S&P Global Ratings

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San Jose-Evergreen Community College District, California

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San Jose-Evergreen Community College District, California

Credit Profile		
US$325.0 mil election of 2016 GO bnds ser B due 09/01/2045		
Long Term Rating	AA+/Stable	New
US$100.0 mil election of 2016 GO bnds ser B-1 due 09/01/2049		
Long Term Rating	AA+/Stable	New
San Jose-Evergreen Comnty Coll Dist GO (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to San Jose-Evergreen Community College District, Calif.'s approximately $425 million election of 2016 series B, and series B-1 general obligation (GO) bonds. 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 district remains a community-supported district, which enables it to receive property tax revenue as its primary source of funding. We believe this gives the district much more financial flexibility and eliminates its dependence on maintaining growing enrollment levels under the state's funding formula. Additionally, the district's extremely strong local economy and assessed value (AV) levels, further support our expectation that the district's financial position will remain very strong, despite potential effects from COVID-19. We note that pension costs are expected to increase during the next several years, although we believe the district will be able to absorb cost increases through its projected growth in property tax revenue.

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 bonds will be used to finance various capital improvement projects of the district, consistent with its facility master plan. Following the issuance, the district will have roughly $905 million in total debt outstanding.

Credit overview

The rating 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;
- Revenue structure that is largely insulated from state funding decisions, as it is a basic-aid district, meaning revenue from property taxes exceed state apportionment;
- Record of maintaining strong reserves, which we expect will continue; and
- 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.

We understand that the district has formally declared a state of emergency due to the COVID-19 outbreak and its broader public safety concerns. This declaration mirrors similar ones made at the national, state, and local levels, and allows the district to be eligible for future assistance, while lifting spending restrictions. The district has been closed to the public effective March 17, 2020, to help reduce the spread of COVID-19. The district has since transitioned most classrooms to remote instruction and has determined that the remaining spring 2020 semester will continue through online instruction only.

Management has assembled an emergency operations center leadership team, which helps guide the district in possible scenarios as the COVID-19 situation progresses. The governor of California recently issued an executive order ensuring state funding for public schools even in the event of physical closure. In addition, the state chancellor's office has confirmed that districts will not suffer loss of apportionment if full-time equivalent student (FTES) counts decline during this state of emergency. We understand this will not directly affect the district in fiscal 2019, since the district's property tax revenue exceeded what the district would otherwise have received under the state's FTES funding mechanism. This situation, previously known as "basic aid" and now known as "community supported" status, means that the district receives property tax revenue generated from its local tax base as its primary source of funding instead of state revenues that were previously dependent on the level of enrollment, which we view as a credit strength.

While there is a high level of uncertainty regarding the duration and extent of the disruption from the COVID-19 outbreak and the related effects on the district's performance, including the ability to resume classes, future enrollment levels, and effect on property tax levels, we do not expect immediate pressure. Additionally, the district has strong liquidity with over $220 million in cash and cash equivalents as of June 30, 2019. We will closely monitor developments for any potential credit effects and take appropriate actions as deemed appropriate.

The stable outlook reflects our expectation that the district's strong local economy and affluent tax base will continue to provide ample revenue flexibility to support its community-funded status. We believe the district will make the necessary budget adjustments to allow it to maintain its very strong reserve levels.

Environmental, social, and governance factors

We analyzed the district's environmental, social, and governance risks relative to its market position, management, and governance and financial performance and determined that all are in line with our view of the sector standard.

Stable Two-Year Outlook

Downside scenario

We could lower the ratings if the district experiences a material weakening in financial performance and reserves fall below a strong level. Although we think the district has taken proactive steps to address COVID-19, and understand the virus to be a global risk, we could consider a negative rating action during the outlook period should unforeseen pressure related to the pandemic materially affect the district's demand or finances.

Upside scenario

Although we consider it unlikely during the next two years, we could raise the ratings if revenue growth translates into sustainable and significant strengthening in reserves to levels comparable with those of its 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.

Credit Opinion

Enterprise Profile

Economy and tax base

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 7.6% 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. Management has indicated based on conversations with the Santa Clara tax assessor that property tax readings for fiscal 2020 will likely not be directly affected by COVID-19. Although, the county may experience softening in the real estate market in the coming years, we understand there are no negative forecasts presented at this time.

Enrollment and state funding formula

As of fiscal 2019, the state's new funding formula will decrease the importance of FTES in the funding formula and increase the importance of student demographics and performance (although FTES will still be the greatest factor of importance). Management projects that the district will remain a community-supported district for the foreseeable future and it continues to receive property taxes as its primary source of revenue rather than the state's new funding formula, which we view as a credit strength.

