Research Update:

Berkeley, CA's 2025 Lease Revenue Notes Assigned 'AA' Rating

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Overview

- S&P Global Ratings assigned its 'AA' long-term rating to the Berkeley Joint Powers Financing Authority, Calif.'s anticipated $9.8 million 2025 lease revenue notes, issued on behalf of the City of Berkeley.
- At the same time, S&P Global Ratings assigned its 'AA+' long-term rating to the City of Berkeley's anticipated $35 million series 2025 general obligation series C bonds.
- Finally, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's general obligation (GO) bonds outstanding and its 'AA' long-term rating on the city's lease revenue debt outstanding.
- The rating action is based on the application of our methodology for rating U.S. governments, published Sept. 9, 2024, on RatingsDirect.
- The outlook is stable.

Rationale

Security

Lease payments by the city, as lessee, to the authority, as lessor, for the use of the leased assets secure the 2025 lease revenue bonds and the lease revenue bonds outstanding. In our view, the lease features and terms are standard for an abatement lease, and the leased asset meets our threshold for seismic risk during the life of the bonds. The city has covenanted to budget and appropriate base rental payments for the use of the leased assets. The transaction documents do not require a debt service reserve, but we believe that the 90-day gap from when the city budgets and when debt payments are due mitigates the risk of late budget adoption. The city may abate base rental payments in the event of damage to or the destruction of the assets. To mitigate abatement risk in such a case, the city has covenanted to maintain rental interruption insurance coverage equal to the maximum lease payments due in any 24-month period.

Lease revenue proceeds will be used to finance capital improvements to buildings that the city leases for fire administration and training.

Revenue from an unlimited ad valorem tax on all taxable property in the city secures the 2025 series C GO bonds and GO bonds outstanding. The city has the power and obligation to annually levy these taxes for the bonds. Proceeds from the 2025 series C bonds will be used to finance the improvement and acquisition of affordable housing.

Credit highlights

The city's strong economic base anchored by the University of California, Berkeley, campus; a robust reserve and liquidity position; and comprehensive risk management and financial policies and practices support our view of creditworthiness. The city's high debt and liability profile limits further rating upside. (For more information on our view of California local governments and recent trends, see "U.S. Local Governments Credit Brief: California Counties And Municipalities Means And Medians," published Oct. 21, 2024.)

The city has a track record of positive operations, posting operating surpluses in six of the past seven years. In recent years, the city's operating performance has been positive, aided by higher local taxes and property tax revenue and prudent expenditure management. The city has committed to fund capital needs with excess revenue, leading to year-to-year volatility in transfers out of the general fund. The fiscal 2024 result primarily reflects a drawdown for capital. For fiscal 2025, management notes that general fund revenue is higher than budgeted because various tax sources are coming in above projections, while expenditures are below budget as a result of vacant positions. The city's five-year forecast indicates deficit spending through fiscal 2028, but we think that the forecasts are conservative and that the city has already taken steps to ease deficit projections. In November 2024, voters approved new parcel taxes and removed sunset provisions for some of the city's local tax measures; we think these actions further support financial stability. In our view, management proactively monitors budgetary performance and maintains some expenditure flexibility to potentially outperform forecast budget estimates and support maintenance of a healthy reserve position within the two-year outlook period.

We believe the debt and liability profile is high, primarily as a result of large pension and other postemployment benefit (OPEB) liabilities. We do not believe the city's 2025 lease revenue note bullet payment poses a liquidity risk. We understand the city plans to refinance the 2025 lease revenue note prior to maturity, with the goal of establishing a level debt schedule for the note. We note that the city has historically had adequate access to capital markets and could use some Measure FF Public Safety Fund revenue available to pay down a portion of the refinancing. The fund held $10.4 million as of fiscal 2024 and management reports that some of those funds could go toward a takeout of the bullet payment.

The rating further reflects our view of the city's:

- Location in the deep and diverse San Francisco Bay Area economy with above-average gross county product and incomes compared with the nation, and significantly healthier population growth than that of the county. Citywide assessed value continues to grow because of development activity and persistently high property prices. We expect this growth to persist given the city's steady development pipeline.
- Stable operating results with available reserves exceeding its formal minimum fund balance policy of 13.8% to 30% of general fund revenue. The city has no plans to use reserves in the

outlook period, and this, coupled with its historically positive budget variances, supports our expectation that its financial position will remain stable.

- Comprehensive management framework that includes forward-looking budgeting practices, embedded long-term planning processes, and robust policies. The city develops biennial budgets with adjustments and monitoring by management monthly, and by council at least a semiannual basis. The city maintains a five-year capital improvement plan, updated annually, that outlines projects and funding plans. The city has a five-year financial forecast that serves as a budgetary planning tool and is updated annually. The city maintains well-defined investment, debt, and reserve policies, with investments reported quarterly. Management is also taking measures to mitigate cyber risk.
- Moderate debt burden relative to the budget, with plans to issue about $22 million in remaining Measure O authorization bonds, though we do not believe this will materially worsen our view of its debt profile. The city has no alternative debt outstanding.
- Large pension and OPEB liabilities, with annual costs that we note are higher than those of similarly rated peers in the state and that we believe limit budgetary flexibility. The city has made some progress in addressing long-term liabilities by establishing a Section 115 trust, with a fiscal 2024 value of $26.4 million, and a city policy to annually add funds to the trust. Given the size of its pension liabilities, we think the Section 115 trust provides some flexibility in case of market volatility. We further note that net pension liabilities have increased statewide. (For more information, see "Pension Spotlight: California," published Oct. 17, 2023.)
- For more information on the context for how we evaluate California municipalities, see "Institutional Framework Assessment: California Local Governments," published Sept. 9, 2024.

