S&P Global
Ratings

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Summary:

Lancaster Power Authority, California; Appropriations; General Obligation

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Credit Profile		
US$19.345 mil taxable rev rfdg bnds ser 2021 due 11/01/2036		
Long Term Rating	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' rating to Lancaster Power Authority, Calif.'s proposed $19.3 million taxable series 2021 revenue refunding bonds, supported by the City of Lancaster. At the same time, S&P Global Ratings affirmed its 'A' underlying (SPUR) and long-term rating on the city's existing appropriation-backed debt. The outlook is stable.

Payments on the 2021 revenue refunding bonds are secured through a lease agreement between the authority and the City of Lancaster, whereby the city is required to make lease payments from legally available funds. The city covenants to budget and appropriate lease payments; however, lease payments are subject to abatement in the event of damage to or the destruction of the leased assets. In our review, the risk of potential abatement is mitigated by the city's covenant to secure insurance, including rental interruption insurance, equal to the maximum lease payments in any future 24-month period. Based on the application of our criteria, "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Nov. 20, 2019), we rate the lease revenue bonds one notch below city's general creditworthiness to account for the appropriation risk. The series 2021 bonds will be used to refund the authority's series 2012A revenue bonds for debt service savings.

The proposed series 2021 bonds are additionally payable from solar revenues derived from power purchase agreements between the authority and two local school districts. Although we understand that solar revenues will be the primary intended repayment source, our rating on these obligations ultimately reflects the city's legally available revenues appropriation pledge.

Credit overview

Lancaster is a large, urban community located about 60 miles northeast of downtown Los Angeles. Despite some near-term weakness in local economic indicators, its financial position remains very strong as management positions the city for long-term stability. Of note, the city passed an additional sales tax measure in November 2020 and modified its fund balance policy to increase the minimum reserve target to 35% of operating revenues from 10%. Despite an all-in long-term liability profile that we consider weak, the city has taken several steps to limit exposure to long-term retirement benefit costs, which decreases the likelihood that long-term liabilities will place material pressure on its operating profile. In our view, Lancaster's economic fundamentals remain the greatest weakness relative to those of higher-rated peers, given a lack of meaningful improvement in resident incomes and susceptibility to above-average unemployment, particularly during the ongoing COVID-19 pandemic.

The rating reflects our view of the city's:

- 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 operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 44% of operating expenditures;
- Very strong liquidity, with total government available cash at 72.6% of total governmental fund expenditures and 13.2x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 5.5% of expenditures and net direct debt that is 176.5% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

Like many California localities, Lancaster has elevated exposure to environmental risks, with earthquakes the most prominent. In our view, the state's updates to building codes in the past half century partially mitigate the city's seismic risk. We have also analyzed the city's social and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that both are in line with our view of the sector standard.

Stable Outlook

Upside scenario

All else equal, should Lancaster's economy demonstrate sustained improvement in unemployment and income measures or significant moderation in its debt load, we could potentially raise the rating.

Downside scenario

While not expected in the near term, a developed budgetary imbalance or significant deterioration in flexibility and liquidity could result in a downgrade.

Credit Opinion

Very weak economy

We consider Lancaster's economy very weak. The city, with an estimated population of 172,660, is in Los Angeles County in the Los Angeles-Long Beach-Anaheim, CA MSA, which we consider broad and diverse. It has projected per capita effective buying income of 62.3% of the national level and per capita market value of $77,164. Overall, market value rose by 4.8% over the past year to $13.3 billion in 2021. The county unemployment rate was 12.8% in 2020, which we consider high and a negative credit factor.

Lancaster is about 60 miles northeast of Los Angeles in the southwest portion of Antelope Valley. The 2020 census

count represented a 12.6% increase since 2010. The Antelope Valley economy is anchored by a long-standing military presence and defense contractors including Edwards Air Force Base (11,285), China Lake Naval Weapons Center (6,838), Lockheed Martin (3,900), and Northrop Grumman (2,294). While employment gains in recent years have driven local unemployment down since the Great Recession, the city unemployment rate has historically remained above state and national averages. At the onset of the COVID-19 pandemic, it spiked to 19%, and remains elevated at 13.8% as of June 2021.

Despite weaker employment trends, Lancaster's tax base continues to expand, spurred by a combination of commercial and residential activity. Residential construction is robust, with about 7,800 single-family units and 1,609 multi-family units in varying stages of development. In the past five years, the tax base has increased by an average annual rate of 5.7%. The 2021 assessed valuation is 13% higher than the city's pre-recession peak in 2009. The property tax base is also diverse, with the top 10 taxpayers comprising less than 4% of assessed value.

In the near term, we expect the local economy will remain stable with some leading indicators modestly improving as pandemic-related restrictions are eased throughout the state. However, elevated unemployment volatility and below-average resident incomes will likely persist as economic weaknesses relative to those of higher-rated peers.

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.

Highlights of the city's financial policies and practices include the use of historical data in the budgeting process and recent results that reflect the conservative nature of the city's underlying budget assumptions. City staff provides semiannual budget-to-actual updates to the city council along with monthly reports on investment holding and performance. Lancaster has formal practices for both debt and investment management. It maintains a long-term capital improvement plan that it updates annually during the budget process. The capital plan identifies funding appropriations only for the budget year. While it is not currently in place, we understand that the city plans to incorporate long-range forecasting into the budget process in the near term. We also understand that Lancaster has taken several steps to protect its physical assets and digital infrastructure from cyber risk.

