

Rating Update: Moody's downgrades rating on City of Sunnyvale's COPs to Aa2

Global Credit Research - 18 Jan 2013

Aaa Issuer Rating confirmed; Outlook is stable

SUNNYVALE (CITY OF) CA
Cities (including Towns, Villages and Townships)
CA

Opinion

NEW YORK, January 18, 2013 --Moody's Investors Service has downgraded to Aa2 from the Aa1 the rating on the City of Sunnyvale's certificates of participation. We have also confirmed the city's Aaa Issuer Rating.

RATING RATIONALE

The downgrade creates a two-notch distinction between the COP rating and the city's Issuer Rating and reflects our changed view of the pledge supporting COPs versus general obligation bonds. We believe this pledge is relatively less secure than our prior estimates, both in terms of probability of default and likely losses in the event of default. Security for the underlying COP payments is a contractual pledge by the city backed by all of their available financial resources assuming the use and occupancy of the leased assets. This promise is notably in contrast to the stronger, voter approved general obligation pledge that provides a baseline for our estimate of the city's credit quality. Under California law, a city's GO pledge is an unlimited ad valorem property tax pledge. The city must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the city's general financial position. The relative performance of California cities' property tax bases and their financial profiles through the recent economic cycle, and likely continued divergence going forward, has resulted in our creating a greater distinction between these different types of pledges than we had previously.

The city's Issuer Rating reflects what the city's secured, general obligation rating would be if the city issued such debt. The confirmation of the Aaa Issuer Rating is driven by the city's large, growing, and dynamic tax base that features a wealthy population and a strong recovery from the economic downturn. It also incorporates the city's exceptionally strong budget management and financial profile, which notably includes paying pensions costs above its annually required actuarial contribution to more fully reflect what the city expects to be its actual long term costs.

STRENGTHS

- Large and wealthy Silicon Valley tax base
- Sound prospects for continued near-term economic growth
- Strong fiscal operations featuring healthy reserves

CHALLENGES

- Still uncertain statewide economy
- Taxpayer and industry concentration

DETAILED CREDIT DISCUSSION

LARGE SILICON VALLEY ECONOMY BENEFITING FROM A STRONG TECH SECTOR TO ACCELERATE FROM THE RECESSION

Sunnyvale is in the heart of the Silicon Valley 44 miles south of San Francisco and is in the midst of a robust acceleration from the recession. Much of this growth has been fueled by continued growth needs of large technology companies that have been expanding in the area. Companies such as LinkedIn, Apple, Juniper Networks, and Microsoft all underwent significant office expansions or renovations. As a result, fiscal 2012

developer fee revenue was actually higher than it has been in any prior year at \$14 million. The city estimates that it will receive about the same level of developer fee revenue in fiscal 2013, a strong turnaround from the nadir of this revenue category of about \$5 million in fiscal 2010. Approximately 6.4 million feet of commercial development is in process for 2013 not including 179 new residential units, an indication that the city continues to be a desirable commercial area of the Silicon Valley. Not surprisingly, each of the city's top ten employers are technology companies with Lockheed, Yahoo, and Apple comprising the top three. The city's unemployment rates, though elevated from its exceptional low of just under 3% in 2007, still remains well below both the state and national marks at 7.8%.

We anticipate that the city's already very large \$25 billion tax base will continue to grow in the short to mid-term. In 2013, assessed valuation grew by 3.7%, its second consecutive year of growth after absorbing a small 1.2% drop in 2011. A minimum growth rate of 2.5% is expected for 2014. However, we note that the city's exposure to the technology industry makes it susceptible to the type of sector-wide downturn that occurred in the early 2000's when unemployment exceeded the state mark. In addition, though the city and Silicon Valley as a whole are economically outperforming the state and nation, they are not immune to macro-economic fluctuations at the national or international level that could dampen future growth. Still, it is a strong credit positive that the city's economy, is exiting the recession at a faster rate than most portions of the country.