Environmental, social, and governance

We view social risk as somewhat elevated as a result of individuals experiencing homelessness and high housing costs that put more people at risk of homelessness, especially during economic downturns. We believe that housing and services for individuals experiencing homelessness will continue to affect expenditures and remain a factor in budget decisions.

Although wildfires have affected California, we note that the city maintains hazard mitigation plans and that the lease revenue bond proceeds will support fire preparedness in the city. The city also has elevated exposure to seismic risk, but we believe that strong state building codes partly mitigate this risk.

We view governance factors as neutral.

Outlook

The stable outlook reflects our view that the city will maintain its nominally strong reserve position throughout the two-year outlook horizon, supported by diligent budgetary monitoring and proactive management practices. We view the city's ongoing tax base growth and place in the San Francisco Bay Area economy as supporting further stability.

Downside scenario

We could take a negative rating action if the city's financial performance deteriorates, leading to material reserve declines without a plan for replenishment, or if its debt profile worsens in such a way that hampers budgetary flexibility.

Upside scenario

We could take a positive rating action if the city's debt and liabilities were to moderate, particularly if the city were to significantly reduce its unfunded pension liability, all other credit factors maintained.

Berkeley, California--Credit summary

Institutional framework (IF)	2
Individual credit profile (ICP)	1.85
Economy	1.0
Financial performance	2
Reserves and liquidity	1
Management	1.00
Debt and liabilities	4.25

Berkeley, California--Key credit metrics

	Most recent	2024	2023	2022
Economy				
Real GCP per capita as % of U.S.	138	--	138	140
County PCPI as % of U.S.	153	--	153	152
Market value ($000s)	29,573,546	27,822,050	25,929,246	23,356,393
Market value per capita ($)	240,943	226,673	211,252	193,228
Top 10 taxpayers as % of taxable value	7.0	7.1	6.8	5.7
County unemployment rate (%)	4.5	4.5	4.1	3.2
Local median household EBI as % of U.S.	136	--	136	138
Local per capita EBI as % of U.S.	145	--	145	164
Local population	122,741	--	122,741	120,875
Financial performance				
Operating fund revenue ($000s)	--	261,783	241,248	232,595
Operating fund expenditures ($000s)	--	241,803	211,304	200,827
Net transfers and other adjustments ($000s)	--	(25,417)	(19,520)	4,393
Operating result ($000s)	--	(5,437)	10,424	36,161
Operating result as % of revenue	--	(2.1)	4.3	15.5
Operating result three-year average %	--	5.9	8.8	8.1
Reserves and liquidity				
Available reserves as % of operating revenue	--	22.9	35.9	37.6
Available reserves ($000s)	--	59,914	86,669	87,347
Debt and liabilities				
Debt service cost as % of revenue	--	4.3	3.6	2.8

Berkeley, California--Key credit metrics

	Most recent	2024	2023	2022
Economy				
Net direct debt per capita ($)	2,090	1,768	1,862	1,960
Net direct debt ($000s)	256,475	216,991	228,550	236,905
Direct debt 10-year amortization (%)	37	49	49	--
Pension and OPEB cost as % of revenue	--	16	16	14
NPLs per capita ($)	--	5,969	5,925	5,697
Combined NPLs ($000s)	--	732,615	727,292	688,681

Financial data may reflect analytical adjustments and is sourced from issuer audit reports or other annual disclosures. Economic data is generally sourced from S&P Global Market Intelligence, the Bureau of Labor Statistics, Claritas, and issuer audits and other disclosures. Local population is sourced from Claritas. Claritas estimates are point in time and not meant to show year-over-year trends. EBI--Effective buying income. GCP--Gross county product. NPL--Net pension liability. OPEB--Other postemployment benefits. PCPI--Per capita personal income.

Ratings List	
New Issue Ratings	
US$9,770,000 Berkeley Joint Powers Financing Authority, California, 2025 Lease Revenue Notes , (Fire Administration and Training Project) (Federally Taxable), dated: Date of delivery, due: October 01, 2029	
Long Term Rating	AA/Stable
US$35,000,000 City of Berkeley, California, 2025 General Obligation Bonds, Series C (2018 Election Measure O: Affordable Housing) (Federally Taxable), dated: Date of delivery, due: September 01, 2055	
Long Term Rating	AA+/Stable
Ratings Affirmed	
Local Government	
Berkeley, CA Lease Appropriation	AA/Stable
Berkeley, CA Unlimited Tax General Obligation	AA+/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.