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Update

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Torrance (City of), CA

Rating Update - Moody's Affirms Torrance, CA's Aa2 Issuer Rating and A1 COP Rating, Outlook Remains Stable

Summary Rating Rationale

Moody's Investors Service has affirmed an Aa2 rating to Torrance, California's issuer rating. Moody's has also affirmed the A1 rating on the city's outstanding Series 2009 Certificates of Participation (COPs) totaling $17.3 million. The outlook remains stable.

The Aa2 issuer rating reflects the city's large and diverse tax base that is supported by strong resident wealth indicators. We expect continued moderate growth in the district's tax in the near term. The rating also reflects the district's stable financial profile that is characterized by ample reserves with a narrow but stable general fund cash position that is likely to remain below-average going forward. The city's debt burden should remain low and manageable given the strong economic growth. The city's elevated pension burden and high fixed costs (lease payments, OPEB and pension contributions) have also been incorporated into the rating.

The two notch rating distinction between the A1 rating on the city's lease-backed obligations and the Aa2 issuer rating represents the weaker security pledge for standard California abatement lease obligations and the additional risk to bondholders from the city's financial, operational, and economic conditions over the more secure general obligation pledge. A "lease pledge" is a contractual obligation, conditioned on use and/or occupancy of the least asset, effectively on parity with a city's other unsecured obligations. The city's issuer rating reflects what its secured, general obligation rating would be if the city issued such debt.

Moody's is currently evaluating comments we received on our proposed, methodological revisions to rating state and local government lease-backed obligations. Our comment period closed on December 2, 2015, and the publication of the final, revised methodology could affect the city's lease-backed obligation ratings. With respect to the city's abatement lease rating, we note that we have proposed to "eliminate the additional downward notch we currently assign for lease-backed obligations with abatement risk relative to lease-backed obligations with appropriation risk." (p.2)

Credit Strengths

» Large and diverse tax base

» Strong financial operations featuring sizeable reserves

» Sound resident wealth levels

Credit Challenges

- Elevated pension liability
- Rising pension costs
- High public safety expenditures

Rating Outlook

The outlook is stable and reflects the city's demonstrated ability to maintain a healthy financial position as well as the city's growing tax base and local economy.

Factors that Could Lead to an Upgrade

- Continued growth in assessed valuation
- Significant improvement in the city's financial position
- Continued work to address city's pension and benefit obligations

Factors that Could Lead to a Downgrade

- Significant deterioration in the city's financial position
- Protracted decline in the city's assessed valuation
- Weakening of the city's economic activity
- Inability to effectively manage retirement costs

Key Indicators

Exhibit 1

Torrance (City of) CA	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 23,450,789	$ 23,904,302	$ 24,024,022	$ 24,902,529	$ 25,927,077
Full Value Per Capita	$ 162,152	$ 164,355	$ 164,338	$ 169,197	$ 174,679
Median Family Income (% of US Median)	141.6%	140.8%	141.4%	143.8%	143.8%
Finances					
Operating Revenue ($000)	$ 153,467	$ 157,442	$ 158,795	$ 167,694	$ 179,235
Fund Balance as a % of Revenues	25.9%	35.0%	25.3%	23.6%	27.1%
Cash Balance as a % of Revenues	19.5%	19.7%	19.0%	20.5%	19.3%
Debt/Pensions					
Net Direct Debt ($000)	$ 62,175	$ 60,695	$ 59,470	$ 58,279	$ 57,300
Net Direct Debt / Operating Revenues (x)	0.4x	0.4x	0.4x	0.3x	0.3x
Net Direct Debt / Full Value (%)	0.3%	0.3%	0.2%	0.2%	0.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	3.2x	3.5x	4.0x	3.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	2.1%	2.3%	2.7%	2.7%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Moderate Growth in Tax Base Expected; Solid Socioeconomic Profile

Moody's expects moderate growth in the tax base to continue in the near term due to the large number of homes assessed below market value as well as new commercial development underway. . The fiscal 2016 total assessed value (AV) reached $26.8 billion, and far exceeds the median for the rating category of $14.9 billion for California and $2.6 billion nationally, with 3.6% growth over the prior year and a three-year growth rate of 2.7%. Torrance weathered the Great Recession better than most of California with only one small 1.3% decline in fiscal 2011. With two thirds of the secured AV in residential property and only modest recessionary drop in the median home sale price, that number is currently up over $600,000 and increasing, Torrance is a largely built-out community that has shown remarkable resilience in the tax base.

