Office of the City Manager

June 4, 2018

To: Honorable Mayor and Members of the City Council

From: DWR Dee Williams-Ridley, City Manager

Subject: Moody's Investor Service's Annual Issuer Comment Report

Attached is Moody's Investor Service's Annual Issuer Comment Report (AICR) on City of Berkeley, CA, dated May 11, 2018.

What is it?

The AICR is a research publication from Moody's which provides a single reference source for the most recent credit information on Moody's-rated local government issuers that access the markets infrequently. The AICR provides a summary of key economic, demographic, financial and operational information within the context of Moody's ratings methodologies.

Key Features of the Report

AICR's key features are the following:

1. Issuer Profile: Issuer background information, economic profile, and industry snapshot.
2. Credit Overview: Summary of finances, economy, debt and pensions used in rating analysis.
3. Sector Trends: Provides insight into the operating environment of similar issuers.
4. Key Indicators: Finances, debt/pensions, economy/tax base.
5. Graphs: Visual interpretation of key statistics table.

Purpose of the Report

Its primary purpose is to provide the bond market with updated credit information for US cities, counties and school districts, including many issuers with no current or recently published Moody's research. Many of these are small and infrequent debt issuer, but have ratings that Moody's reviews annually. Public Finance market participants benefit by having a single reference source of information about these less frequent debt issuers.

It is not an announcement of debt rating actions.

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Funds Covered in Moody's Analysis
Moody's analysis includes all governmental funds, except capital improvement funds: the city's General Fund, all Special Revenue Funds, including the Library Fund and all the Debt Service Funds in the financial calculations.

Summary of Moody's Conclusions
To recap the results Moody's credit overview and what it found in the sector trends:

1. **Credit Overview:** Berkeley has a very strong credit position, and its Aa2 rating slightly exceeds the median rating of Aa3 for US cities.

2. **Notable credit factors comments:**
   - Berkeley has an extensive tax base with a very strong wealth and income profile.
   - Berkeley has a robust financial position.
   - Berkeley has a modest debt burden.
     Berkeley has an unfavorably high pension liability.

3. **Sector Trends Comments:**
   - Economy / Tax Base:
     Berkeley's economy and tax base are exceptionally healthy, improving and are relatively favorable when compared to the assigned rating of Aa2. The median family income equates to a robust 180.9% of the US level. In addition, the City's full value of real estate properties ($16.2 billion) is significantly above the US median, and increased markedly between 2013 and 2017. In addition, the full value per capita ($133,629) is much stronger than other Moody's-rated cities nationwide.
   - Finances:
     Berkeley has a very healthy financial position, which is relatively favorable when compared to its Aa2 rating. The cash balance as a percent of operating revenues (57.5%) is well above the US median (35.4%), and saw an impressive increase from 2013 (37.4%) to 2017 (57.5%).
     However, although the fund balance increased from FY 2013 as a percentage of operating revenues (18.8%) to 22.4% in FY 2017, the FY 2017 percentage is lower than the US median of 32.5%.
   - Debt/pensions:
     The debt burden of the City is modest and is a credit strength relative to the assigned rating of Aa2. The net direct debt to full value (0.6%) is lower than the US median (1.2%), and was flat between 2013 and 2017.
     On the other hand, Berkeley has a very burdensome pension liability that is a weakness in relation to its Aa2 rating. The Moody's-adjusted net pension liability to operating revenues (3.8 times) far surpasses the US median of 1.46 times.

Actions Council Needs to Take As a Result of the Report

Staff believes that in order for the City to maintain its current bond rating (Aa2) that Council needs to continue its conservative policies that have resulted in a strong financial position for the City. If the pension obligation situation continues as it is or deteriorates, staff believes the City's bond rating will be downgraded.

Staff believes the City Council needs to pursue policies that result in increases in fund balances. The ratio of available fund balance to operating revenues (22.4%) for Berkeley is low compared to the US median (32.5%), and Berkeley's declined in FY 2017.

The City Council needs to aggressively deal with the deteriorating pension liability or the City is likely to face a downgrade in its bond rating. The City's ratio of net pension liability to operating revenues (3.82 times) is 2.61 times greater than the US median cities (1.46 times), and it actually worsened between FY 2016 (3.56 times) and FY 2017 (3.82 times).

