FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Sacramento, CA's Golden 1 Center Bonds to 'AA'; Outlook Stable

Thu 16 Jan, 2025 - 5:18 PM ET

Fitch Ratings - San Francisco - 16 Jan 2025: Fitch Ratings has upgraded the following ratings of the City of Sacramento, CA:

--Golden 1 Center 2015 lease revenue bonds (LRBs) issued by the Sacramento Public Financing Authority to 'AA' from 'AA-'.

In addition, Fitch has affirmed the city's Issuer Default Rating (IDR) at 'AA+'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Sacramento (CA) [General Government]	LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
Sacramento (CA) /Issuer Default Rating - General Government/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

Sacramento (CA) /Lease Obligations - Non-Standard/1 LT	LT	AA Rating Outlook Stable	Upgrade	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The upgrade of the lease revenue bonds to 'AA' from 'AA-' reflects Fitch's view that the structure is now consistent with a typical lease obligation. Fitch rates the bonds one notch below the city's IDR due to the slightly higher optionality for lease/appropriation payments.

The city's revenue sources intended for debt service have matured from their "prospective" status since the bonds were issued in 2015. As the city anticipated when the bonds were sold, net revenues from its parking system and rental payments from the Sacramento Kings have usually been sufficient to cover debt service. However, the pandemic stressed parking revenues and caused lower lease payments from the Sacramento Kings, which invoked the force majeure clause in the lease agreement with the Sacramento Kings. These reduced revenues caused the city's general fund to temporarily provide some debt service assistance for two years.

The 'AA+' IDR incorporates the city's 'aaa' financial resilience given its high level of reserves relative to its low ability to raise revenues and midrange expenditure control. In fiscal 2019, city voters increased a sales tax supporting general fund services, which helped boost the city's financial cushion.

Despite this additional revenue source and other improving revenues, revenues have started to grow more slowly than expenditures, resulting in a projected $66 million deficit in fiscal 2025. To close this budget gap, the city council increased charges for services and eliminated vacant positions in the adopted fiscal 2025 budget. Fitch expects the city will continue taking proactive steps to address out-year budget gaps and maintain its reserves at levels that support a 'aaa' financial profile.

The 'AA+' IDR is supported by continued population growth, the city's large size, diverse economy and above-average education retainment levels. The city's unemployment rate consistently tracks above the national rate, and income levels are slightly below Fitch's portfolio median (when adjusted for price parity), resulting in a midrange demographic level assessment.

The city's long-term liability burden is weak given its high debt and net pension liabilities when compared with both resident personal income and total revenues. Fixed costs associated with debt service and adjusted for benefits contributions accounted for about

19% of total governmental expenditures in fiscal 2024, which is on the higher range in Fitch's portfolio.

The IDR incorporates Fitch's application of an Additional Analytical Factor of +1.0 due to the city's economic and institutional strength as the state capital and an anchor within the Sacramento-Roseville-Folsom MSA.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Inability to align expenditures with revenues, resulting in imbalanced operations and the city's unrestricted fund balances used for general purposes falling below 25% of expenditures and transfers out, the minimum level needed for a 'aaa' financial resilience assessment;

--The long-term liability burden more than doubling when assuming no changes from current personal income levels, or total governmental expenditures or revenues.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A nearly 15% decrease in the long-term liability burden when assuming no changes from current personal income levels, or total governmental expenditures or revenues;

--A stronger demographic level assessment through the city's unemployment rate sustaining below the national rate combined with median household income levels trending consistently above Fitch's portfolio median.

SECURITY

The LRBs are payable from lease rental payments from the city (the obligor) to the Sacramento Public Financing Authority (the issuer) for use and occupancy of the arena. The city has covenanted to budget and appropriate lease rental payments from any legally available resource. The lease is subject to abatement risk and bondholders lack the right to foreclose on the property in a default.

FITCH’S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model generates Model Implied Ratings, which communicate the issuer's credit quality relative to Fitch's local government rating portfolio. (The Model Implied Rating will be the Issuer Default Rating except in certain circumstances explained in the applicable criteria.) The Model Implied Rating is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher (AAA), 9.0 (AA+), 8.0 (AA), and so forth down to 1.0 (BBB- and below).

Model Implied Ratings reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile and a structured framework to account for Additional Analytical Factors not captured in the Metric Profile that can either mitigate or exacerbate credit risks. Additional Analytical Factors are reflected in notching from the Metric Profile and are capped at +/-3 notches.

