

# RatingsDirect®

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## Summary:

# Oxnard, California; Gas Tax

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## Table Of Contents

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Rationale

Outlook

Related Research

## Summary:

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### Credit Profile

US\$16.26 mil gas tax rev rfdg bnds ser 2020 due 09/01/2037

<i>Long Term Rating</i>	A+/Positive	New
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#### **Oxnard gas tax**

<i>Unenhanced Rating</i>	A+(SPUR)/Positive	Affirmed
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Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings assigned its 'A+' long-term rating to Oxnard, Calif.'s series 2020 gas tax revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'A+' underlying rating (SPUR) on the city's gas tax revenue certificates of participation. The outlook is positive.

### Security and use of proceeds

The series 2020 is secured by a first lien on gas tax revenue that the city receives each month under the state's Streets and Highways Code sections 2105, 2106, and 2107 (but not 2107.5). The series 2007 represents an interest in installment payments by the city to the authority.

We understand that the legislature has the discretion to change the population-driven gas tax distribution formulas as long as the equity of allocations is maintained, and that it may also change the overall fuel tax rate. Based on the precedent in 2008, when the state borrowed fuel tax payments due to local agencies during March through July and paid those sums in August and September, we think that future adverse fiscal environments could lead the state to attempt to again postpone such payments. However, this may be more difficult for the state next time as a result of voters' approval in 2010 of Proposition 22, which circumscribed the state's ability to suspend or divert gas tax distributions.

Proceeds of the series 2020 will refund the series 2007, which is an obligation of the city and whose proceeds were used to fund a variety of road projects, including resurfacing and sidewalk and accessibility improvements. The series 2020 underwriter estimates that this transaction will generate net present value savings of about 18% of refunded principal and that the payment structure will remain substantially similar to the existing arrangement. We expect to discontinue the SPUR on the series 2007 after the city refunds it with the proceeds of the series 2020.

### Credit fundamentals

Our rating on Oxnard's gas tax obligations is limited by our view of the city's creditworthiness as obligor given what we see as a close linkage between the city and its gas tax obligations under our priority lien criteria. But with a positive outlook on our issuer credit rating (ICR) on the city, we see at least a one-in-three chance that we will raise our rating on series 2020 during the next two years should the city show stability in senior leadership and continue to implement

governance improvements. For the stand-alone credit profile associated with the series 2020, we see the statewide collection and population-driven gas tax distribution formulas as a credit strength, although collections in practice have been more volatile than our baseline assessment of this type of revenue. We anticipate that coverage will remain very strong in the medium term, consistent with our expectation of real GDP growth in the Pacific U.S. states and an inability to issue additional parity debt other than for refunding purposes.

Key credit considerations are:

- Strong economic fundamentals, with statewide collections of gas tax revenue;
- Very strong coverage and liquidity profile, with 2.4x series 2020 maximum annual debt service coverage based on the most recent full collection year and an inability to issue additional "new money" debt;
- Our view that pledged revenue has demonstrated moderate volatility; and
- A close linkage to Oxnard's creditworthiness as obligor, which results in a cap on the rating.

### **Economic fundamentals: Very strong**

The tax revenue is collected across the state and distributed to each city largely based on population, after some deductions for more targeted purposes. So while the City of Oxnard's population is a key factor in how much revenue is received, we have considered the tax base as gas sales throughout California.

Oxnard, with an estimated population of 209,880, serves a 27-square-mile area that continues to serve as a market and housing center for an agricultural area focused on fruit and berry production, and includes a coastal area that is a locus of second homes and maritime recreation. Although it operates just outside the city, the three-site Naval Base Ventura County is a local economic anchor, employing about 11,000 military and 9,000 civilian personnel. The city is part of the Oxnard-Thousand Oaks-Ventura metropolitan statistical area, which we consider broad and diverse. Income levels for Oxnard residents, as measured by per capita effective buying income, are a low 68% of the U.S. level. At a preliminary 3.6% for November 2019, Ventura County's unemployment rate was comparable to the national average of 3.5%. Our assessment also reflects the city's slowly growing population, which has increased by 1% on average in comparison with 0.6% annual growth in the state during fiscal years 2009 to 2018.

We view the city's population growth trend as likely to continue in some form into the next decade. The city's developable land and affordability relative to its Ventura County peers has made it a primary housing development location in the western Los Angeles region. Management has identified several ongoing and upcoming development projects within the city, including approximately 673 residential housing units under construction as of June 2019. Major projects include The Village, a 63-acre pedestrian and transit-oriented development located in the Wagon Wheel area with 219 units under development and Gateway Station Apartments, a 12-acre site located within the Five Points Northeast Neighborhood, a 240-unit residential apartment complex. Management also reports that development plans for approximately 782 residential housing units have been approved and that an additional 409 units of residential development plans have been proposed or are in plan check phase.

### **Coverage and liquidity: Very strong**

In fiscal 2019, pledged revenue fell 1% to \$3.1 million, which followed similarly sized declines in fiscal years 2017 and 2018 and a 4% decline in fiscal 2016. Coverage relative to peak debt service in fiscal 2023 is very strong, in our view,

at 2.4x. Coverage of pre-refunding MADS is slightly lower, at 1.9x.

