FitchRatings

Fitch Affirms Menlo Park, CA's GO Bonds at 'AAA'; Outlook Stable

Fitch Ratings-New York-16 March 2017: Fitch Ratings has affirmed the following ratings for Menlo Park, CA at 'AAA':

--Issuer Default Rating (IDR);
--$10.1 million general obligation (GO) bonds, series 2009A and 2009B (federally taxable).

The Rating Outlook is Stable

SECURITY
The bonds are supported by an unlimited ad valorem tax levied on all taxable property in the city.

KEY RATING DRIVERS

The rating reflects the city's strong operating performance, which is supported by a history of strong revenue growth and solid expenditure flexibility, and low long-term liabilities.

Economic Resource Base
Menlo Park has a population of approximately 33,000 and is located midway between San Francisco and San Jose, adjacent to Stanford University. The city is primarily a residential community but also includes substantial employment in the technology sector, most prominently the headquarters of Facebook.

Revenue Framework: 'aa' factor assessment
Historical revenue growth has outpaced inflation and overall U.S. economic performance. Fitch expects continued above-average revenue growth based on ongoing tax base gains. The city's legal ability to raise revenues is constrained by state constitutional provisions that require voter approval for tax increases.

Expenditure Framework: 'aaa' factor assessment
Based on the city's current spending practices, and recurring operating surpluses, Fitch expects the natural pace of expenditure growth to be below revenue growth. Expenditure cutting flexibility is solid and fixed costs for debt service and pensions are moderate.

Long-Term Liability Burden: 'aaa' factor assessment
Long-term liabilities for overall debt and pensions are low relative to the city's resource base.

Operating Performance: 'aaa' factor assessment
Solid reserve levels contribute to strong gap-closing ability relative to revenue declines anticipated in a moderate recession. Financial flexibility is further supported by ongoing funding of capital needs from current resources.

RATING SENSITIVITIES
Financial Flexibility: The IDR is sensitive to shifts in fundamental credit characteristics, most notably Fitch's expectations for the city's ongoing strong financial flexibility throughout economic cycles.

CREDIT PROFILE

The city is situated in the heart of Silicon Valley and benefits from the technology industry's substantial levels of investment and ongoing wealth generation. Many of the nation's most prominent technology companies are headquartered in the region, which has also achieved fame for its ability to attract startup businesses. Unemployment rates are very low, and both property values and income levels are notably high.

Revenue Framework
Property taxes account for the largest share of support for city services at about 36% of general fund revenues in fiscal 2016. Sales taxes provide the second largest share at about 11%.

General fund revenues have historically outpaced overall U.S economic performance by wide margins. Fitch expects future revenue performance to remain strong based on continued tax base appreciation and general economic growth.

Like other California local governments, the city's independent legal ability to raise revenues is limited by state constitutional provisions requiring voter approval for tax increases. In 2007 Menlo Park voters authorized an increase to the utility users' tax that has not yet been fully implemented by the city. Management estimates that an additional $2.5 million (just under 5% of 2016 general fund revenues) could be generated if the city increased this tax to the maximum rate approved by voters.

This flexibility provides Menlo Park with exceptional revenue control for a California city.

Expenditure Framework
The city provides a broad range of municipal services with public safety accounting for about 37% of general fund expenditures in fiscal 2016. The city has also prioritized capital improvements and makes regular transfers out of the general fund in support of such activities.

Based on current spending practices and a history of revenue growth in excess of expenditures, Fitch expects the natural pace of future expenditure growth to be below revenue growth.

The city's ability to reduce expenditures is solid, and is supported by moderate fixed costs for debt service and pension benefits, which accounted for approximately 12.5% of governmental expenditures in fiscal 2016. The city's regular commitment of general fund surpluses to capital needs provides additional spending flexibility as such amounts could be reduced in the event of a budgetary imbalance. Capital transfers were notably high at $7.9 million in fiscal 2016 (more than 15% of general fund spending) and have regularly exceeded $2 million per year.

Long-Term Liability Burden
Long-term liabilities are low relative to the city's resource base at less than 8% of personal income. The city's direct debt obligations represent a small portion of long-term liabilities, which are dominated by overlapping school debt.

The city participates in several state-sponsored pension plans with typical actuarial assumptions. Pending changes in investment return assumptions could increase the reported net liability materially over the next several years, but Fitch expects the city's overall long-term liability burden to remain low as pension liabilities represent a small portion of this total. The city fully funded its other post-employment benefit (OPEB) liability in fiscal 2008.

Operating Performance
The city's gap-closing ability in a moderate recession scenario is very strong despite a history of above-average revenue volatility. Reserve levels of $30 million were equal to 50% of general fund spending in fiscal 2016, and the city retains additional flexibility from $19 million in unrestricted capital fund balance.

Budget management is conservative and the city has maintained strong reserves during the economic recovery while maintaining pay-as-you-go capital investments.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/879478)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1020681&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiN01CWkVRWFBLTU9DSjdHV1ZZWkQ2RkI2U0tQQTFEVVVDOVUwN1VCWCIsImV4cCI6MTQ5MDI5NDEwMiwidXNlckIkIjoxODAxNTA5fQ.kU1s-x4ciwoCB17dctod5T5lUHUKho0MZuVKSakMiGY)
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