

RatingsDirect®

Summary:

San Jose-Evergreen Community College District, California; General Obligation

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Credit Profile

US\$68.62 mil GO rfdg bnds ser 2019 due 08/01/2041

Long Term Rating AA+/Stable New

San Jose-Evergreen Comnty Coll Dist GO bnds

Long Term Rating AA+/Stable Affirmed

San Jose-Evergreen Comnty Coll Dist GO bnds (Election of 1998)

Long Term Rating AA+/Stable Affirmed

San Jose-Evergreen Comnty Coll Dist GO (AGM)

Unenhanced Rating AA+(SPUR)/Stable Affirmed

San Jose-Evergreen Comnty Coll Dist GO

Unenhanced Rating AA+(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to San Jose-Evergreen Community College District, Calif.'s series 2019 general obligation refunding bonds (GORB). In addition, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating (SPUR) on the district's general obligation (GO) bonds outstanding. The outlook is stable.

The ratings reflect our view of continued strong tax base growth, which, as a result of the district's property tax revenue collection is above what the district would otherwise receive under the state funding formula, has further insulated the district from the state funding environment--leading to sustained improvement to our view of the district's budgetary flexibility.

Unlimited-ad valorem taxes levied on taxable property within the district secure the GO bonds. The Santa Clara County Board of Supervisors has the power and obligation to levy these taxes at the district's request for the bonds' repayment. The proceeds from the series 2019 GORB bonds will be used to advance refund a portion of the district's debt outstanding.

The ratings reflects our opinion of:

- The district's location in the heart of Silicon Valley with a very strong to extremely strong wealth and income profile;
- The district's revenue structure that is largely insulated from state funding decisions, as it is a basic-aid district, meaning revenues from property taxes exceed state apportionment;
- The district's record of maintaining strong reserves for the past four fiscal years, which we expect will continue; and

- The inherent operational flexibility of community colleges given their ability to control class sections and curriculum offerings, an operational feature not shared by kindergarten through 12th grade districts.

Partly offsetting these strengths is the district's high debt burden relative to its population size.

Economy

The district serves the eastern portion of Silicon Valley, including downtown San Jose, all of Milpitas, and portions of Santa Clara and unincorporated Santa Clara County. The district operates two colleges, a community college center for economic mobility, and a college extension. We estimate its median household effective buying income (EBI), to be 174% of the national level, which we consider very strong. Assessed valuation (AV) rebounded strongly in fiscal 2014, from a 6.5% peak-to-trough loss during fiscal years 2009 through 2012, to surpass the prerecession peak. Since 2015, the district's AV has been growing by about 7% annually, with growth of 7.5% to \$162.4 billion in fiscal year 2020. Market value per capita, a measure of wealth, is about \$182,386, which we consider extremely strong.

Finances and enrollment

Enrollment in community colleges generally trend opposite economic cycles, with higher demand during economic contractions and lower demand during expansions. The district is projecting funded full-time equivalents (FTEs) to be about 12,598 for the 2019-2020 school year, which is up from 12,231 and 11,905 for the 2018-2019 and 2017-2018 school years, respectively. During the past several years, the district has continued to improve its financial position through positive operations. In 2018 (audited), the district increased the unrestricted general fund balance to \$17.8 million, or about 12.2% of combined general fund expenditures (including transfers), which we consider very strong. This followed the fiscal 2017 deficit of \$1 million (or 0.9% of combined general fund expenses), resulting in an unrestricted general fund balance of \$17.4 million. However, according to management, much of the deficit in 2017 was the result of spending down grant funds. So, in our view, the district was operationally balanced. Management attributes the positive operations to the improved funding under the district's basic aid status as well as to its own expenditure reductions. Management indicates it anticipates another surplus for audited fiscal 2019 in line with fiscal 2018 results. For fiscal 2020, the district has budgeted for another modest surplus of about \$770,000 and management reports no material variances from budget to date. As a community college district, it is not subject to Assembly Bill 1463, which may limit school district reserve levels. In addition, we consider the district to have relatively low levels of funding interdependencies with the federal government.

