total governmental fund result % of expenditures		6.05	0.33	(7.30)
Very strong budgetary flexibility				
Available reserves % of operating expenditures		42.76	16.61	26.55
Total available reserves (\$000)		9,657	3,926	5,843
Very strong liquidity				
Total government cash % of governmental fund expenditures		32.12	15.82	10.82
Total government cash % of governmental fund debt service		284.83	280.72	253.77
Strong management				
Financial Management Assessment	Good			
Weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		11.28	5.64	4.26
Net direct debt % of governmental fund revenue	83.40			

Barstow, Calif.: Key Credit Metrics (cont.)

	<u>Most recent</u>	<u>Historical information</u>		
		2021	2020	2019
Overall net debt % of market value	4.21			
Direct debt 10-year amortization (%)	55.07			
Required pension contribution % of governmental fund expenditures	2.88	9.80		
OPEB actual contribution % of governmental fund expenditures	2.39	2.40		

Strong institutional framework

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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