S&P Global Ratings

One California Street, 31st Floor
San Francisco, CA 94111-5432
tel 415 371-5000
reference no.: 1572072

July 17, 2019

City of Aliso Viejo
12 Journey, Suite 100
Aliso Viejo, CA 92656--5335
Attention: Mr. David Doyle, City Manager

Re: ***US$12,260,000 Aliso Viejo, California, Certificates Of Participation, (Aliso Viejo Ranch), Series 2019, dated: Date of delivery, due: November 01, 2049***

Dear Mr. Doyle:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA+" . S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

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cc: ***Ms. Chelsea Redmon***
Ms. Gina Tharani
Warren Diven, Esq.

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Summary:

Aliso Viejo, California; Appropriations

Primary Credit Analyst:
Benjamin P Geare, San Francisco + 1 (415) 371 5047; benjamin.geare@spglobal.com

Secondary Contact:
Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@spglobal.com

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Summary:

Aliso Viejo, California; Appropriations

Credit Profile		
US$12.26 mil certs of part (Aliso Viejo Ranch) ser 2019 due 11/01/2049		
Long Term Rating	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the Aliso Viejo Public Facilities Corp., Calif.'s series 2019 certificates of participation (COPs), issued on behalf of Aliso Viejo. The outlook is stable.

Security and use of proceeds

Lease rental payments made by Aliso Viejo, as lessee, to the Aliso Viejo Public Facilities Corp., as lessor, secure the COPs. We rate these obligations one notch lower than the city's general creditworthiness to account for the appropriation risk associated with the lease payment. The city has pledged its best efforts to seek appropriations annually out of its operating budget, and has considered the affordability of the lease payment in its long-term plans. In our view, the lease features and terms identified in our "Issue Credit Ratings Linked To U.S. Public Finance Obligor's Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect) 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 abatement risk in such a case, the city will maintain at least two years of lease-interruption insurance as well as casualty insurance equal to the full replacement cost of the damages. The proceeds from the COPs will be used to support improvements and new construction at the city's Aliso Viejo Ranch project. The city has roughly $42.5 million in outstanding net direct debt--including the pro forma effects of this financing.

Credit overview

The city of Aliso Viejo's credit quality is anchored by its residents' extremely strong wealth and income levels, combined with the city's desirable location near the Pacific Coast between Los Angeles and Orange County. Importantly, the city has successfully leveraged this wealth to fortify the city's financial position. A long history of strong operating surpluses has allowed the city not only to maintain very strong budgetary flexibility, but also to keep debt burdens low by cash-funding much of the city's capital spending. In addition, the city's reliance on contracts for much of the services it provides, combined with its lack of legacy pension costs due to its relatively recent incorporation in 2001, has helped keep fixed costs associated with postemployment obligations low.

The rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2018 of 178% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.7x total governmental fund expenditures;
- Adequate debt and contingent liability profile, with no debt service paid from governmental funds and net direct debt at 164.6% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Adequate institutional framework score.

Very strong economy

We consider Aliso Viejo's economy very strong. The city, with an estimated population of 51,372, is located in Orange County in the Los Angeles-Long Beach-Anaheim, Calif., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 168% of the national level and per capita market value of $200,901. The city's market value grew by 5.8% over the past year to $10.3 billion in 2019. The county unemployment rate was 2.9% in 2018.

Aliso Viejo is about 50 miles southeast of downtown Los Angeles and 70 miles north of San Diego. The city is located very close to the Pacific Ocean in between Laguna Beach and Newport Beach. Residents have access to employment opportunities both within the city itself--the city is home to several large corporate offices--and throughout the Orange County and Los Angeles County metropolitan areas. Leading employers in the city include UPS (1,000 employees), Pacific Life Insurance (811 employees), and Capistrano Unified School District (679 employees).

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or regularly monitor all of them.

Highlights of the city's management practices include:

- A budget formation process that incorporates external sources with an internal analysis of historical revenue and expenditure trends;
- An annual budget process with budget-to-actual reports presented to the city council twice a year (supplemental budget revisions can be made to operating and capital expenditures at the midyear revision);
- A financial forecast--updated annually--that covers at least five years and incorporates historical information as well as current economic activity to project revenues and expenditures;
- A seven-year capital improvement plan, updated annually as part of the budget process, that identifies all known revenue sources to support potential projects in the current year;
- A formal investment policy that details permitted instruments and portfolio objectives and includes monitoring requirements with monthly presentation to council;
- A robust debt policy that includes qualitative limitations on issuing debt and annual monitoring requirements, but

lacks robust quantitative guidelines regarding the city's overall debt burden; and

- A minimum reserve and fund balance policy, adopted through council resolution, of 15% maintained for unforeseen emergencies or catastrophes, but total unreserved general fund balances are significantly above this level on a generally accepted accounting principles basis.