Supporting the district's revenue structure is its participation in the Silicon Valley economy, which has seen robust growth in housing, commercial, and industrial values in recent years. Since fiscal 2013, the district has maintained basic-aid status, a term that refers to the district's ability to realize revenues above the state funding formula based on resident FTE student enrollment. The district reports its fiscal 2019 operating revenues are above what it would receive under the state funding formula by about \$39.5 million.

Management

We consider the district's management practices good under our Financial Management Assessment (FMA) methodology. An FMA of good indicates our view that practices exist in most areas, although they may not be formalized or be monitored regularly by governance officials.

Key management polices include:

- A budget formation process that incorporates an internal analysis of historical revenue and expenditure trends;
- An annual budget process with budget-to-actual reports produced every quarter and presented to the district board;
- A three-year financial forecast--updated annually--that incorporates historical information as well as current economic activity to project revenues and expenditures;
- A five-year rolling 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;
- Adherence to the county's investment policy that details permitted instruments and portfolio objectives with quarterly presentation to the board;
- A formal debt management policy adopted in compliance with Senate Bill 1029, which provides qualitative guidelines for issuing debt; and
- A minimum reserve policy of maintaining 7% of expenditures, or 2% above the 5% general reserve recommended by the state.

Debt, pension, and other postemployment benefit (OPEB) liabilities

The district's overall net debt burden is moderate to high, in our opinion, at about 3.2% of market value and \$5,490 per capita. In addition, amortization of direct debt is slower than average, with 45% of principal scheduled to be retired in the next 10 years and debt service carrying charges were elevated at 17.8% in fiscal 2018. About \$663 million remains from the \$748 million in unlimited-tax GO authority approved by the November 2016 Measure X authorization. The district plans to issue the remaining bonds in roughly four to five issuances likely about two to three years apart.

Included in the district's debt portfolio is alternative financing in the form of \$47.5 million in bonds to fund the district's OPEB liability. The district entered into a swap agreement to effectively fix its payments on these variable-rate obligations. Because the district's debt is rated more than two notches higher than the 'BBB' rating category trigger stipulated as an additional termination event for the swap, we consider the contingent liability risk associated with this liability to be manageable at the current rating level. We also note that the district had \$136.8 million in cash and cash equivalents on June 30, 2018--a sufficient amount to provide liquidity if necessary. In fiscal 2018, the district paid its full required contribution towards its pension obligation which translated to 4.8% of total operating expenditures. Because the district has a net OPEB asset, a payment was not required for the OPEB liability in 2018. Combined pension and OPEB carrying charges totaled 4.8% of total operating expenditures in 2018.

The district participates in defined-benefit pension plans managed by the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS). Using updated reporting standards in accordance with Governmental Accounting Standard Board (GASB) Statement No. 67 and 68, the district's net pension liability measured as of June 30, 2018, was \$66.7 million for CalSTRS and \$50.6 million for CalPERS. CalSTRS, its largest plan, maintained a funded level of 71.0%, using its fiduciary net position as a percentage of the total pension liability.

In addition, the district has an irrevocable trust dedicated to its long-term OPEB liability, which had a \$45 million balance at the end of fiscal 2018. While this money cannot be transferred back to the general fund, it can offset OPEB payments from the general fund should the board deem it necessary.

Outlook

The stable outlook reflects our view of expected continuing operating revenue growth facilitated by the district's strong financial position and strong momentum in tax base growth.

Upside scenario

We could raise the ratings during the next two years if revenue growth translates into sustainable and significant strengthening in reserves to levels comparable with those of higher-rated peers, particularly if reinforced by enhancements to the district's formal policies and reporting practices, leading to sustained improvement in the district's budgetary flexibility.

Downside scenario

We could lower the ratings if the district experiences a material weakening in financial performance and reserves fall below a strong level.

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