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MEMORANDUM

TO: Buffy Bullis, Administrative Services Director

FROM: Jeff White and Jim Prichard
Columbia Capital Management, LLC ("Columbia")

DATE: September 22, 2022

RE: Review of Monrovia's Issuer Credit Rating/General Obligation Credit Rating

The primary purpose of a credit rating (or bond rating) is for a rating agency to provide its opinion of the likelihood that the issuer of the debt will repay its principal and interest in full and on time. In doing so, rating agencies review certain factors they deem most important when evaluating credit, such as economic, fiscal and debt metrics. Though they can be helpful when formulating policies, rating methodologies are not guidelines or suggestions for municipal policies; they only represent a framework that a rating agency uses when evaluating a credit. Ratings are also relative, as the agencies compare similar issuers to each other before making a final rating determination. The goal of this memorandum is to help the City better understand its credit rating and overall credit position with respect to its general obligation bond rating/issuer credit rating.

The City's Current General Obligation Rating

The City's issuer credit rating ("ICR" in rating speak), sometimes referred to as the general obligation or GO rating, is currently 'AA+' from S&P Global ("S&P"). The table below illustrates S&P's rating scale. The City's credit rating is very strong, only one "notch" from the highest rating attainable.

S&P Rating Scale	
AAA	
AA+	City's Current Issuer Rating
AA	
AA-	
A+	
A	
A-	
BBB+	
BBB	
BBB-	Investment Grade
BB+	Non-Investment Grade
BB	
BB-	
B+	

Credit Rating Factors

Generally, all rating agencies use the same mix of factors to determine a City's ICR. For S&P, these include:

Institutional Framework. This is a metric, established by S&P for all comparable cities within the state, measuring the relative flexibility cities have in raising revenue, setting expenditures and managing their budgets.

Economy. This is an evaluation of the depth, breadth, concentration and growth of the city's economy using metrics such as per capita market value (same as assessed value in California), per capita and household income, employment concentration and unemployment rates.

Management. This is a measure of the quality of the City's financial management practices looking at written policies (debt, investment, etc.), budget-to-actual reporting and related factors.

Budget Performance/Flexibility. This is an evaluation of the ability of the City to make mid-year adjustments in budgetary spending in order to deliver a balanced or surplus budget at year-end. Factors influencing this score include the scope of the City's pension liabilities (negative) and the amount of discretionary capital spending (positive) in the City's budget.

Liquidity. This metric evaluates the amount of cash the City has access to at various points in the year to cover normal operating costs, capital expenditures and debt service.

Debt/Contingent Liabilities. This factor looks at the scope of fixed charges for bonds, pensions and contingent liabilities against the City's total operating budget.

S&P's uses a "scorecard" to help determine a local government's rating. Each factor is given a score based on certain calculated metrics. Those metrics are then subject to several potential qualitative adjustments. Though S&P's scorecard is comprehensive and usually is an accurate indicator of the final assigned rating, S&P reserves the right to consider other factors or information not explicitly included in the scorecard and to make so-called "below-the-line" adjustments to its rating. The actual assigned rating is determined by a majority vote of a credit committee, comprised of senior officials at the agency, many of whom are not familiar with California general government locally and most of whom could not point to Monrovia on a map! Sometimes the actual rating can vary by one or more notches from the scorecard result.

The table below provides our opinion of the City's S&P scorecard result. The table illustrates S&P's seven credit factors, the weight of each factor assigned by S&P in its methodology (e.g. the economy is the most important factor at 30%), and our projection of how the City scores. The scores range from 1 to 5, with 1 being the best. The scores for each factor are then averaged on a weighted basis to come up with a total score, which is then matched to the rating ranges in the small table to the right. **Our scorecard projection for the City results in a triple-A rating**, one notch higher than the City's actual rating**.** This is driven by the very strong general fund and total governmental fund results as reported in the 2021 ACFR. From reviewing the Management Discussion and Analysis, we understand the strong performance was primarily due to overall strong tax performance (e.g. general fund up 26%). On June 23, 2022, S&P upgraded the City's ICR from 'AA' to 'AA+'. As Columbia has been working with City staff to understand its credit rating, this upgrade came at no surprise as our internal models and prior memoranda to the City suggested an upgrade was highly likely. It is clear from the S&P report announcing this upgrade that our assumption that S&P does not rate the City triple-A, like our models suggest, is related to some unfavorable median comparisons for fund balance, debt burden (shown below) and some economic metrics to other S&P-rated municipalities S&P considers as peers.

