FitchRatings

FITCH DOWNGRADES FRESNO JOINT POWERS FIN AUTH, CA'S LEASE REVS TO 'A-' FROM 'AA-'; OUTLOOK STABLE

Fitch Ratings-San Francisco-01 August 2011: Fitch Ratings has downgraded the following city of Fresno, CA (the city) bonds:

--$175 million Fresno Joint Powers Finance Authority lease revenue bonds (series 2004 A, B, & C; 2006 A & B; 2008 A, C, E & F; and 2009A) to 'A-' from 'AA-'.

In addition, Fitch downgrades the city's implied general obligation (GO) bond rating to 'A' from 'AA'.

The Rating Outlook is Stable.

SECURITY
The lease revenue bonds are secured by lease rental payments, governed by a master lease structure, made by the city of Fresno to the Fresno Joint Powers Financing Authority for use and occupancy of various essential and non-essential assets. Lease payments are subject to annual appropriation and abatement.

CREDIT SUMMARY
Weak Economy Erodes Finances: The downgrades reflect a rapid erosion in the city's financial position evidenced by use of the emergency reserve and low overall financial flexibility. With a dependence on both property and sales taxes, management remains challenged in achieving structural budget balance as the tax base continues to decline and economic deterioration over the last several years shows little signs of recovery. Fitch expects the city to manage expenses over the near term to maintain balanced operations at the current lower level of financial flexibility.

KEY RATING DRIVERS
Weak Financial Position: The city's financial position has deteriorated sharply as significant expenditure reductions failed to keep pace with declines in economically sensitive tax revenues. With low liquidity, the city is relying on elevated cash flow borrowing when compared to a few years ago.

No Plan To Build Reserves: The city completely depleted its unreserved general fund balance over the past three fiscal years and continues to struggle to close ongoing fund balance deficits outside the general fund. The city has no current plan to build reserve levels.

Adequate Financial Management: Fresno has made significant cuts in expenditures, gaining traction toward restoring structural budget balance in the general fund; however, the city's fiscal 2012 budget continues to rely on unsustainable one-time budget solutions.

Revenue Weakness: The city's tax revenues declined sharply during the recession, but recovered somewhat in fiscal 2011. A weak local economy and housing market leave the city vulnerable to further revenue declines at a time when the city has very limited financial flexibility.

Downturn in Economy & Tax Base: Fresno is the cultural and commercial hub of the San Joaquin Valley, one of the world's most productive farming regions, and it benefits from a large and increasingly diverse economy that is currently in a deep cyclical downturn. Significant tax base contraction continues, but management projects a slight gain is projected for fiscal 2012.

Manageable Long-Term Liabilities: Overall debt is expected to remain moderate given no additional debt plans. Pension and other post-employment liabilities are manageable and compare favorably to other large cities.

CREDIT PROFILE

Fresno's financial position deteriorated rapidly during the recent recession and has not yet begun to recover. General revenues declined 3.7% in 2009 and tumbled 12.5% in fiscal 2010, led by double-digit declines in property and sales taxes, the city's two biggest revenue sources. The revenue decline appears to have eased in 2011, but the city has yet to see significant recovery. The city - which came into the recession with a slight budget imbalance, but significant reserves - failed to adequately curb spending in fiscal 2009 due in part to obligations under existing labor contracts. After a short delay in fiscal 2009, Fresno has made significant cuts to both its payrolls and public services, suggesting a strong willingness to make decisions to restore budgetary balance. Spending dropped a sizeable 15.7% between fiscals 2009 and 2010.

The recently approved fiscal 2012 budget authorizes about 900 fewer positions than the fiscal 2010 budget, a 22% reduction, resulting in the layoff of 300 to 400 employees. In addition to various service cuts, privatization, and consolidation, budget balance in fiscal 2012 requires a 3% compensation cut to all employees, subject to labor negotiations, as well as one-time solutions. As do all California municipalities, the city has a very limited ability to raise revenues due to the state's legal framework, leaving spending reductions the major driver supporting future budget balance.

Despite the aggressive cuts, the city's combined emergency reserve and unreserved fund balances fell from a healthy $30.6 million, or 11.7% of expenditures, at the end of fiscal 2008 to 3% of expenditures at the end of 2010. Unaudited results for fiscal 2011 show no remaining fund balance and management does not expect any change in fiscal 2012. The lack of reserves leaves the city vulnerable to revenue shocks at a time of economic uncertainty, with no flexibility to absorb unexpected budget deficits.

The final depletion of the city's reserves was due to prudent action to address ongoing negative fund balances outside the general fund. The negative fund balances developed over several years as many minor funds - most notably the city parking fund - suffered revenue weakness or cost overruns. After curing about $10 million of non-general fund deficits using its remaining general fund reserves in fiscal 2011, the city estimates a remaining $26 million of negative fund balances.

The city's multi-year plan to reverse remaining deficits does not include the parking fund estimated $18 million deficit. The general fund has taken responsibility for debt service of about $2.5 million a year that it intended to pay from parking revenues. Fitch believes the city's action to directly address these problems is a positive development, despite the impact on general fund reserves, but a resolution of the parking fund balance deficit will be important to returning the city to financial stability and maintaining the current rating.

Fresno's economy and tax base are large and increasingly diverse, but both are experiencing a prolonged period of stress. The city is the cultural and commercial hub of a productive farming region, and its economy is largely driven by agriculture-related activity. As such, unemployment over time has trended higher than the national and state averages. Employment and labor force losses of 1.2% from May 2010 to May 2011 continues that trend; the unemployment rate in May 2010 was a high 15% and unchanged from the year prior. Socioeconomic indicators are also weak with above-average poverty rates and below-average income levels.

Both construction employment and assessed value (AV) fell as the housing market collapsed. The tax base is both diverse and large with AV of $28 billion in fiscal 2011. AV declined a sizeable 5.6% in fiscal 2010, but the decline eased to 1.8% in 2011. The city believes it will experience a small increase in fiscal 2012. While the forecast appears reasonable, Fitch believes continued weakness in the local and national housing markets suggest that the tax base remains vulnerable to further declines.

Fresno's debt burden is manageable. Overall debt is moderate at about $2,789 per capita, or 4.9% of AV. Amortization is below average with 44% retired in 10 years. Fitch notes with some concern that the city has taken on additional debt since the last review after the city absorbed debts of a local museum and athletic facility that it had guaranteed. Total carrying costs associated with long-term liabilities are high at 33% of fiscal 2012 spending. Total carrying costs include payments on pension obligation bonds, 100% funding of the actuarially required contribution for normal pension costs, and all debt service on general fund-backed debt. When debt service paid by other governmental funds is excluded, the fixed-cost burden declines slightly to 27% of fiscal 2012 spending.

Pensions are well funded at 111% using Fitch's more conservative 7% rate of return assumption, and the city's other post-employment benefit obligations are quite manageable at $84 million, or 0.3% of AV.

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In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, S&P/Case-Shiller Home Price Index, IHS Global Insight, and Zillow.com.

Applicable Criteria and Related Research:
'Tax-Supported Rating Criteria', dated 16 Aug. 2010.
'U.S. Local Government Tax-Supported Rating Criteria', dated 08 Oct. 2010.

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564566