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Fitch Upgrades California Tax Allocation Bonds.

Fitch Ratings-New York-13 April 2017: Fitch Ratings has upgraded nearly all its ratings on tax allocation bonds (TABs) issued by California Redevelopment Agencies (RDAs). The upgrades follow a review of the portfolio under Fitch's revised U.S. tax-supported rating criteria (released April 18, 2016).

The revised criteria introduced consistent scenario analysis to support the evaluation of the financial resilience of dedicated tax bonds. They also emphasize the structure's resilience to declines in pledged revenue relative to historical economic cyclicalities. In addition, positive credit events since the dissolution of the RDAs in December 2011, including the prohibition on issuing additional debt, have led Fitch to conclude that pledged revenues supporting most TABs can withstand more significant stress while still providing sound debt service coverage than was assumed in the prior ratings.

DISSOLUTION PROCESS PASSES FIVE-YEAR MARK

Legislation dissolving the RDAs (AB 1x 26) was upheld by the California Supreme Court in December 2011. The ensuing dissolution process included state-required procedures to insure that pledged incremental tax revenues were properly allocated and remitted to make timely TAB debt service payments. Early in the process, market participants including Fitch had significant concerns that these somewhat complicated and untested procedures might result in missed payments. It has since become clear that the procedures set forth by the state to insure timely bond repayment have become institutionalized.

REAL ESTATE MARKET RECOVERY

At the time of the RDA dissolution, there was uncertainty as to the pace and durability of the real estate market recovery. Statewide assessed valuation (AV) was flat in fiscal 2012 but had declined by 4% from its peak in fiscal 2009. Some RDA project areas suffered much greater declines. Uncertainty regarding the future direction of AV was heightened by the lag in timing between changes in market conditions and tax collections and the non-linear impact of changes in market values on property assessments created by Proposition 13. The amount of 'Prop 13 cushion,' or the difference between assessed and market value, varies based on a property's age or the date of its most recent resale.

Since fiscal 2012, the real estate market recovery has been strong in most parts of the state. Statewide AV was up 20% as of fiscal 2016, although a few project areas have not fully recovered. The Prop 13 cushion, which helped keep AV from falling more during the housing downturn, is being rebuilt.

STRONG RESILIENCE HIGHLIGHTED BY NEW CRITERIA

The combination of prior concerns about the sufficiency of state procedures and the direction of the real estate market led Fitch to be cautious in changing ratings for RDAs. Ratings have been stable to rising since dissolution but at a modest rate.

Fitch's review of dedicated tax bond structures under its revised criteria includes analysis of the

dedicated revenue stream's vulnerability to cyclical decline. Fitch considers the revenue stream's sensitivity to a 1% decline in national GDP as well as the largest aggregate decline in pledged revenues over the period covered by the revenue sensitivity analysis. The review period extends as far back as fiscal 1999. The analysis focuses on the cushion between pledged revenues and maximum annual debt service (MADS), taking both revenue sensitivity measures into account.

This analysis highlights the resilience of California TAB structures given generally sound debt service coverage, the inability to issue additional parity debt, and mostly moderate historical revenue declines. For a few, resilience to downturns is still a concern, but for most the high coverage cushions lead Fitch to believe the bonds would be well insulated even in a reprise of the Great Recession, which Fitch does not expect. The recovery has led to a rebuilding of the Prop 13 cushion between AV and market values, which should again provide a buffer in the event of another drop in real estate prices.

Tax base concentration continues to weigh on ratings, though many have become more diversified as AV has grown. The increased diversification further reduces Fitch's concerns about the ability of the project areas to generate sufficient revenue to repay the bonds.

SUCCESSOR ENTITIES REMAIN DISTINCT ENTITIES

Pursuant to the California Health and Safety Code, successor agencies are separate and distinct public entities and are therefore not exposed to the operating risks of the governments that have assumed responsibility for their operations. Given the limited scope of successor agency operations, Fitch does not assign them Issuer Default Ratings.

Contact:

Amy Laskey
Managing Director
+1-212-908-0568
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Karen Ribble
Senior Director
+1-415-732-5611

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com

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