Projected S&P Scorecard Results

Factor	Weight	Implied Score/ Rating	Qualitative Adjustments	Implied Score/Rating After Adjustments
Factor 1: Institutional Framework	10%	2.0	N/A	2.0
Factor 2: Economy	30%	2.0	**-1.0**	1.0
Factor 3: Management	20%	1.0	0.0	1.0
Factor 4: Budget Flexibility	10%	1.0	0.0	1.0
Factor 5: Budgetary Performance	10%	1.0	1.0	2.0
Factor 6: Liquidity	10%	1.0	0.0	1.0
Factor 7: Debt/Contingent Liabilities	10%	5.0	0.0	5.0
Weighted Average Score		**1.80**		**1.60**
Corresponding Rating		**AA+**		**AAA**

Qualitative Adjustment Notes:

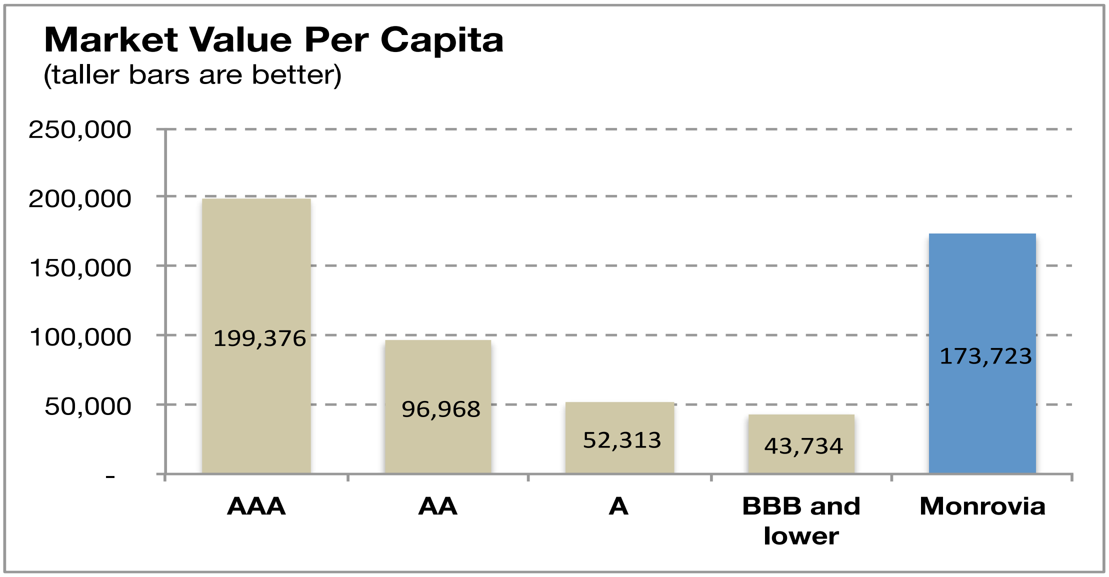
1. Factor 2: One point positive adjustment for participation in a broad diverse economy
2. Factor 5: One point negative adjustment for projected general fund result (flat) in the 2021-22 proposed budget

