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Review finds default threat high for three Coachella Valley cities

Some dispute assessment of review

The financial troubles revealed in Desert Hot Springs in November were foretold two months earlier in a report that ranked the city as the 10th most likely in California to default on its debts.

The hard-luck city with amazing natural spas wasn't the only Coachella Valley city to get the warning. Cathedral City came in even higher at seventh of the 260 California cities reviewed in an expansive statistical analysis of debt, interest and revenues. A third area city, Coachella, also was deemed "at risk," coming in at 40 on a list ranking the probability of municipal bond default.

To better understand the risks to bond holders in the Coachella Valley, The Desert Sun analyzed the financial statements of the desert's nine cities and sister redevelopment agencies, which carry a combined $1.7 billion in bond debt. The money has been used to pay for roads, utility lines, an athletic complex, improvements to Palm Springs International Airport and the36-hole Indian Wells Golf Resort, among other projects.

The most recent financial statements available from Desert Hot Springs showed the city had $21 million in long-term obligations as of mid-2012 and is paying $476,250 in annual interest on $9.7 million borrowed in 2004 to help cover the cost of legal judgments that contributed to the city's bankruptcy in 2001. The mayor and City Council declared a fiscal emergency in November to allow for the draconian steps they say are necessary to avoid a second bankruptcy.

Even as the city cuts salaries by 20 percent, Mayor Pro Tem Russell Betts wants to pay off the decade-old judgment bonds to free up the nearly half-million dollars of yearly interest.

Payments on the bond's principal aren't scheduled to begin until 2023.

"My objective would be to find a way to eliminate that bond debt," Betts said, "because interest is a totally unproductive use."

Interest payments were heavily weighted in the September municipal bond report commissioned by the California Debt and Investment Advisory Commission, a division of the state Treasurer's Office. Co-author Marc Joffe told The Desert Sun in an interview last week that while subsequent analysis shows recent financial statements have marginally improved in Desert Hot Springs and Cathedral City, substantial revenue in the cities is obligated to pay debt interest and pensions.

Joffe found that in Cathedral City, 22 percent of revenues were going to pay pensions and interest, while in Desert Hot Springs, it was 20 percent. The average was 11 percent.

"The fact that those two cities have well above average uncontrollable costs is something that should be a worry to taxpayers and other stakeholders in the city," said Joffe, principal consultant with Public Sector Credit Solutions in Walnut Creek.

On average, the cities and counties reviewed by Joffe and co-author Matthew J. Holian, associate professor of economics at San Jose State University, had general fund surpluses equal to 58 percent of expenditures as of 2012, slightly above Desert Hot Springs' 53 percent. Cathedral City was below average at 34 percent. Coachella was at 57 percent.

"Stockton, San Bernardino and Vallejo ... were all negative or close to zero when they had a bankruptcy," Joffe said.

Desert Hot Springs is one of five California cities to declare bankruptcy since 2001. The city defaulted on its debt in 1999 and filed Chapter 9 bankruptcy two years later. The city's financial hardships went back further, to at least 1996, when its general fund balance fell below zero, the municipal bond report noted.

A look at other cities

Cathedral City declared its own fiscal emergency in 2010 as it grappled with plummeting tax revenues and an order to pay the state $11.45 million from its redevelopment agency.

Voter-approved measures to increase utility and sales taxes helped Cathedral City rebound, but Administrative Services Director Tami Scott said any significant hit to the city's revenues would be difficult to overcome.

Missed debt payments won't happen, Scott said. Most of the city's $213 million in outstanding debt is tied to its former redevelopment agency.

“We’re comfortable we’ll be able to meet our debt obligations,” said Cathedral City Mayor Kathy DeRosa.

The only debt tied to the city’s general fund is $4.4 million tied to a lease revenue bond for the city-owned Big League Dreams sports complex and debt payments come directly from a lease with the city to operate the park, Scott said.

“We’re 15 years into this and the value of the property is three times what the debt is,” she said.

Coachella Finance Director Bill Pattison said Joffe’s report is misleading about his city’s debt. Coachella’s bonds are repaid with utility and gas tax revenues, and are not draining money away from the general fund.

Coachella reported $96 million in debt as of last June, with $47 million tied to its redevelopment agency.

Joffe’s report classified Indio and Palm Springs as “moderately at risk” to default on municipal bonds, Palm Desert was categorized as “moderately safe” and La Quinta was “safe.” Because of smaller populations in Rancho Mirage and Indian Wells, the analysts did not examine those cities.

Indio Finance Director Rob Rockwell agreed with the report’s assessment of where the city stood in 2011, but he said corrective steps have been taken, including a utility tax increase, concessions from employees and layoffs.

