Moody's
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Contacts

Maddie Atkins +1.415.274.1725
Analyst
maddie.atkins@moodys.com

Alexandra J. Cimmiyotti +1.415.274.1754
VP-Sr Credit Officer
alexandra.cimmiyotti@moodys.com

San Jose - Evergreen Community Coll. Dist.,CA

Update to credit analysis following assignment of positive outlook

Summary

San Jose-Evergreen Community College District, CA (Aa1 positive) benefits from a robust and diverse tax base that is poised for additional healthy growth, strong residents' incomes and a healthy and strengthening financial position supported by deep entrenchment into community funded status. The district has a manageable debt and pension burden, and a fully funded OPEB liability.

On January 10, 2023, Moody's assigned a positive outlook to the district.

Credit strengths

» Extremely large and growing Silicon Valley tax base

» Strong resident incomes

» Sound and improved financial position supported by deep entrenchment into community funded status, which reduces exposure to variations or reductions in state funding

» Conservative fiscal practices

Credit challenges

» Rising pension costs common across all California Community College Districts

» Above-average balance sheet leverage from debt and pension

» Pandemic-driven enrollment declines, however community funded status provides financial stability

Rating outlook

The positive outlook reflects strengthening in the district's financial position and our expectation that management will maintain reserves at higher levels, supported by continued tax base growth and a manageable debt and pension burden.

Factors that could lead to an upgrade

» Sustained financial position at its current strong level

» Sizable decline in outstanding pension liability

Factors that could lead to a downgrade

- Protracted decline in assessed value
- A material deterioration of financial position, including reserves and liquidity

Key indicators

Exhibit 1

San Jose - Evergreen Community Coll. Dist.,CA

San Jose - Evergreen Community Coll. Dist.,CA	2018	2019	2020	2021	2022
Economy/Tax Base					
Total Full Value ($000)	$141,755,664	$150,932,461	$162,399,698	$172,045,539	$179,902,445
Population	894,215	894,215	894,215	894,215	894,215
Full Value Per Capita	$158,525	$168,788	$181,611	$192,398	$201,185
Median Family Income (% of US Median)	176.4%	176.4%	176.4%	176.4%	176.4%
Finances					
Operating Revenue ($000)	$212,556	$233,677	$221,799	$238,877	$249,194
Fund Balance ($000)	$77,269	$85,822	$79,599	$104,065	$102,786
Cash Balance ($000)	$136,757	$199,174	$108,525	$139,248	$161,520
Fund Balance as a % of Revenues	36.4%	36.7%	35.9%	43.6%	41.2%
Cash Balance as a % of Revenues	64.3%	85.2%	48.9%	58.3%	64.8%
Debt/Pensions					
Net Direct Debt ($000)	$580,148	$540,717	$929,240	$934,480	$1,079,496
3-Year Average of Moody's ANPL ($000)	$299,236	$318,502	$348,384	$422,880	$474,450
Net Direct Debt / Full Value (%)	0.4%	0.4%	0.6%	0.5%	0.6%
Net Direct Debt / Operating Revenues (x)	2.7x	2.3x	4.2x	3.9x	4.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.2%	0.2%	0.2%	0.2%	0.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.4x	1.4x	1.6x	1.8x	1.9x

Source: US Census Bureau, San Jose Evergreen CCD's financial statements and Moody's Investors Service

Profile

San Jose-Evergreen Community College District is located in Santa Clara County (Aa1 stable) and encompasses approximately 303 square miles in the heart of Silicon Valley, including a portion of the City of San Jose (Aa1 stable) and all of the City of Milpitas. The district operates San Jose City College (SJCC) and Evergreen Valley College, each of which is fully accredited by the Accrediting Commission for Community and Junior Colleges, in addition to its Community College Center for Economic Mobility and SJCC Extension at Milpitas. The district is governed by a seven-member board of trustees. The district's full-time equivalent students are projected at 10,569 for fiscal 2023.

Detailed credit considerations

Economy and tax base: large, diverse tax base will continue to experience healthy growth

San Jose-Evergreen Community College District has a robust and diverse tax base poised for continued healthy growth within the vibrant Silicon Valley economy. The district's assessed value (AV) reached $179.9 billion in 2022 after growing at a strong average annual rate of 6.% over the last five years. During and after the last recession, the tax base demonstrated resilience as it only contracted by 6.5% cumulatively. The size of the district's tax base compares favorably with the Aa1 national median for CCDs ($61.5 billion).

The tax base is mainly residential (74.3% of secured AV) and is diverse, with the Top 10 taxpayers contributing to just 2.8% of 2023 assessed value. The largest property owners are mainly apartment complexes and office buildings of major technology companies such as Adobe Inc. (A2 stable), Cisco Systems, Inc. (A1 stable) and Apple Inc. (Aaa stable).