Attachment

cc: Jovan Grogan, Deputy City Manager
Ann-Marie Hogan, City Auditor
Mark Numainville, City Clerk
Henry Oyekanmi, Director of Finance
Teresa Berkeley-Simmons, Budget Manager
Matthai Chakko, Assistant to the City Manager / Public Information Officer

MOODY'S INVESTORS SERVICE

ISSUER COMMENT
11 May 2018

RATING

General Obligation (or GO Related) [1]

Aa2	No Outlook

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City of Berkeley, CA

Annual Comment on Berkeley

Issuer Profile

The City of Berkeley is located in Alameda County in the East Bay region of the San Francisco metro area, approximately 10 miles northeast of San Francisco. The county has a population of 1,605,217 and a high population density of 2,176 people per square mile. The county's median family income is $97,145 (1st quartile) and the March 2018 unemployment rate was 2.9% (1st quartile) [2] . The largest industry sectors that drive the local economy are health services, professional/scientific/technical services, and retail trade.

Credit Overview

Berkeley has a very strong credit position, and its Aa2 rating slightly exceeds the median rating of Aa3 for US cities. Notable credit factors include an extensive tax base with a very strong wealth and income profile, a robust financial position, a modest debt burden, but an unfavorably high pension liability.

Economy and Tax Base: Berkeley's economy and tax base are exceptionally healthy and are relatively favorable when compared to the assigned rating of Aa2. The median family income equates to a robust 180.9% of the US level. In addition, the city's total full value ($16.2 billion) is significantly above the US median, and increased markedly between 2013 and 2017. Lastly, the full value per capita ($133,629) is much stronger than other Moody's-rated cities nationwide. The city benefits from the presence of University of California - Berkeley in addition to its proximity to San Francisco.

Finances: Berkeley has a very healthy financial position, which is relatively favorable when compared to its Aa2 rating. The cash balance as a percent of operating revenues (57.5%) is well above the US median, and saw an impressive increase from 2013 to 2017. That said, the fund balance as a percent of operating revenues (22.4%) is under the US median.

Debt and Pensions: The debt burden of the city is modest and is a credit strength relative to the assigned rating of Aa2. The net direct debt to full value (0.6%) is lower than the US median, and was flat between 2013 and 2017. On the other hand, Berkeley has a very burdensome pension liability that is a weakness in relation to its Aa2 rating. The Moody's-adjusted net pension liability to operating revenues (3.8x) far surpasses the US median.

Management and Governance: California cities have an Institutional Framework score [3] of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. California cities' major revenue sources can only be raised with voter approval, or, in the case of ad valorem property taxes, cannot be raised except to meet GO bond payments. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, California has strong public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

Sector Trends - California Cities

California cities will continue to benefit from a strong and improving state economy. Growing assessed value trends and resulting property taxes, as well as robust statewide sales tax growth, will continue to raise city property tax and sales tax revenues. Housing values statewide continue to increase and provide long-term strength to the state's cities. Employment trends are positive and will continue to boost the statewide economy, particularly in the high tech sector. California cities, however, remain exposed to growing long term pension and OPEB liabilities.

EXHIBIT 1

Key Indicators [4] [5] Berkeley

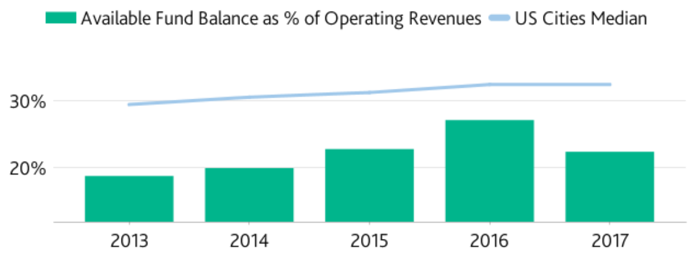
	2013	2014	2015	2016	2017	US Median	Credit Trend
Economy / Tax Base							
Total Full Value	$13,508M	$14,363M	$14,774M	$15,927M	$16,200M	$1,787M	Improved
Full Value Per Capita	$118,459	$124,161	$125,867	$134,313	$133,629	$88,380	Improved
Median Family Income (% of US Median)	173%	175%	179%	181%	181%	113%	Improved
Finances							
Available Fund Balance as % of Operating Revenues	18.8%	20.0%	22.8%	27.2%	22.4%	32.5%	Stable
Net Cash Balance as % of Operating Revenues	37.4%	43.8%	51.8%	55.8%	57.5%	35.4%	Improved
Debt / Pensions							
Net Direct Debt / Full Value	0.6%	0.7%	0.6%	0.6%	0.6%	1.2%	Stable
Net Direct Debt / Operating Revenues	0.38x	0.40x	0.38x	0.35x	0.35x	0.93x	Stable
Moody's-adjusted Net Pension Liability (3-yr average) to Full Value	5.3%	5.9%	5.9%	5.9%	6.5%	1.7%	Weakened
Moody's-adjusted Net Pension Liability (3-yr average) to Operating Revenues	3.23x	3.49x	3.65x	3.56x	3.82x	1.46x	Weakened

