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Ratings

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Summary:

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

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Table Of Contents

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Credit Profile		
US$200.0 mil GO bnds (Election Of 2016) ser 2022C dtd 03/16/2023 due 09/01/2045		
Long Term Rating	AA+/Stable	New
US$38.0 mil GO bnds (Election Of 2016) ser 2022C-1 due 09/01/2032		
Long Term Rating	AA+/Stable	New
San Jose-Evergreen Comnty Coll Dist GO (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to San Jose-Evergreen Community College District, Calif.'s approximately $200.0 million election of 2016 series C, and $38.0 series C-1 general obligation (GO) bonds.
- In addition, S&P Global Ratings affirmed its 'AA+' rating on the district's general obligation (GO) bonds outstanding.
- The outlook is stable.

Security

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. Bond proceeds will be used to finance various capital improvement projects. Following these issuances, the district will have roughly $1.08 billion in total direct debt outstanding at fiscal 2023 year-end.

Credit overview

The rating is supported by the district's large and wealthy tax base located in the heart of Silicon Valley, its healthy reserves levels, and deeply entrenched community funded status, though we view its elevated fixed costs and high per capita debt burden as somewhat limiting credit factors. The district has reported positive operating results and improved its reserve levels during the past five years, with property tax revenue, the district's key revenue driver, growing steadily year over year. The district's total assessed valuation (AV) has been increasing at a healthy rate, supported by a tight housing market, but tax base growth may be tempered beyond fiscal 2023 by rising interest rates and potential economic pressures. Still, we expect the district's conservative budget practices to support structurally balanced operations and we believe the district's robust reserves provide ample flexibility should budgetary adjustments be needed over the next few years.

The rating also reflects our opinion of the district's:

- Inherent operational flexibility of community colleges, given their ability to control class sections and curriculum offerings;

- Good financial management policies and practices; and
- Manageable pension obligations, though pension costs are expected to escalate, and overfunded other postemployment benefit (OPEB) liability.

Environmental, social, and governance factors

The region is exposed to elevated wildfire, flood, and seismic risk. Although wildfires have broadly affected California, we do not consider wildfire within the district a significant credit risk given property values are concentrated in urban areas with little combustible vegetation. The district is exposed to inland flooding, particularly in north San Jose where properties lie within a high hazard flood zone. The district also has elevated exposure to seismic risk; however, we believe this risk is mitigated in part by strong state building codes. We view social and governance risks as neutral in our credit analysis.

Outlook

The stable outlook reflects our expectation that the district's tax base will continue to provide revenue flexibility to support its community funded status. Moreover, we expect the district will make the necessary budgetary adjustments to maintain healthy reserve levels.

Downside scenario

We could lower the ratings if the district experiences a material weakening in financial performance, resulting in a sustained deterioration in reserves at levels no longer supportive of the current rating.

Upside scenario

We could raise the rating if the district continues to sustain robust tax base growth and positive financial performance supporting continued growth in reserves levels that are comparable to those of its higher-rated peers, while moderating its high debt service costs relative to budget.

Credit Opinion

Economy and tax base

The district serves a large portion of San Jose, including downtown San Jose, all of Milpitas, and portions of Santa Clara and unincorporated Santa Clara County. The district's largely residential tax base has grown at a 6% average annual rate during the past five years, rising to $192.9 billion in fiscal 2023. Its largest taxpayers include Adobe Systems, Apple, and Google, but the tax base is very diverse with the top 10 taxpayers representing less than 3% of total AV. The district's wealth and income metrics are among the highest compared to its peers, with a median household effective buying income of 182% of the national average and market value per capita of $216,675 as of fiscal 2023. We recognize that rising interest rates could create downward pressure on the housing market and temper AV growth during the next few years, but we believe the region's tight housing market will support continued growth.

Funding and enrollment

As with most community college districts, its enrollment declined during the pandemic, but management reports that they are seeing a recovery in the current fiscal year. Because the district's local tax base generates property tax revenue that exceeds the state apportionment formula, qualifying it as community funded (formerly known as basic aid), the district's operating revenue is not dependent on the state's per-student funding mechanism. We believe the district's community funded status provides it with greater financial strength and flexibility given revenue is less affected by state budget cuts or full-time equivalent student fluctuations. The district is well into community funded status, with local revenue exceeding its entitlement under the state's funding formula by about $35 million. We expect continued AV growth within the district will support the district's community-funded status.

Finances

The district has reported positive operating results during the past five fiscal years and grown its available reserves to robust levels. At fiscal 2022 year-end, it reported a surplus of $5.3 million (3% of operating expenditures) and an available fund balance of $39.5 million (24%). The district's available fund balance does not include COVID-19 relief funds, and we understand the district has no plans to spend down its reserves during the next few years. For fiscal 2023, the district's budget reflects a $4.1 million (2%) deficit, but we understand the budgeted deficit reflects the spend down of restricted funds. The district uses conservative budget assumptions and has historically outperformed its budgets. We believe its community funded status and the strength of its tax base will continue to support revenue stability for the district. Though near-term economic pressures and a softening in the housing market could temper property tax revenue growth, we believe management's policies and practices as well as its robust reserve levels will help to support credit quality should revenue growth slow.

Financial management assessment

We consider the district's management practices good under our Financial Management Assessment (FMA) methodology. 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's 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, that identifies all known revenue sources to support potential projects;
- 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, which it has historically exceeded.

Debt

Though the district's large tax base helps mitigate debt-related risk, we view the district's elevated carrying charges as a somewhat limiting credit factor. We also view the district's overall net debt burden as high on a per capita basis at $6,326 but low on a market value basis at 2.9%. We consider debt service carrying charges elevated at roughly 24% in fiscal 2022. In addition, amortization of direct debt is slower than average, with 35% of principal scheduled to be retired in the next 10 years, after incorporating the current debt issuance. The series 2023 C and C-1 bonds represent the final tranche under the 2016 Measure X bond authorization, after which the district will not have any authorized but unissued bonds remaining. Officials report no plans to seek an additional authorization or to issue additional debt.

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 $161.5 million in cash and cash equivalents on June 30, 2022--which we consider sufficient to provide liquidity if necessary.

Pension and other postemployment benefit liabilities

We do not view pension liabilities as a near-term source of credit pressure for the district despite lower funding levels and our expectation that costs will increase. The district's OPEB liability is currently overfunded, which we view as a credit positive. The district has an irrevocable trust dedicated to its long-term OPEB liability, which had a $49.6 million balance at the end of fiscal 2021. 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.

The district participates in the following plans as of June 30, 2021:

- California State Teachers' Retirement System (CalSTRS): 87% funded with a net pension liability of $38.0 million;
- California Public Employees' Retirement System: 81% funded with a net pension liability of $47.8 million; and
- Single-employer OPEB plan: Net OPEB asset of $20.3 million.

For more information on our view of California pensions, see our report "Pension Spotlight: California", published July 13, 2021.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of January 10, 2023)		
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

Ratings Detail (As Of January 10, 2023) (cont.)

Many issues are enhanced by bond insurance.