Going forward, we expect the district's AV will continue to grow with the turnover of homes and with additional residential and commercial developments underway and anticipated, including ongoing office expansions of several large technology companies and service extension of the San Francisco Bay Area Rapid Transit District (Aaa stable) through the City of San Jose. Given the strong local economy, the area continues to absorb strong housing price appreciation; the current median sale price of a home in the area is around $1.17 million, double the district's median AV of $581,267.

The district has strong wealth measures with a per capita AV of approximately $201,000 and a median family income that is around 176.4% of the US. The City of San Jose's unemployment rate, which serves as a proxy for the district, has compared favorably with the state and the nation over the last decade and was 2.5% as of November 2022, below that of the state (4.0%) and the nation (3.4%) for the same period.

Financial operations and reserves: sound, improved reserve position supported by deep entrenchment in community funded status

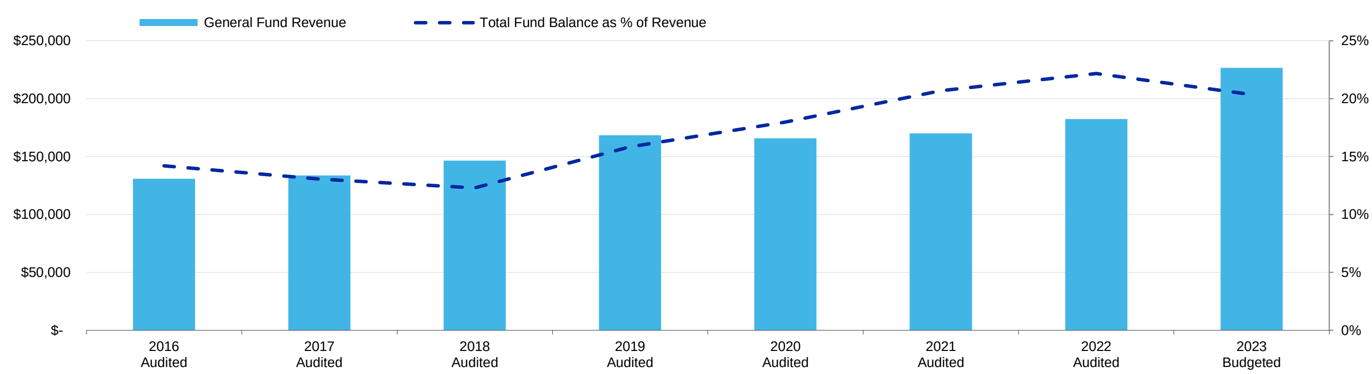
The district has a healthy financial position that has further improved in recent years, which we expect will remain stable given its deep entrenchment into community funded status and management's conservative fiscal practices.

The district ended fiscal 2022 with a sizable surplus of $5.3 million and available general fund balance reached an all-time high of $39.5 million or a solid 21.6% of general fund revenue. The surplus was driven largely because of strong local property tax receipts as well as stable staffing expenditures supported by a three-year agreement that began in fiscal 2021. Management expects to open negotiations for another three-year salary agreement in early 2023.

Available operating fund balance, which includes available general fund and bond interest and redemption fund reserves, totaled a healthy $102.7 million (41.2% of operating revenue). Management expects to close fiscal 2023 with another surplus of approximately $4.1 million, and multiyear financial projections also show continued additions to its general fund with no planned use of reserves in the near term. The district's projections are reasonable given that management has traditionally taken a conservative approach to financial planning, and has a strong history of outperforming budget. For example, revenue projections conservatively incorporates property value growth of 3.5% annually, compared to recent actual results that have consistently exceeded 5%.

Exhibit 2

San Jose-Evergreen CCD's general fund balance has continued to strengthen in recent years



Source: San Jose-Evergreen CCD's financial statements and Moody's Investors Service

The district has a formal policy to maintain unrestricted general fund at no less than 7% of annual expenditures, which it has consistently exceeded. In addition, the district has a stabilization fund, which was established in 2016. Management has a policy to transfer $250,000 of property tax revenue in any given year when property tax revenue growth exceeds 6% and an additional $250,000 in any given year when growth is above 7%. The current balance in this fund is $1.75 million (1% of general fund revenue).

As a community funded district, San Jose-Evergreen CCD receives more revenue from local sources than the level of funding it would receive under the state's funding model. In fiscal 2023, the district's local property tax revenue is projected to exceeded what it would otherwise receive under the state's student centered funding formula by $34.8 million (15.3% of projected 2023 revenue). Having strong local revenue is beneficial for the district's finances given the state's history of education funding challenges during economic downturns. The major risks of community funded districts include a material decline in AV and a large increase in enrollment. Positively, the district's AV demonstrated resilience during the last recession and enrollment growth prior to the pandemic was moderate.