	2013	2014	2015	2016	2017	US Median
Debt and Financial Data						
Population	114,037	115,688	117,384	118,585	121,238	N/A
Available Fund Balance ($000s)	$42,074	$48,211	$54,695	$71,353	$61,712	$7,221
Net Cash Balance ($000s)	$83,771	$105,733	$123,980	$146,529	$158,233	$7,930
Operating Revenues ($000s)	$223,786	$241,216	$239,557	$262,596	$275,133	$21,262
Net Direct Debt ($000s)	$84,446	$95,575	$91,354	$90,611	$94,971	$18,822
Moody's Adjusted Net Pension Liability (3-yr average) ($000s)	$722,057	$841,821	$874,603	$934,796	$1,052,145	$29,896

Source: Moody's Investors Service

EXHIBIT 2

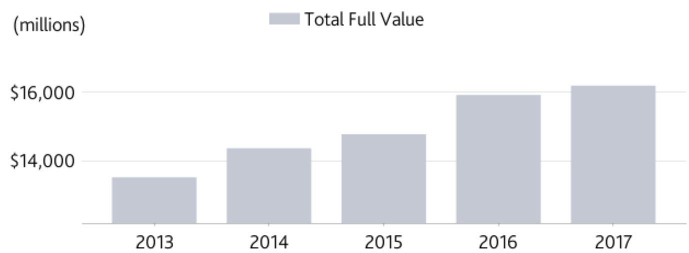
Available fund balance as a percent of operating revenues increased from 2013 to 2017



Source: Issuer financial statements; Moody's Investors Service

EXHIBIT 3

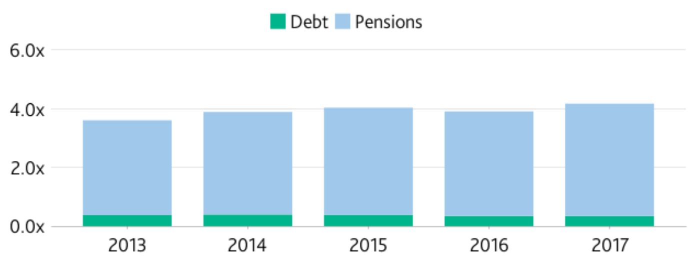
Full value of the property tax base increased from 2013 to 2017



Source: Issuer financial statements; Government data sources; Offering statements; Moody's Investors Service

EXHIBIT 4

Moody's-adjusted net pension liability to operating revenues decreased from 2013 to 2017



Source: Issuer financial statements; Government data sources; Offering statements; Moody's Investors Service

Endnotes

1 The rating referenced in this report is the issuer's General Obligation (GO) rating or its highest public rating that is GO-related. A GO bond is generally backed by the full faith and credit pledge and total taxing power of the issuer. GO-related securities include general obligation limited tax, annual appropriation, lease revenue, non-ad valorem, and moral obligation debt. The referenced ratings reflect the government's underlying credit quality without regard to state guarantees, enhancement programs or bond insurance.

2 The demographic data presented, including population, population density, per capita personal income and unemployment rate are derived from the most recently available US government databases. Population, population density and per capita personal income come from the American Community Survey while the unemployment rate comes from the Bureau of Labor Statistics.

The largest industry sectors are derived from the Bureau of Economic Analysis. Moody's allocated the per capita personal income data and unemployment data for all counties in the US census into quartiles. The quartiles are ordered from strongest-to-weakest from a credit perspective: the highest per capita personal income quartile is first quartile, and the lowest unemployment rate is first quartile.

3 The institutional framework score assesses a municipality's legal ability to match revenues with expenditures based on its constitutionally and legislatively conferred powers and responsibilities. See US Local Government General Obligation Debt (December 2016) methodology report for more details.

4 For definitions of the metrics in the Key Indicators Table, US Local Government General Obligation Methodology and Scorecard User Guide (July 2014) . Metrics represented as N/A indicate the data were not available at the time of publication.

5 The medians come from our most recently published local government medians report, Medians - Tax Base Growth Reinforces Sector Stability as Pension Troubles Remain (March 2017) which is available on Moodys.com. The medians presented here are based on the key metrics outlined in Moody's GO methodology and the associated scorecard.

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