S&P Global
Ratings

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Summary:
Mill Valley, California; Appropriations; General Obligation

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Credit Profile		
US$6.345 mil certs of part (Capital Improvement Financing And Refing Proj) ser 2021 dtd 08/20/2021 due 10/01/2051		
Long Term Rating	AA+/Stable	New
Mill Vy ICR		
Long Term Rating	AAA/Stable	Affirmed
Mill Vy GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Mill Valley, Calif.'s $6.345 million series 2021 certificates of participation (COPs). At the same time, S&P Global Ratings affirmed its 'AA+' underlying rating (SPUR) on the city's series 2011 COPs. Additionally, S&P Global Ratings affirmed its 'AAA' rating on the city's series 2008 taxable pension obligation bonds (POBs). Finally, S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on the city. The outlook on all ratings is stable.

Lease rental payments made by the city, as lessee, to the Mill Valley Public Financing Authority, as lessor, secure the 2021 COPs and outstanding appropriation debt. The city has pledged its best efforts to seek appropriations annually out of its operating budget and has considered the affordability of the lease payments in its long-term plans. In our view, the lease features and terms identified in our criteria are standard, with no unusual risks regarding timely payment of debt. Under the agreements, the city can abate lease payments in the event the leased property is damaged or destroyed. To mitigate the risk of abatement in such a case, the city has agreed to maintain at least two years of lease-interruption insurance as well as casualty insurance equal to the full replacement cost of the damages. In addition, we evaluated the seismic risk of the leased asset pursuant to our criteria and the leased assets meets our criteria for seismic risk during the life of the obligations. The transaction documents do not require the city to fund a debt service reserve. In accordance with our criteria, we do not view the lack of a debt service reserve as a significant credit weakness, because payment due dates occur at least three months after the start of the city's fiscal year (July 1). We rate this obligation one notch lower than the city's general creditworthiness to account for the appropriation risk associated with the lease payments. Proceeds from the series 2021 COPs will be used to refund the city's outstanding 2011 COPs and finance capital improvement in the city.

The outstanding POBs are obligations of Mill Valley and are payable from any source of its legally available funds. We rate the city's POBs on par with its general creditworthiness, reflecting our view that its ability to pay the obligation is closely tied to its operations, and that the revenue used to secure the city's POBs is not limited in scope, or distinct and separate from its general fund.

The city's POBs are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. We do not expect the city to default in a stress scenario likely to accompany a sovereign default given autonomy from sovereign intervention. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," U.S. local governments are considered to have moderate sensitivity to country risk. We view the city as exhibiting relatively low funding interdependency with the federal government, as local derived revenues represent the majority of total governmental funds revenue. However, consistent with our view that U.S. state and local governments are moderately sensitive to country risk, we would be unlikely to set ratings on the city's POBs more than two notches above the U.S. sovereign rating.

The ICR reflects our view of the city's general creditworthiness and does not incorporate the features of any particular debt instrument.

Credit overview

Mill Valley's general credit characteristics reflect an affluent, highly desirable residential tax base in the vibrant Bay Area that exhibits above-average wealth and income metrics relative to those of similarly rated peers on a national scale. Despite its economically sensitive budget, management reports the COVID-19 pandemic and statewide shelter-in-place order did not have a material impact on the city's primary revenue streams and only minimally affected on the local economy. The city's credit stability and positive credit trends are largely attributed to its proactive management team, with formalized plans and policies that support the continued maintenance of its structurally sound financial profile through economic cycles. In our view, the city's favorable management practices and its trend of conservative budgeting, in combination with its very strong reserve level, will help stabilize any fiscal stress the city may experience.

The ratings further reflect our opinion of the following credit factors:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 47.3% of total governmental fund expenditures and 16.7x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 2.8% of expenditures and net direct debt that is 36.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Adequate institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's ESG risks relative to its economy, management, financial measures, and debt-and-liability profile. Although the city has elevated exposure to wildfire, flood, and seismic risks, we assess that state and local government management efforts in the wake of recent wildfires and floods as well as strong state building codes have substantially mitigated the risks. We also note the city participates in a hazard mitigation plan, which helps circumvents these risks to its tax base and other assets.

We consider the city's social and governance risk in line with our view of the sector standard. The city has addressed cyber security at the policy level, with a formal document governing management of this risk, and we understand that the city conducts regular employee education efforts and vulnerability tests.

Stable Outlook

Downside scenario

We could lower the ratings if the city were to experience sustained financial deterioration due to softening of key revenue streams or prolonged capital spending without making corresponding budgetary adjustments, resulting in a significant decrease in available reserves to a level that is no longer comparable with those of similarly rated peers.