“In 2011, you’re talking about the results of the recession,” Rockwell said. “We were just in a situation where we were trying to bring down spending to what the economy would generate through revenues.”

Palm Springs City Manager David Ready had not seen the municipal default report, but said it doesn’t account for the positive moves that have occurred since 2011 such as approval of the Measure J sales tax increase that voters authorized to fund development projects.

“There’s a lot more pieces to the puzzle of our economic health,” Ready said.

The recession was a significant drag throughout the desert, but in July the rating agency Standard and Poor’s upgraded Palm Springs’ credit rating a notch, which Ready noted was a sign of confidence in the city’s fiscal standing and could make it cheaper for the city to borrow in the future.

Recent rating agency reports have produced mixed results for Coachella Valley cities. Cities or their redevelopment agencies had their ratings affirmed or upgraded in most cases. But in September, Moody’s downgraded the successor agency for Cathedral City’s redevelopment agency from Ba1 to Ba3, citing limited debt coverage and falling property values. A Ba3 rating is meant to indicate substantial risk to investors and is on the stable end of the ratings scale for bonds considered junk bonds.

In December, Standard and Poor's downgraded Desert Hot Springs from A to A-, which the rating agency defines as "strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances." In its report, Standard and Poor's referenced the city's recently declared fiscal emergency, "recent poor budgeting" and the risk of bankruptcy.

A lower bond rating can make it more expensive for governments to take on more debt, since the rating is meant to give potential investors an indication of the risk involved. Cities deemed riskier will have to borrow money at higher interest rates.

A different view

The massive credit bill for $1.7 billion in city borrowing is paid down a few dollars at a time over decades as people fly out of Palm Springs International Airport, tee off at Desert Willow Golf Resort or mail a water payment to the city of Coachella.

City managers and finance directors said city debts across the valley are at reasonable and manageable levels. They and financial analysts who rate municipal debt said the amount of debt doesn't give a complete financial picture.

"Debt is one of many variables we analyze," David Jacobson, a spokesman for Moody's Investors Service, wrote in an email, "and the amount of debt is less important than how the debt is structured and what the municipality's ability to pay it back is."

Palm Springs had $42 million in debt from its redevelopment agency and $190 million tied directly to the city. Most of that debt has helped the city improve its airport, expand the convention center and pay retiree pensions.

The nearly $20 million in pension obligation bonds that the city took out in 2007 allowed Palm Springs to take advantage of an opportunity to borrow at a lower rate than what was available from the California Public Employee Retirement System and reap potential savings while covering about half of the city's unfunded pension obligation, said Suzanne Harrell, a consultant in Orange who works with Palm Springs on its bond financing. Payments on the principal of that debt are set to begin in 2019 and as of last June, the outstanding balance stood at just over $20 million.

The largest segment of city debt stems from the Palm Springs Convention Center. City residents voted in 2001 and again in 2003 to increase the city's hotel occupancy tax rate to cover the cost of expanding the convention center to make it more attractive to larger events. Debt for the convention center stood at $76.7 million as of last summer, and the city could be paying on the debt over the next 20 years.

Those expansions have allowed events such as the Palm Springs International Film Festival to grow, generating hundreds of millions of dollars for local and regional businesses, especially the hotels and spas that generate the occupancy tax.

Harrell said Palm Springs is unique in its borrowing needs. It's not a large city, she noted, but serves as a regional hub with attractions like the airport and convention center.

In Palm Springs, the convention center bonds are technically paid from the general fund, but there's also a specific revenue source, the increased hotel occupancy tax, earmarked for those payments.

Ready said he expected the City Council to decide soon whether Palm Springs should borrow money to upgrade its library, a project that could cost as much as $14 million. Other downtown renovations could be funded by Measure J.

"We've been very selective about what we've done this bonding on," Ready said. "The (City) Council, I suspect, would be open to it if it made sense for the city and the community."

Coachella may consider a bond to expand the city-controlled water and sewer systems, but that debt would be largely covered by more customers hooking into the system, Pattison said.

Officials in other cities said they don't anticipate more borrowing in the next five years.

"I'd put my foot down," said Cathedral City's Scott.

With $448 million in bond debt, Palm Desert has the largest bond obligation of any city in the valley. But according to Joffe's analysis, Palm Desert has its finances in order. Based on 2012 financial reports, Joffe ranked Palm Desert as the ninth least likely government at risk of default among 276 California cities and counties. The city's pension and interest obligations were near average, but it got a boost because of a general fund balance that was 180 percent of annual expenses.

Leaders in Palm Desert were big believers in redevelopment projects and tax increment financing, using increased property tax revenues to cover the cost of capital investments. Before Gov. Jerry Brown moved to abolish redevelopment agencies, Palm Desert's RDA was one of the wealthiest in California.