The district's FTES enrollment has increased the past several years, despite some neighboring districts experiencing declines. The district budgeted for funded FTES of 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. Management has indicated that based on the spring 2020 census, FTES is expected to be above 13,000. Management remains focused on adding new certificates, developing dual enrollment programs, and enhancing the experience of students on campus.

The state's funding environment has improved in recent years for community college districts in California, after a history of state funding cuts. The governor's fiscal 2019-2020 proposed budget includes a $367 million increase in funding for community colleges, with a majority related to cost-of-living adjustment for apportionments. Adjusted for inflation, this would bring per-student funding to the highest levels since the passage of Proposition 98 in 1988. In addition, FTES may benefit from the California College Promise fee waiver; the governor's budget proposes an additional $40 million ongoing to cover a second year of enrollment fees for second-year students. We expect to monitor the effects of COVID-19 on the state's budget and expectations around funding over time.

Financial Profile

Finances

Unrestricted general fund balances have remained strong in our view during the past several years, in part due to the growing property tax revenue that the district receives from its growing AV and local economy. Based on the fiscal 2019 audit, the district ended the fiscal year with an operating surplus of roughly $8.6 million. This brought its unrestricted general fund balance up to $25.9 million or a very strong 17% of total general fund expenditures. This is primarily due to one-time revenue received in conjunction with Redevelopment Agency (RDA) liquidations along with prudent expense management. For fiscal 2020, the district initially budgeted for a $5.5 million deficit, although management has indicated results will likely post a modest surplus due to the repeal of the Cadillac tax burden associated with the Affordable Healthcare Act, which will no longer be a liability. The removal of this liability in the out years reflects a significant reduction in projected expenses. The district has qualified as a basic aid district since fiscal year 2012-2013 and its fiscal 2019 operating revenues are above what it would receive under the state funding formula by about $42 million.

Financial management assessment

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

The district's overall net burden is moderate to high, in our opinion, at about 3.3% of market value and $6,103 per capita. In addition, amortization of direct debt is slower than average, with 36% of principal scheduled to be retired in the next 10 years, after incorporating the current debt issuance. Debt service carrying charge is high at roughly 32% in fiscal 2019. Following the issuance of the bonds, approximately $238 million from the $748 million in unlimited-tax GO authority approved by voters for the November 2016 Measure X authorization will remain unissued. The district plans to issue the remaining bonds in possibly three years, depending on future project needs.

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 $220 million in cash and cash equivalents on June 30, 2019--a sufficient amount to provide liquidity if necessary.

Pension and other postemployment benefit liabilities

We do not view pension and other postemployment benefit (OPEB) liabilities as a near-term source of credit pressure for the district despite lower funding levels and our expectation that costs will increase.

While the district's pension contributions are set to increase for the next few years, the statutory funding policy for the district's larger pension plan mitigates the risk of dramatic cost escalation contributions because the state is required to absorb most of any needed future cost increases.

While the district is not making full actuarially determined contributions toward its OPEB liability, the district's practice of partially prefunding its liability, combined with the district's legal flexibility to alter OPEB benefits, limits adverse credit factors from its OPEB liability.

The district participates in the following plans as of June 30, 2019:

- California State Teachers' Retirement System (CalSTRS): 73% funded with a net pension liability of $66.6 million;
- California Public Employees' Retirement System: 70% funded with a net pension liability of $57.9 million; and
- Single-employer OPEB plan: Net OPEB asset of $10.6 million.

The district's required pension contributions totaled 5.8% of total governmental fund expenditures in 2019. Largely due to one-time supplemental state contributions, total actual 2019 CalSTRS contributions exceeded static funding, making some progress in reducing liabilities, but fell short of our assessment of minimum funding progress. Looking forward, the statutory funding plan requires the state, to raise funding up to 0.5% per year through 2046; and for districts to increase contribution rates each year through 2021, to achieve full funding by 2046. Also, the state is scheduled to make additional one-time supplemental contributions of $1.1 billion in 2020 and $802 million in 2021. Given that legal discretion for CalSTRS to increase rates to address any new unfunded liability caps district contributions to only slightly above the 2021 level, we believe the state would absorb most rate increases, if necessary, beyond the current schedule. This limits the risk of future cost increases to districts; however, if current actuarial assumptions are not realized, existing authority to increase state contributions may not be sufficient to eliminate new unfunded liabilities generated before 2046 without additional increases to district contribution rates beyond the existing legal limit.

In addition, the district has an irrevocable trust dedicated to its long-term OPEB liability, which had a $44.7 million balance at the end of fiscal 2019. 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.

Ratings Detail (As Of April 16, 2020)		
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 (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.