We expect the city's economy to remain healthy because of its location in the Greater Los Angeles area and the presence of large industrial employers. The city's proximity to the port complexes of Long Beach Port Facility (Aa2/Stable Revenue Bonds) and Los Angeles Harbor Department (Aa2/Stable Revenue Bonds), the Los Angeles International Airport (Aa3/Positive revenue bonds), and several major freeways make it an active player in the local economy with attractive infrastructure benefits to companies. The city has experienced significant growth in the retail sector in 2015 with a large expansion to Del Amo Fashion Center mall adding roughly 100 new stores and restaurants and the addition of two new high end car dealerships that will yield healthy sales tax receipts for the city.

There is some concentration in the tax base with the top ten taxpayers equaling 11.2% of AV. The taxpayers do however represent a diverse mix of industrial, retail, office, hotel, and multi-family residential properties. The top taxpayer in fiscal 2016 was ExxonMobil, owner of a petroleum refinery that suffered a catastrophic fire in February 2015. The property was sold to PBF Energy on July 1, 2016 for an undisclosed price, it will remain to be seen the impact this has on the tax base. Also of note is the divestment of Toyota Motor Sales USA Inc. Toyota is moving the majority of its operations to Texas and will leave a much smaller, one-third the size, footprint in Torrance. Management expects the ovearll impact to assessed value to be neutral as new businesses move into the current Toyota facility.

The city's fiscal 2016 full value per capita of $180,922 and MFI equal to 143.8% of US are somewhat higher than the medians for the Aa2 rating category of 119.6% nationally and 114% for California. Positively, employment in Torrance continues to increase and the unemployment rate was an extremely low 3.2% in April 2016, compared to 5.3% in California and 5.0% nationally for the same period.

Financial Operations and Reserves: Conservative Management Healthy Results Despite Volatile Revenue Source

We anticipate that as the economy continues to improve, the city's financial position will continue to strengthen though that may be somewhat muted by rising pension costs. Based on year-to-date figures, fiscal 2016 will mark the city's third consecutive operating surplus, maintain reserves at healthy levels.

While the city suffered decreasing revenues and deficit spending through the recession, in recent years the city has enjoyed stronger financial results as expenditure cuts and revenue increases have led to significant surpluses of 5% and 3% of general fund revenues in fiscal years 2014 and 2015, respectively. The fiscal 2015 total fund balance of $66.7 million (36% of revenues) is comparable to the median for national and state Aa2-rated cities. The year to date actuals for fiscal 2016 results indicate slight total fund balance increase of around $1.5 million due to revenues coming in higher than expected from increased sales tax and recovery of the utility user tax.

The Los Angeles metro area has been in a state of economic expansion which has led to an improved funding environment that should continue in the near term. Torrance, as a part of the this area has enjoyed in the economic gains. General fund revenues for the city have been steadily increasing over the last four fiscal years growing 15.6% since 2011. The city's utility users tax, which accounts for 18% of revenues, continues to be the most volatile revenue source for the city as utility usage fluctuates depending on the economic activity of the city's industries and residents. Recent disruptions in service of the Exxon-Mobil refinery slowed overall utility user tax receipts leading to a readjustment of projected revenue increases from a 3% increase to a 1.6% increase in fiscal 2016.

Historically, city management has adjusted expenditures when revenues have diminished. Moody's expects the city's expenditure reduction practices to help address the risks posed by the prevalence of economically sensitive city tax revenues. The city's practice of holding vacant positions open and cutting administrative expenses when revenues fall short is a credit positive.

As with many full service cities, public safety costs as a percentage of total operating expenditures continues be a large portion of the city's operating expenditures and will likely remain so for the predictable future. Public safety costs have increased from approximately $86.9 million or 54% of total operating expenditures in fiscal 2008 to $101.7 million or 58.6% of operating expenditures in fiscal 2015. Public safety costs will continue to be a high portion of the city's overall expenditures and has the potential to crowd out future financial flexibility.