In fiscal 2021, Lancaster revised its formal fund balance policy to increase the minimum target to 35% of annual revenues from the previous target of 10% of expenditures and transfers. The updated policy establishes four different categories of reserves: working capital reserve (10%), emergency operational reserves (15%), emergency response reserves (5%), and business opportunity/investment reserves (5%).

Strong budgetary performance

Lancaster's budgetary performance is strong in our opinion. The city had operating surpluses of 2.5% of expenditures in the general fund and 17.4% across all governmental funds in fiscal 2020. Our forward-looking assessment of strong budgetary performance reflects the city's recent history of consistently positive operations along with new revenue enhancements, including the approval of an additional sales tax measure in November 2020. In general, budget results have been fueled by a combination of conservative budgeting and consistent tax revenue growth to support the city's increasing service demands.

In fiscal 2022, leading sources of general fund revenue were sales taxes (36%), property taxes (24%), charges for services (9%), and franchise taxes (7%). The new sales tax measure, Measure LC, is expected to generate an additional $13.7 million in revenues in fiscal 2022. Collections for Measure LC began April 1, 2021, with no sunset.

The fiscal 2021 general fund budget was balanced at $75.2 million, reflecting a 7.7% reduction from the previous year. While revenues are estimated to have performed better than budgeted, the city expects to draw down a modest portion of fund balance due to elevated expenditures to address one-time pandemic-related priorities, including the operation of a COVID-19 testing and vaccination clinic. In addition to available reserves, the city was able to leverage federal funding including $2 million from the CARES Act to address one-time expenditures. Lancaster is also slated to receive about $36.3 million in funding from the American Rescue Plan Act, which it will use for various initiatives including its ongoing pandemic response and revenue replacement.

The adopted general fund budget for fiscal 2022 forecasts a modest increase in the general fund balance.

Very strong budgetary flexibility

Lancaster's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 44% of operating expenditures, or $35.6 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.

Lancaster has reported consistently strong reserves over at least the past five fiscal years. It also took recent steps to meaningfully strengthen its reserve policy by increasing the policy minimum to 35% from 10%. Given our expectation of continued strong results supported by new revenue enhancements, we expect the city's reserve position to remain strong and above 30%, in line with the newly established policy.

Very strong liquidity

In our opinion, Lancaster's liquidity is very strong, with total government available cash at 72.6% of total governmental fund expenditures and 13.2x governmental debt service in 2020. We do not expect liquidity to deteriorate in the medium term, based on historical performance and a lack of identified material risks to liquidity. Our view of the city's strong access to external liquidity reflects the city's historical ability to issue primarily appropriation and tax-backed debt obligations over the past 20 years. Lancaster primarily invests in the state-managed investment fund, certificates of deposit, federal and agency securities, and corporate securities, which we do not consider aggressive.

The city's 2021 lease refunding bonds, par amount of $3.8 million or 2% of total direct debt, were privately placed. Bond provisions are standard, and we have not found any indications of contingent liquidity risk related to the 2021 lease refunding.

Weak debt and contingent liability profile

In our view, Lancaster's debt and contingent liability profile is weak. Total governmental fund debt service is 5.5% of total governmental fund expenditures, and net direct debt is 176.5% of total governmental fund revenue. Our ratios are based on approximately $238.9 million of debt including the proposed 2021A lease refunding bonds, debt issued through the Lancaster Financing Authority, and existing tax allocation bonds issued by the city's successor agency. Management does not anticipate issuing additional long-term bonds in the next two to three years. Our ratios have been adjusted to consider the self-supporting nature of the bonds issued on behalf of the Lancaster Power Authority.

Pension and other postemployment benefits (OPEB) liabilities:

We do not expect Lancaster's long-term pension and OPEB liabilities will present a near-term risk to the operating budget. The city has taken steps to reduce its exposure to long-term legacy fixed costs, including closing its supplemental retirement benefits plan in 2012 and closing its OPEB plan to new entrants after Jan. 1, 2016. In addition, its ongoing contract with Los Angeles County Sheriff for police services reduces the city's exposure to rising public safety pensions costs.

The OPEB plan is partially pre-funded with a trust, and the city has historically fully paid its required contributions to California Public Employees' Retirement System (CalPERS) while also taking steps to prepay a portion of the unfunded accrued liability. Lancaster's combined required pension and actual OPEB contributions were 8.8% of total governmental fund expenditures in 2020. Of that amount, 6.0% represented required contributions to pension obligations, and 2.8% represented OPEB payments. In 2020, the city paid $478,000 above the actuarially required contribution to OPEB.

As of June 30, 2020, the city had the following retirement plans:

- CalPERS miscellaneous pension plan: 68.59% funded (based on a 7% discount rate) with a net pension liability of $58.3 million;
- Public agency retirement services plan (closed): 74.68% funded with a net pension liability of $3 million; and
- Single-employer defined-benefit health care plan (closed): $17.3 million in net liability, and 37% funded.

CalPERS lowered the discount rate to 6.8% from 7.0% starting in fiscal 2022, with the idea of reducing market risk. We note the new discount rate is still above our pension guideline of 6% and 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 RatingsDirect.

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
- 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
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of September 10, 2021)		
Lancaster APPROP (BAM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Ratings Detail (As Of September 10, 2021) (cont.)		
Lancaster Pwr Auth, California		
Lancaster, California		
Lancaster Pwr Auth (Lancaster) rev bnds (Solar Renewable Energy Prog)		
Long Term Rating	A/Stable	Affirmed
Lancaster Redev Agy, California		
Lancaster, California		
Lancaster Redev Agy (Lancaster) APPROP		
Long Term Rating	NR	

Many issues are enhanced by bond insurance.

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