RATINGS HEADROOM & POSITIONING

Sacramento Model Implied Rating: 'AA+' (Numerical Value: 9.81)

-- Metric Profile: 'AA' (Numerical Value: 8.81)

-- Net Additional Analytical Factor Notching: +1.0

Individual Additional Analytical Notching Factors:

-- Economic and Institutional Strength: +1.0

Sacramento's Model Implied Rating is 'AA+'. The associated numerical value of 9.81 is at the upper end of the 9.0 to 10.0 range for a 'AA+' rating.

KEY RATING DRIVERS

FINANCIAL PROFILE

Financial Resilience - 'aaa'

Sacramento's financial resilience is driven by the combination of its 'Low' revenue control assessment and 'Midrange' expenditure control assessment, culminating in a 'Limited' budgetary flexibility assessment.

-- Revenue control assessment: Low

-- Expenditure control assessment: Midrange

-- Budgetary flexibility assessment: Limited

-- Minimum fund balance for current financial resilience assessment: >=25.0%

-- Current year fund balance to expenditure ratio: 48.6% (2023)

-- Lowest fund balance to expenditure ratio for the fiscal-year period 2019-2023: 41.3% Analyst Input (vs. 40.9% actual in fiscal 2019)

Revenue Volatility - 'Weak'

Sacramento's weakest historic three-year revenue performance has a modest negative impact on the Model Implied Rating.

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenues dating back to 2005): 8.4% decrease for the three-year period ending fiscal 2012

-- Median issuer decline: -4.7% (2023)

Fitch is using fiscal 2024 audited unrestricted general fund balance levels when compared to total general fund expenditures and transfers out.

DEMOGRAPHIC AND ECONOMIC STRENGTH

Population Trend - 'Midrange'

Based on the median of 10-year annual percentage change in population, Sacramento's population trend is assessed as 'Midrange'.

Population trend: 1.1% 2022 median of 10-year annual percentage change in population (58th percentile)

Unemployment, Educational Attainment and MHI Level - 'Midrange'

The overall strength of Sacramento's demographic and economic level indicators (unemployment rate, educational attainment, median household income [MHI]) in 2023 are assessed as 'Midrange' on a composite basis, performing at the 43rd percentile of Fitch's local government rating portfolio. This is due to high education attainment levels offsetting midrange median-issuer indexed adjusted MHI and elevated unemployment rate.

-- Unemployment rate as a percentage of national rate: 130.6% 2023 (20th percentile), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 35.8% (2022) (66th percentile)

-- MHI as a percent of the portfolio median: 94.4% (2022) (42nd percentile)

Economic Concentration and Population Size - 'Strongest'

Sacramento's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the Metric Profile are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 525,297 (2022) (above the 15th percentile)

-- Economic concentration: 40.8% (2023) (above the 15th percentile)

Demographic and Economic Strength Additional Analytical Factors and Notching: +1.0 notch (for Economic and Institutional Strength)

The one-notch increase for economic and institutional strength reflects the city's role as a core component of the Sacramento-Roseville-Folsom MSA, which has a real metro product equal to 0.8% of U.S. GDP. In conjunction with the city's size, it serves as the state capital providing a stabilizing employment institution.

LONG-TERM LIABILITY BURDEN

Long-Term Liability Burden - 'Weak'

Sacramento's liabilities to governmental revenue have deteriorated while carrying costs to governmental expenditures and liabilities to personal income remain moderately weak. The long-term liability composite metric in 2023 is at the 32nd percentile, indicating a somewhat elevated liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 6.7% Analyst Input (38th percentile) (vs. 6.6% 2023 Actual)

-- Liabilities to governmental revenue: 212.6% Analyst Input (34th percentile) (vs. 221.7% 2023 Actual)

-- Carrying costs to governmental expenditures: 18.9% Analyst Input (24th percentile) (vs. 19.6% 2023 Actual)

Direct debt, governmental revenues, and governmental expenditures reflect audited fiscal 2024 numbers.

PROFILE

Sacramento is California's state capital and sixth-largest city with approximately 525,000 residents. The city's economy is driven by the government sector but has been diversifying into healthcare, education and business services.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

FITCH RATINGS ANALYSTS

Graham Schnaars
Director

Primary Rating Analyst
+1 415 732 7578
graham.schnaars@fitchratings.com
Fitch Ratings, Inc.
One Post Street Suite 900 San Francisco, CA 94104

Karen Ribble
Senior Director
Secondary Rating Analyst
+1 415 732 5611
karen.ribble@fitchratings.com

Pascal St Gerard
Senior Director
Committee Chairperson
+1 415 732 7577
pascal.stgerard@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

U.S. Public Finance Local Government Rating Criteria (pub. 02 Apr 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

U.S. Local Government Rating Model, v1.2.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Sacramento Public Financing Authority (CA)	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of

Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.