John Wohlmuth, Palm Desert city manager and executive director of the RDA successor agency, said that while RDAs helped cities pay for projects with broad public benefits, the perception among some people was that the money was mostly benefiting developers.

"The majority of these bond funds were for improvements that our residents and visitors enjoy," he said, pointing to the widening of Highway 111 in Palm Desert as just one example.

Wohlmuth doesn't anticipate Palm Desert needing to borrow from of its general fund in the near future, even without the use of redevelopment agency borrowing. The city will instead look at alternative help it can give developers, he said, possibly similar to an agreement approved in December to split transient occupancy tax money with the El Paseo Hotel expected to break ground in late May.

Wohlmuth and other city officials maintain that debts owed by redevelopment agencies, which the state moved to dissolve in 2011, are not obligations of the cities and shouldn't be lumped in with other debts.

Joffe, however, said that while there may be a legal separation between the cities and the successor agencies now managing the redevelopment debt, any defaults from redevelopment agencies would likely damage the city's image with rating agencies.

"It may be separately managed debt but it's still the same management," he said. "I think an investor would think if they can't get their act together to pay those (redevelopment) debts maybe they can't get their act together to pay their general obligations either."

Rancho Mirage owes $4.6 million in outstanding bond debt remaining from a 2005 refinancing of city library debt and new debt for the city's maintenance yard, making it one of four valley cities with less than $10 million in city bond obligations.

Rancho Mirage's RDA owes a much larger $133 million, which is below the average debt held by redevelopment agencies from the nine cities. The city has a low-interest loan from the state for an energy efficient cooling system at the city library and an interest-free loan from the Agua Caliente Band of Cahuilla Indians for improvements to Bob Hope and Dinah Shore drives. The loan from the tribe is repaid with money from developers.

"We're fortunate that the city has the reserves that it does (about $77 million) because it gives us options," Rancho Mirage Finance Director Isaiah Hagerman said. "Council can choose to pay out of reserves or over time with debt."

Indian Wells has no bond debt of its own, but its former redevelopment agency is paying off $132 million in borrowing.

The amount means the city of 5,000 people has a per capita debt load of $26,576. Each city resident would have to make a payment that size to completely eliminate the debt. All other valley cities had per capita debts under $10,000.

The debt in Indian Wells was equal to 3 percent of the city's assessed property values. Valley cities had debts ranging from 2 percent in Rancho Mirage to 6.5 percent in Coachella, according to a Desert Sun analysis.

In La Quinta, with borrowing for the defunct redevelopment agency no longer an option, the city may have to hold off on at least one project, City Manager Frank Spavecek said. La Quinta's former redevelopment agency is paying down $278 million in bond debt, the second most of any RDA behind Palm Desert.

La Quinta also has about $4 million in bond obligations for improvements to the La Quinta Civic Center. Spavecek said that debt is expected to be repaid in about five years.

With redevelopment agency debt no longer an option, La Quinta has delayed an expansion around SilverRock Resort until the city can secure an estimated $40 million needed to extend utility lines to vacant land, Spaveck said.

"At this point, without a dedicated funding source, we don't see an ability to borrow because we don't want to put the general fund at risk," he said.

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DATABASE: Coachella Valley city and redevelopment agency debt 2006-2013

City debt in the Coachella Valley

City	Total Outstanding Debt	City Debt	Redevelopment Agency Debt	Total Debt Per Capita	Total Debt/Assessed Value
Cathedral City	$ 213,113,000	$ 1,913,762	$ 211,199,238	$ 4,162.36	6.29%
Coachella	$ 96,002,052	$ 49,042,052	$ 46,960,000	$ 2,358.54	6.48%
Desert Hot Springs	**$ 60,498,451**	**$ 17,725,000**	**$ 42,773,451**	**$ 2,332.43**	**5.06%**
Indian Wells	$ 131,762,012	$ -	$ 131,762,012	$ 26,575.64	2.86%
Indio	$ 187,842,000	$ 114,362,000	$ 73,480,000	$ 2,470.44	3.19%

La Quinta	$ 283,212,803	$ 5,682,982	$ 277,529,821	$ 7,558.99	2.76%
Palm Desert	$ 448,492,352	$ 108,706,083	$ 339,786,269	$ 9,257.76	3.72%
Palm Springs	$ 238,583,138	$ 189,684,854	$ 48,898,284	$ 5,355.16	2.68%
Rancho Mirage	$ 137,845,000	$ 4,605,000	$ 133,240,000	$ 8,005.87	1.93%

Source: City financial statements and city officials