Credit Opinion

Very strong economy

We consider Mill Valley's economy very strong. The city, with an estimated population of 14,550, is located in Marin County in the San Francisco-Oakland-Hayward, Calif., MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 283% of the national level, which we view as extremely high and a positive credit factor and per capita market value of $448,766. The city's market value grew by 5.7% over the past year to $6.5 billion in 2021. The county unemployment rate was 6.7% in 2020.

The city is primarily an affluent bedroom community, and residents have access to employment opportunities in the Bay Area economy. Additionally, the city is adjacent to recreational areas including Mt. Tamalpais to the west and the Golden Gate National Recreation Area on the south. The city's scenic beauty, high-end retail, and recreational activities generate economic activity through consumer spending by attracting a respectable number of visitors. Despite the effects of COVID-19 on some retail in the city, the majority of city general fund revenues come from property taxes, and they have not been affected by the pandemic.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Key policies and practice include:

- A budget formation process that incorporates external sources with an internal analysis of historical revenue and expenditure trends that incorporates external resources to help formulate budgetary assumptions;

- Quarterly reporting of budget-to-actuals;
- A 10-year financial forecast, updated biannually with the two-year budget;
- A five-year capital plan that is updated annually;
- A comprehensive debt management policy that includes limitations on annual debt service costs, variable-rate debt issuance, and refundings; and
- Maintenance of a fund balance reserve of at least 15% of expenditures for contingencies.

Strong budgetary performance

Mill Valley's budgetary performance is strong, in our opinion. The city had balanced operating results of 0.4% of expenditures in the general fund and 0.3% across all governmental funds in fiscal 2020.

The city ended fiscal 2020 with basically balanced general fund operations and continued transfers out of about $2 million to fund future capital projects. Management reduced expenditures for fiscal 2021 to mitigate the potential effects of pandemic-related revenue reductions. They instituted a hiring freeze and salary reductions for some staff.

The city expects to end fiscal 2021 with an additional $400,000 surplus. Management reports that this does not include any of the $3.2 million it expects to receive from federal American Rescue Plan (ARP) funds, including $1.6 million in each of fiscal 2021 and 2022. The city is awaiting further guidance on spending limitations for those funds before determining how they will be used.

The city expects an additional surplus for fiscal 2022. We expect the city will have at least balanced operations because of the additional ARP moneys, a stable revenue mix, and strong city management.

Very strong budgetary flexibility

Mill Valley's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 19% of operating expenditures, or $6.1 million.

Given that the city is projecting surpluses for the next two fiscal years and also significant additional ARP receipts, we expect that the city will continue to maintain reserves of at least 15% of expenditures, as its management policy requires. The available fund balance includes the committed fund balance for contingencies.

Very strong liquidity

In our opinion, Mill Valley's liquidity is very strong, with total government available cash at 47.3% of total governmental fund expenditures and 16.7x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

We expect that liquidity will remain very strong over the medium term as the city has no plans to draw down on reserves. We do not view the city's investments as aggressive as they are primarily invested in money market, federal agencies, and Local Agency Investment Fund. The city has issued COPs and POBs, and we view its access to external liquidity as strong.

Adequate debt and contingent liability profile

In our view, Mill Valley's debt and contingent liability profile is adequate. Total governmental fund debt service is 2.8% of total governmental fund expenditures, and net direct debt is 36.0% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, which is in our view a positive credit factor.

The city has no plans for additional debt plans and we expect that debt metrics will remain consistent

In our opinion, a credit weakness is Mill Valley's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Mill Valley's combined required pension and actual OPEB contributions totaled 14.9% of total governmental fund expenditures in 2020. Of that amount, 9.6% represented required contributions to pension obligations, and 5.3% represented OPEB payments. The city made its full required pension contribution in 2020. The funded ratio of the largest pension plan is 74.0%.

Pension and OPEB liabilities:

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for the city.
- The city funds OPEB beyond pay-go, and the OPEB is currently 37% funded.

The city participated in the following plans funded as of June 30, 2019:

- California Public Employees' Retirement System (CalPERS) miscellaneous pension plan: 74% funded with a net pension liability of $41.5 million.
- Single employer defined benefit health care plan: $22.9 million in net liability, and 37.3% funded.

The 2019 discount rate of 7.15% (on a GASB basis) for both plans is above our guideline of 6.0%, which we believe could lead to contribution volatility. However, this was reduced to 7.0% in 2021 and will be reduced further to 6.8% in 2022. While CalPERS' recent adoption of a 20-year, level dollar amortization approach for new gains and losses will lead to more rapid contribution increases and increased payment volatility, a shorter amortization period will provide a faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability, which we view favorably from a credit perspective.

Adequate institutional framework

The institutional framework score for California municipalities not required to submit a federal single audit is adequate.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 26, 2021)		
Mill Vy APPROP (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.