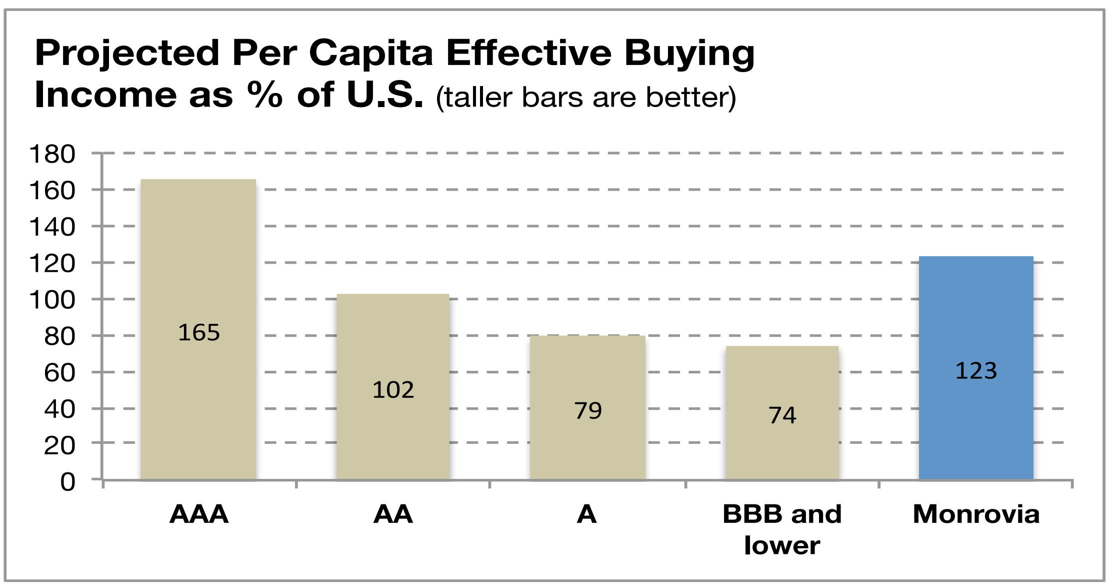
Rating	Range	
AAA	1.00	1.64
AA+	1.65	1.94
AA	1.95	2.34
AA-	2.35	2.84
A+	2.85	3.24
A	3.25	3.64
A-	3.65	3.94
BBB+	3.95	4.24
BBB	4.25	4.54
BBB-	4.55	4.74
BB	4.75	4.94
B	4.95	5.00

Median Comparison

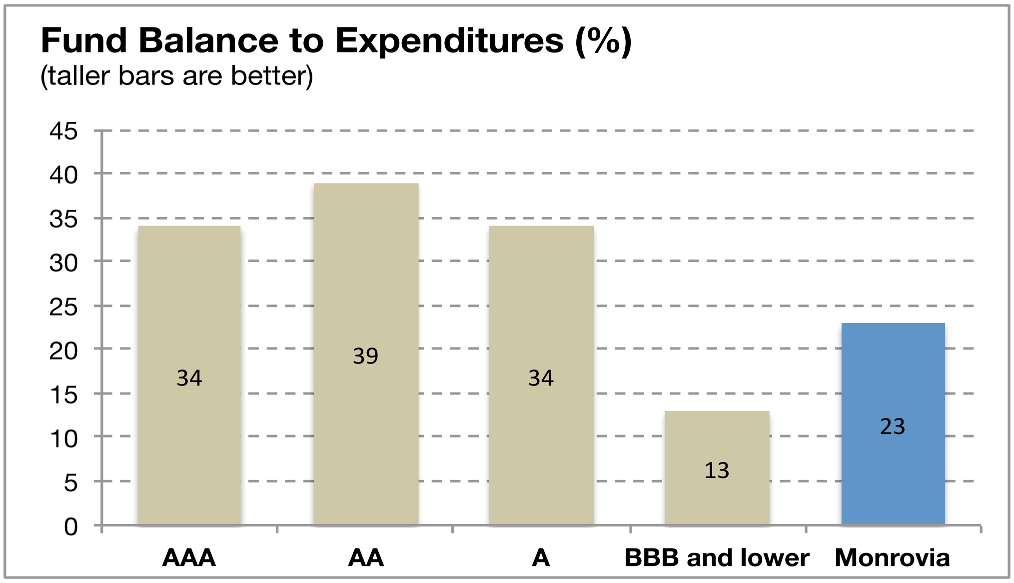
When reviewing credit quality, it can also be useful to compare the City's metrics to data for other cities rated by S&P within a certain rating category ('AAA','AA', etc.). S&P periodically publishes a report where it shows, by rating category, the median (middle point) for several of the metrics it reviews, many of which are part of the scorecard. We have calculated estimates of those metrics for the City based on its 2019, 2020 and 2021 ACFR and other publicly available data, and have charted those results against the S&P median value. This type of illustration is useful for identifying both strengths and weaknesses.

Key economic indicators that carry the most weight in a GO rating are shown below. As expected given the City's score of '1' for the Economy factor, the City's metrics are quite strong, with values between the double-A and triple-A medians.