Very strong budgetary performance

Aliso Viejo's budgetary performance is very strong, in our opinion. The city had operating surpluses of 20% of expenditures in the general fund and of 13.1% across all governmental funds in fiscal 2018.

The city tends to pay for a significant portion of its capital projects with cash on hand. So, the city generally reports significant operating surpluses at audit. While the city is currently budgeting for a significant deficit in fiscal year 2020, its budget included the spending associated with the project funded by this issuance, in anticipation that the general fund would be repaid with COP proceeds. Once this is taken into account, the city is budgeting for a surplus in 2020.

The city's largest sources of general fund revenue are property tax (roughly $7.9 million, or 39%), sales taxes (roughly $6.5 million, or 32%), and transit occupancy taxes (roughly $1.6 million, or 8%).

We have adjusted general fund expenditures upward and the corresponding net transfers out to reflect ongoing transfers out for the aquatic center and other governmental funds.

Very strong budgetary flexibility

Aliso Viejo's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2018 of 178% of operating expenditures, or $30.3 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Based on budget projections for fiscal 2020, we expect the ending available general fund balance to remain significantly above 75% of adjusted expenditures in the current and subsequent fiscal years. We also note that the city's robust available fund balances mitigate some event-related risks, such as an earthquake, fire, or other event that might shock the city's economy, resulting in sustained reductions in revenue collection.

Very strong liquidity

In our opinion, Aliso Viejo's liquidity is very strong, with total government available cash at 1.7x total governmental fund expenditures in 2018. In our view, the city has satisfactory access to external liquidity if necessary.

The city has issued COPs in the past 20 years. We believe the city's investment policy restricts its ability to maintain an aggressive investment portfolio, and we have not identified any contingent risks that would jeopardize the city's liquidity. We expect our assessment of the city's liquidity to remain very strong.

Adequate debt and contingent liability profile

In our view, Aliso Viejo's debt and contingent liability profile is adequate. Aliso Viejo does not pay any debt service out of governmental funds, but net direct debt is 164.6% of total governmental fund revenue. Overall net debt is low at 0.7% of market value, which is in our view a positive credit factor.

Our calculation of the city's net direct debt, overall net debt, and debt amortization reflects our adjustments to include tax-secured debt associated with special purpose districts such as community facilities districts that the city has created to fund infrastructure. However, we do not include debt service on such debt in our calculations. The city has no plans to issue additional debt in the near term.

Aliso Viejo participates in a cost-sharing, multiple-employer defined-benefit miscellaneous pension plan managed by the California Public Employees' Retirement System. Aliso Viejo's combined required pension and actual other postemployment benefit contributions totaled 1.2% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018. The city's net pension liability (NPL) measured as of June 30, 2017, was $1.8 million. As of the same measurement date, the funded ratio of the city's only pension plan was 80.2%, using a discount rate of 7.15%. In our view, the city does not have a large unfunded pension obligation due to the small size of the NPL relative to the city's budget.

The city contracts for its public safety services through the county, and so associated pension costs for public safety employees are not broken out separately in the city's audit since the contributions are paid by the county. Therefore, while the city does make these payments indirectly, they are not fixed obligations of the city. Further contributing to the city's low pension burden is the fact that the city was incorporated recently in 2001, and so does not face significant legacy pension costs.

Adequate institutional framework

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

The city is currently pursuing some federal grants to support the Aliso Viejo Ranch project. Therefore, our assessment of the city's institutional framework could improve if the city becomes required to conduct a single audit over multiple years.

Outlook

The stable outlook reflects our view that the city's stable, affluent economy will remain very strong. The city's location adjacent to the Pacific Ocean, with access to both the Los Angeles and Orange County MSAs, lends stability to the rating. We also anticipate that the city will maintain very strong budgetary flexibility with very strong budgetary performance. We do not expect to change the rating during the two-year outlook time frame. If the city is unable to maintain balanced operations and reduces its budgetary flexibility to a strong level, we could consider lowering the rating.

Related Research

2018 Update Of Institutional Framework For U.S. Local Governments