

Summary:

Fresno, California; Appropriations; General Obligation

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Credit Profile

Fresno Fresno ICR
Long Term Rating

A/Negative

Downgraded

Rationale

Standard & Poor's Ratings Services lowered its issuer credit rating (ICR) to 'A' from 'AA' on Fresno, Calif. and its long-term rating and underlying rating (SPUR) to 'A-' from 'AA-' on the city's lease revenue bonds. The outlook is negative.

The ratings reflect our view of the city's:

- Role as a regional economic center;
- Balanced general fund budget for fiscal 2012;
- Moderate debt burden, with no plans to issue additional debt; and
- Property tax override to support earmarked for any specific type of pension costs, including its pension obligation bonds (POBs).

Although the city reported that the fiscal 2012 general fund budget is balanced, persistent structural imbalance has resulted in the city's significantly weakened financial position, as well as the near-depletion of the city's emergency reserve, which it used to balance the general fund budget in prior years and to support deficit spending outside of the general fund. The negative outlook reflects our view that current general fund reserves and cash balances leave the city with inadequate short-term flexibility if revenue performance is weaker than budgeted. In addition, the city's resolution of additional structural imbalances would likely require political and collective bargaining cooperation that may not be achievable in the short or intermediate term, resulting in a further weakening of the city's financial profile.

The bonds are secured by lease payments for the use of a variety of leased city assets. The city covenants to budget and appropriate lease payments although the leases are subject to abatement in the event of damage. The city covenants to maintain liability and casualty insurance, as well as business interruption insurance sufficient to make 24 months' lease payments.

The city's financial performance has been consistently weak, in our view, as demonstrated by three consecutive years of general fund deficits through fiscal 2009. In our view, deficit operations were driven by expenditure growth outpacing revenue growth through fiscal 2009. Fiscal 2010 results would have also been negative if not for \$17 million of lease revenue bond proceeds transferred in to reimburse the general fund for loans the city paid on behalf of the Fresno Metropolitan Museum during fiscal 2009. In addition, revenue pressures in other nongeneral funds have required increased support from the general fund, including \$2.5 million of annual debt service for the convention center parking garage lease revenue bonds due to deficit operations in the parking fund and support of

the redevelopment agency.

Fiscal 2010 general fund results included an ending balance of \$40 million (19% of expenditures) and an unreserved negative balance of \$3.1 million (1.4% of expenditures). The deficit in the unreserved general fund balance is attributable, in our view, to the reservation of about \$31.8 million for noncurrent receivables related to the advances to other funds asset of an equal amount, which represents the accumulation of support by the general fund to other funds with deficit operations.

Also included in the reserved general fund is a reserve for emergency of \$10.6 million for fiscal 2010, down from \$17 million in fiscal 2009. The city adopted an emergency reserve policy in 2004, which it had initially funded in fiscal 2002 from savings from the refunding of its POBs. If the fiscal 2010 emergency reserve were reduced by the negative unreserved general fund balance, the emergency reserve would be equal to about 4% of general fund expenditures. The amount of the reserved general fund balance for emergencies is also equal to the amount of restricted cash on the fiscal 2010 balance sheet, which was less than one month of expenditures. Unrestricted cash and investments were just \$62,515. Management informed us that liquidity needs will be supported by citywide cash available in its investment pool.

We understand that the city has been making budget cuts, including reducing ongoing expenditures through staff reductions, which have resulted in a 15.7% year-over-year decline in expenditures. However, a portion of those savings required the city to declare a fiscal emergency in order to use the emergency reserve to fund one-time costs related to an early-retirement program. Management informed us that the emergency reserve balance for fiscal 2012 is budgeted at \$1.46 million, or 1% of budgeted expenditures. In addition, the fiscal 2012 budget is balanced and the city has adopted more comprehensive reserve policies and multiyear forecasting. We understand that the focus of the budget planning is on structural balance and that forecasts do not currently include rebuilding reserve levels.

The overall debt burden is about 4.6% of market value, which we consider moderate. The city's debt outstanding includes about \$365 million of lease revenue bonds and \$174 million of POBs. The debt service carrying charge for fiscal 2010 was elevated, in our view, at 15% of total governmental funds expenditures. We understand that the city does not have any variable-rate debt outstanding and has no current plans to issue additional debt during the next two years.

The city currently maintains two retirement systems for its employees. The systems are single-employer defined-benefit pension plans administered by the City of Fresno Retirement Boards. The plans had been prefunded from the POB proceeds. However, because prefunding has been depleted, the rise in the city's required contributions has also been a source of budget pressure. One plan required 100% contributions starting in fiscal 2010 while the second started in fiscal 2011. According to the notes to the fiscal 2010 audited financial statements, the city's other postemployment benefit actuarial accrued liability relates to the "implicit rate subsidy" for retirees that purchase health insurance through the city's health care plan.

Outlook

The negative outlook reflects our view that current general fund reserves and cash balances leave the city with inadequate short-term flexibility if revenue performance is weaker than budgeted. We could lower the ratings if general fund deficits persist and we believe the general fund's exposure to liabilities in other funds is worsening. We could revise the outlook to stable if management maintains stable financial performance and results.

Related Criteria And Research

USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of October 3, 2011)		
Fresno (Master Lse Projs) Ise 2008A&B (ASSURED GTY)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno (Master Lse Projs) Ise 2008C&D (ASSURED GTY)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Ise rev bnds		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Ise rev bnds (Taxable)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno GO Pension		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Judgement Bnds		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno 2004 Ise rev bnds		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth, California		
Fresno, California		
Fresno Jt Pwrs Fin Auth (Fresno) Ise rev bnds ser 2009A		
<i>Long Term Rating</i>	A-/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) Ise rev bnds (Fresno) (Convention Center Improv Projs) ser 2006 A dtd 06/28/2006 due 10/01/2011-2026		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) Ise rev bnds (Master Lease Projects Federally Taxable)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) Ise rev bnds (Master Lease Projects)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth Ise rev bnds (Exhib Hall Expansion Proj) ser 1998 dtd 10/01/1998 due 09/01/2001-2013 2018 2028 2006-2028		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth Ise rev bnds (Multi-Purp Stad) ser 2001A dtd 06/07/2001 due 06/01/2004-2013 2015-2020 2026 2028 2031		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth Ise rev rfdg bnds (Street Light Acq Proj) ser 2002A dtd 05/23/2002 due 10/01/2002-2015		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth taxable Ise rev bnds (Multi-Purp Stad) ser 2001B dtd 06/07/2001 due 06/01/2004-2011 2016 2023 2031		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) Ise rev bnds (Fixed Rate) ("No Neighborhood Left Behind Cap Imp Projs) (XL CAPITAL		

Ratings Detail (As Of October 3, 2011) (cont.)		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) (Convention Center Improv Projs) ser 2006A		
<i>Unenhanced Rating</i>	A-(SPUR)/Negative	Downgraded
Fresno Jt Pwrs Fin Auth (Fresno) (Convention Center Improv Projs) ser 2006B		
<i>Unenhanced Rating</i>	NR(SPUR)	Downgraded

Many issues are enhanced by bond insurance.

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