Similarly to most California CCDs the district experienced a pandemic-driven decline in full time equivalent students (FTES) in fiscal 2021 and 2022 of -9% annually. Prior to the pandemic the district's FTES had increased moderately year-over-year because of increased marketing efforts and dual-enrollment initiatives. In fiscal 2023 management has begun to see gains in FTES and expects continued modest growth in enrollment in upcoming years, which should be manageable given the district's current facility and faculty capacity.

Liquidity

Similar to the district's reserve position we expect that liquidity will remain healthy. At the end of fiscal 2022 the district's operating cash position was strong at $161.5 million or 64.8% of operating revenue.

Debt and pensions: above-average debt and pension burden; fully funded OPEB liabilities

The district has an above-average debt burden which we expect will remain manageable with no anticipated future borrowing plans or new bond measures, in addition to continued growth in the tax base. The net direct debt represents a low 0.6% of AV, however, in relation to the district's size of operations, the debt burden is above average at 3.1 times operating revenue compared to the national median of Moody's-rated CCDs (1.0 times operating revenue). Post issuance of the 2023 Series C and Series C-1 GO bonds the district will have no remaining authorization under its Measure X.

Legal security

The district's general obligation bonds are secured by an unlimited property tax pledge of all taxable property within the district boundaries. Santa Clara County, rather than the district, will levy, collect and disburse the district's property taxes, including the portion constitutionally restricted to pay debt service on general obligation bonds.

Debt structure

The district's GO bonds are long-term fixed rate obligations with a final maturity in 2045.

The district's OPEB Bonds are privately-placed variable rate obligations with a final maturity in 2043 and subject to a mandatory tender on May 1, 2027. The bonds have an initial Libor index rate period ending on April 30, 2027, subsequent to which the district can elect various rate methods with a maximum rate of 12%. The variable rate bonds should not cause any undue stress to the district's credit quality since they only represent 5.1% of the district's total debt portfolio and are currently hedged with a fixed-payor swap. The OPEB Bonds are a general fund obligation and annual effective debt service currently represents a moderate 1.7% of general fund revenue.

Debt-related derivatives

The district’s variable rate OPEB bonds are swapped to fixed-rate through a swap agreement with Deutsche Bank AG (A1) that will expire on July 1, 2043. Under the swap, the district pays the counterparty a fixed payment of 4.239% and receives a variable payment based on the Libor index rate. The rating termination triggers for the swap are a function of the district’s and the swap provider’s ratings, with the district’s option to terminate if the counterparty’s rating falls below Baa1 and the counterparty’s option to terminate if the district’s rating falls below Baa2.

Pensions and OPEB

The district participates in CalPERS and CalSTRS multi-employer defined benefit pension plans. In fiscal 2022, the district reported net pension liability totaling $85.7 million using a weighted average discount rate of 7.12%. Moody's adjusted net pension liability (ANPL) for the district, using a discount rate of 2.84% under our methodology for adjusting reported pension data, was $476.5 million. The three-year average of ANPL represents a moderate 0.2% of AV or 1.9 times operating revenue.

The district's OPEB liability has been fully funded by proceeds of its OPEB bonds. As of fiscal end 2021, the district reported a total OPEB liability of $31.0 million and had $49.6 million in an OPEB irrevocable trust. Moody's adjusted OPEB liability for the district is

$41.3 million, also sufficiently covered by assets in the OPEB irrevocable trust. Moody's adjusted NOL reflects the use of the same discount rate we apply to pensions to improve comparability between pension and OPEB liabilities and across rated issuers.

ESG considerations

Environmental

Environmental risks are not a material credit driver for the district at this time. However, by virtue of its location in Santa Clara County, and in common with most of the state, the district has high exposure to water stress. Strong regional planning and investment will shield the district from immediate credit impacts, but drought conditions persistent.

Social

Social considerations are incorporated into our credit analysis of the district's profile but is not a key driver of the credit profile. The coronavirus pandemic had a deleterious effect on the district's enrollment in fiscal 2021 and 2022, though the credit risks are somewhat muted given the district's community funded status. In addition, resident wealth measures in the district are well above average as measured by median family income and full value per capita.

Governance

The district demonstrates good governance with conservative budgeting practices, which has supported the district's healthy financial position. The district currently has an interim chancellor under contract through June 30, 2023. District management is actively recruiting for a new chancellor with the expectation that the position will be filled by the start of fiscal 2024.

California CCDs have an Institutional Framework score of “A”, or moderate compared to the nation. California CCDs' major revenue sources are determined by the state government or, for the most part, can only be raised with voter approval. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

As a basic aid district, San Jose-Evergreen Community College District operates under a different funding model from most CCDs within the state. As discussed above, it is primarily funded from local property taxes, at a level that is substantially above the state guaranteed minimum. Therefore, the district's revenue predictability, especially during periods of state budgetary challenges, is somewhat higher than the typical district described by the Institutional Framework paragraph above. The district's expenditure flexibility is also potentially higher than average, given the relatively high revenue per student.

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