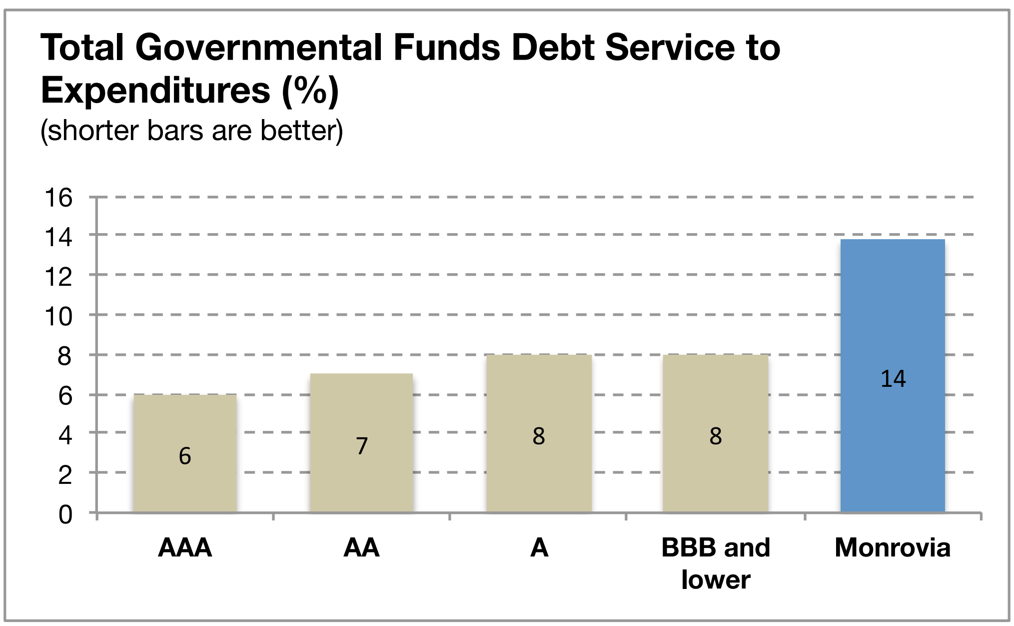


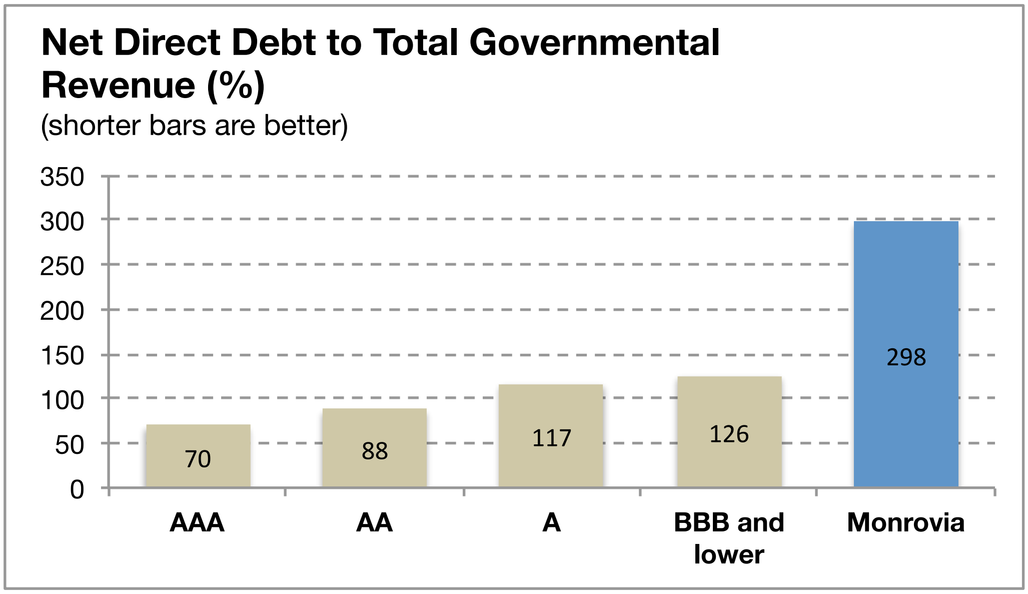


Key fiscal position metrics (reviewed under Factors 4, 5 and 6), together account for 30% of the rating result, include annual budget results (both general fund only and total governmental funds), fund balance and liquidity. Most interestingly, as shown in the chart below, though the City has a "strong" fund balance (as defined by S&P as 15% or higher) and grew that balance significantly in FY 2021, when comparing to the median data, the City's fund balance is still significantly lower than rated municipalities in the 'A' category and above.