After fluctuations in gas prices in the state generally, we think the trajectory of the city's population is likely to be the main driver of pledged revenue for the foreseeable future. The distribution formulas for the statutes governing gas tax have been consistent historically without a decrease since at least 1994. Article 19 of the state constitution, which provides that motor vehicle fuel tax proceeds be used for transportation projects, dictates that the tax continue to be distributed in a manner consistent with statutory formulas. However, the legislature has the discretion to change the formulas as long as the equity of allocations is maintained; it may also change the overall fuel tax rate. We also think that an adverse state budget environment could lead the state to attempt to divert or delay gas tax distributions, notwithstanding voter-approved protections approved since the latest period of deferrals.

The state makes monthly gas tax distributions to the city, which, under the series 2020 bond provisions, must pass on gas tax revenue to the trustee at least five business days prior to each interest payment date. The city will manage liquidity risks with a debt service reserve initially fulfilled with a surety policy and sized to the least of 10% of principal, 1.25x average annual debt service, and maximum annual debt service.

#### **Volatility: Moderate**

We assess the volatility of revenue to determine the likelihood of the availability of revenue during different economic cycles. We have two levels of volatility assessment: macro and micro.

On a macro level, we consider gas tax revenue to have a low historical volatility assessment given the critical nature of gasoline for automobiles and other transportation. Nationwide gasoline sales have historically fluctuated less than total consumption of goods and services, even despite severe economic downturns and price fluctuations, given the relative inelasticity of demand for motor fuel.

On a micro level, retail gas prices in the state have been on upward trajectory since 2016, and we are forecasting largely stable crude oil prices using the U.S.' most widely benchmarked index through 2022. These patterns have translated into uneven pledged revenue, with up and down years during the past decade, and a current four-year declining trend, although California Department of Finance projections point to a 1% increase for fiscal 2020. Adding to uncertainty, in our view, was a 2017 change to a flat per-gallon tax from one based on the price per gallon, but the change appears likely to have a moderating effect on revenue collections. In addition, we see potential for statewide demand for gasoline to decline given the small but growing market share for nontraditional powertrains, with IHS data showing electric and plug-in hybrid vehicles making up 8% of California auto sales for most of 2019.

#### **Obligor linkage: Close**

We believe the priority lien on pledged revenue provides some protection from operating risk. However, because pledged revenue is collected monthly by the city--which then is responsible for transferring the money to the trustees--we consider the flow of pledged revenue to be within the city's direct control. We also do not view the city as benefiting from a limited scope of operations or extraordinary expenditure flexibility. Under our criteria, this narrows the linkage between the priority lien pledge and the obligor's creditworthiness, as we believe pledged revenue has some exposure to operating risk.

## **Rating linkage to the City of Oxnard**

Our 'A' ICR on Oxnard limits our rating on its gas tax obligations because the ICR is more than a notch lower than our view of both series' stand-alone credit profile, but we see at least a one-in-three chance that we could raise the ICR during the next two years, which could lead us to raise our gas tax rating.

We think Oxnard is at the tail end of a period of institutional stress and political conflict, with ineffective wastewater utility management earlier in the decade leading to dramatic rate increases and political conflict culminating in a recall election that saw voters turn down the opportunity to replace the mayor and three council members. Concurrently, the city identified governance shortcomings in 2014 and requested an external evaluation, to which the city responded publicly and which we think the city has substantially addressed. Turnover in the city manager, deputy city manager, and chief financial officer roles may have slowed progress in improving governance, but city leadership has been making efforts to build confidence among stakeholders, with a recently adopted "sunshine ordinance" designed to go beyond the state's already robust transparency procedural requirements and a proposed ethics ordinance that will go before voters in March 2020. Although two lawsuits regarding the city's wastewater fees and use of wastewater resources for governmental cost recovery are still unresolved, fiscal 2019 general fund net results were positive and we see positive implications for long-term credit quality in the form of ebbing controversy over the city's multiyear wastewater rate increase plan and the city's ability to fill three senior management roles this year. We plan to continue to monitor the extent to which the city's management team stabilizes and how well the city manages cost pressures and the risk that a recession will slow or reverse tax revenue growth.

## **Outlook**

The positive outlook reflects our view of Oxnard as obligor because the city's creditworthiness caps the rating. Provided that the factors informing our view of the priority lien stand-alone credit profile remained comparable, we could raise our rating during the next two years if we saw evidence that the city were consolidating management gains, particularly if there were improvement in other factors informing our view of the city's creditworthiness, such as a swing to strong financial performance, strengthening in key economic ratios, or a formal plan to accelerate amortization of the pension liability.

We could revise the outlook to stable if we thought the city were having difficulty using its financial monitoring and planning tools to bring its operations back to balance in the medium term, or if we saw signs that organizational improvement had stalled such as from additional senior management turnover. We could also revise the outlook to stable if we saw a reemergence of wastewater rates as a source of political controversy that complicated the city's attempts to find consensus on budgeting decisions generally, or if we thought it was having difficulty managing contingent liabilities, such as an adverse outcome from utility user fee lawsuit.

## **Related Research**

U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed

*Summary: Oxnard, California; Gas Tax*

to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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