STRONG TRADITION OF CONSERVATIVE LONG TERM PLANNING RESULTS IN CONSISTENTLY ROBUST RESERVES

The city has long maintained very sound long term fiscal policies that set parameters for all elements of its financial operations. This includes 20-year budget and capital improvement plans that are continually revised to make sure the city is properly funding operations over the long term. The result of this consistent focus on conservative long range planning is that the city maintains exceptionally strong reserves. In fiscal 2012, the city's \$88.4 million in total reserves was 77.7% of total general fund revenues, an exceptionally strong level of reserves even for the rating category.

Like its property taxes, the city's sales taxes grew in fiscal 2012, at 4.3%, after falling sharply in 2009 and undergoing minimal growth in 2010. These revenues are also trending up for fiscal 2013 though they remain vulnerable to the capital spending of business, which can start and stop abruptly. Given the ongoing strength of the commercial sector and recovering home prices, the city's revenue base is likely to remain strong through fiscal 2013.

The city's largest expenditure component is public safety, accounts for 54% of the city's budget. The city uniquely employs "public safety officers", which means that all police officers are also trained firefighters and serve both purposes. Though this model costs marginally more to employ than traditionally separated fire and police operations, the city believes that it results in a much higher level of service, thereby making the community more supportive of public safety functions and their attendant costs. Sunnyvale has been the only city in the county to not undergo any layoffs or furlough days during the recession. Headcounts were reduced entirely through attrition, which has dropped the total number of employees from 918 in 2007 to 822 in 2012.

Reflective of its conservative approach to long-term fiscal management, the city is contributing 19% more than its ARC for its pension costs. The city adopted this approach to hedge against the possibility of future change in CalPERS, which the city does not think is conservative enough. The city also established an irrevocable trust to pay OPEB costs in 2009 and transferred \$10 million from its reserves to establish the fund. Despite this transfer, the city's general fund reserves remain exceptionally healthy.

VERY LOW DIRECT DEBT BURDENS AND MINOR VARIABLE RATE DEBT EXPOSURE

The city has two COPs that are ultimately obligations of the city's general fund, though in practice the general fund has had little exposure to debt service. These obligations create a direct debt burden of a very low 0.10% of total assessed value. The city's overall debt burden is more typical at 2.8%.

The city's 2009 Government Center COPs mature in 2031 and have total annual debt service of just \$433,000 or just 0.3% of total general fund revenues. Debt service has been paid from lease revenues and contributions from utilities and not encumbered the general fund. The leased asset is two parcels adjacent to the city hall complex. One parcel contains several buildings that are occupied by city staff and leased to commercial tenants. The other parcel is vacant.

The city also has a 1998 Parking COP that will mature in 2023. The total annual debt service payment of \$1.2 million is only 0.8% of the total general fund revenues, but had been paid from tax increment revenues from the

city's redevelopment agency. With the dissolution of the state's RDAs, the state has determined the 1998 Parking COP was not an enforceable obligation of the former RDA, and therefore has not permitted tax increment revenue to be made available for debt service. Absorption of debt service on the obligation is easily manageable by the city.

OUTLOOK

The stable outlook reflects our expectation that the city will continue to maintain an exceptionally strong fiscal profile, stable and wealthy economy and modest debt profile.

WHAT COULD CHANGE THE RATING UP

N/A

WHAT COULD CHANGE THE RATING DOWN

- Significant decline in cash and general fund reserves
- Significant and protracted deterioration of the city's economy

KEY STATISTICS

Assessed value, 2013: \$25.8 billion

Direct debt: 0.1%

Overall debt: 3.0%

General fund reserves as a percentage of general fund revenues: 77.7%

General fund cash as a percentage of general fund revenue: 63.1%

RATING METHODOLOGIES

The principal methodology used for the Certificates of Participation rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. The principal methodology used for the Issuer rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Michael Wertz
Lead Analyst
Public Finance Group
Moody's Investors Service

Eric Hoffmann
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA



© 2013 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance

independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for retail clients to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.