With respect to debt metrics, S&P and other agencies attempt to gauge the magnitude of debt levels and affordability of debt service. The charts below illustrate the two metrics S&P incorporates into their scorecard. Though the City's debt metrics look challenged, it is important to note the 2017 Pension Bonds are incorporated into the figures. The higher debt is offset by lower unfunded accrued liability (UAAL) payments that otherwise would be due.





State Auditor Classification

It is difficult to reconcile S&P's view (and our view) of the credit of the City as being "very strong" when studying the California State Auditor's fiscal health analysis of hundreds of cities provided on its website. In 2016 the Auditor listed the City as the tenth most fiscally-challenged city in the state. The Auditor's analysis attempts to classify by risk category (low, moderate or high) factors they deem important (e.g. debt, pensions, liquidity, etc.).

Fundamentally, their classification gives us pause. S&P's credit assessment, which looks at all the same types of fiscal information (plus additional factors), comes to a very different conclusion by assigning a 'AA+' rating, just one notch from the best rating possible. S&P indicates that an obligation with a 'AA' category rating "…differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitments on the obligation is *very strong*." (emphasis added)

Further, we would expect the most challenged cities in the Auditor's report to have the weakest credit ratings. That, however, is not the case. Some cities that fare better on the Auditor's list than the City have lower bond ratings than the City: some in the 'A' category for S&P or even in the 'Baa' ('BBB' S&P-equivalent) category by Moody's Investors Service. Perhaps the best takeaway from this conflict in rating and ranking is the audience intended for each report. We cannot speak for the intended audience for the State Auditor's project, but S&P's credit rating is intended telegraph to investors S&P's opinion of the City's willingness and ability to repay its bonds in full and on-time. The City would be unable to do either if it were under material fiscal stress.

Primary Drivers of the City's Rating

To protect its high ICR, or to make moves to increase it over time, the City should focus on the factors over which it has direct control. The City cannot directly control its economy score over the short- or mid-term or erase half of its debt overnight. What the City *can* do is focus on enhancing its fiscal position over time.

In S&P's most recent rating report of the City's ICR, it cites reserves levels as an important factor in either contributing to a rating increase or, should reserves fall, contributing to a rating downgrade. Moderating debt levels is also listed as a factor that can help push the City's rating higher. **With that guidance, coupled with the analysis provided above, if the City desires to increase its ICR, we recommend it focus on executing budgets with surpluses that allow it to build its general fund balance over the next several years, moving closer to the 30% range that the median data suggest for cities in the triple-A category.** We realize this could be a large undertaking, but it does not need to be accomplished immediately. Some cities with which we have worked plan to increase their fund balance in increments of less than one-percent each year until they reach their target.

Pension obligations—whether in the form of a UAAL or their proxy in the form of pension obligation bonds (POBs)—are a challenge faced by nearly every California city and create downward pressure on ratings. The City's debt burden is heavily driven by its POBs. The City's debt position should naturally moderate over time as these bonds amortize and as the City's market valuation (hopefully) increases. Though the City created its Section 115 Trust in 2018, we understand it just recently identified a revenue stream to fund it. That is a positive development and we encourage the City to continue progress towards funding that trust to a meaningful level, which will also be seen as a positive development by S&P.

Policy Discussion

In order to protect the City's very strong bond rating and to potentially drive it higher over the short to mid-term, **we suggest the City should focus on three metrics: (1) general fund balance as a percentage of expenditures, (2) debt service as a percentage of total governmental funds expenditures and (3) outstanding debt as a percentage of market values**. Note for the second point, although S&P compares debt to total governmental revenues, they and the other agencies look at debt service as a percentage of expenditures metric as well; we feel revenue is a better measure of debt load because debt is measured against the resources that secure and will ultimately repay the debt.

Potential Policy	Target	Est. Current
General Fund Balance as % of Expenditures	30%	23.0%
Debt Service as % of Expenditures	<15%	14.0%
Debt as a % of Market Value	<4%	2.6%

As a final note, it is perfectly reasonable for the City to decide that its current 'AA+' ICR is the right policy target. The economic benefit to the City of a higher rating only comes into play during a bond financing and provides only a modest financial gain. Even making that decision, however, the City can use the metrics provided by S&P to assess its progress toward its own financial goals.