LIQUIDITY

The city's year-end net cash balances have remained relatively stable and are expected to remain adequate for the rating category. Ending net cash balances (excluding TRAN receipts), have declined from a high of $44.7 million (26.5% of revenues) in fiscal 2007 to $30.9 million (16.7% of revenues) in fiscal 2015. Similar to the city's reserve position, we expect its liquidity position to remain stable.

Debt and Pensions: Low Direct Debt with Moderate Lease Burden; Outsized Pension Liability that Could Pose Budget Constraints in the Long-Term

The fiscal 2015 net direct debt represents just 0.2% of AV and $386 per capita, while the lease burden as a percentage of general fund expenditures is low at 2%. Payout of principal is slow but comparable to other California cities at 25.2% in ten years. Moody's expects the debt burden to decrease in the near term as management cited a City Council mandate to pay down existing debt and liabilities prior to issuing any future debt.

DEBT STRUCTURE

The city has all fixed rate certificates of participation ($57.1 million currently outstanding) and a small $155 thousand in capital lease obligations.

DEBT-RELATED DERIVATIVES

The city has not entered into any derivative agreements.

PENSIONS AND OPEB

The city's pension obligation continues to be a financial pressure point. Current contribution levels are manageable given the city's strong financial position, however California Public Employees' Retirement System (CalPERS) is projecting escalating contribution rates for all of its participants through 2021 which will create future budgetary pressure. The city has acknowledged this financial pressure and has taken some measures to address the unfunded liability such as contributing above its 2015 annual contribution ($3 million from one-time revenues related to a sale of property) and adjusted benefits for new hires.

As of fiscal 2015, the city contributed $30 million on behalf of their employees to the city's defined pension benefit plan provided through the CalPERS. The city's fiscal 2015 contribution to CalPERS as a percentage of general fund expenditures was 16.35%. These pension costs are projected to increase for the foreseeable future. When combining the city's fiscal 2015 CalPERS contribution with the fiscal 2015 debt service on the lease obligations, and OPEB contribution the city's debt burden as a percentage of total general fund expenditures increases to 19.67%, an above-average general fund obligation burden. The city also runs a small single employer pension plan that contributed $1.3 million in 2015.

Moody's 3-year average adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $707 million or, compared to other California cities, an elevated 3.95 times operating revenues and 2.73% of AV in FY 2015. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

OPEB

The city's OPEB plan currently has an unfunded actuarial accrued liability of $73.2 million or 69.7% of covered payroll at the end of fiscal year 2015. The city contributed 39.8% of the annual OPEB cost in 2015. The city has adopted a policy in fiscal year 2017 to pre-fund 100% of the OPEB annual required contribution at the beginning of the fiscal year which is seen as credit positive.

Management and Governance

California cities have an institutional framework score of "A," or moderate. Revenue predictability is moderate, because the primary sources are property taxes and sales taxes. Property taxes are very predictable, given the state's constitutional formula, known as Proposition 13, while sales taxes are economically sensitive. Revenue-raising ability is moderate because increases almost always require voter approval. Expenditure reduction ability is moderate, because of collective bargaining and growing pension and OPEB pressures. Expenditure predictability is high, as police and fire typically make up 60% of discretionary spending in full-service cities.

Legal Security

The lease revenue bonds are secured by payments made by the Public Facilities Financing Authority of the City of Torrance, which are the derived from rental payments made by the city to the authority for the use and occupancy of leased property.

Use of Proceeds

Not applicable

Obligor Profile

The City of Torrance is located in Los Angeles County (Issuer Rating Aa2/Positive) and has a large and diverse tax base that should remain healthy for the foreseeable future. The city is Los Angeles County's sixth largest with a population of 145,927 as of 2011 and borders the Pacific Ocean. Economic activity incorporates a wide range of services, including the headquarters of several auto manufacturers, auto dealerships, and a large regional shopping mall. Notable corporations headquartered in Torrance include Toyota Motor Sales USA, American Honda Motor Company, and ExxonMobil Torrance Refinery.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. An additional methodology used in rating the lease rental debt was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

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