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Summary:

San Carlos School District, California; General Obligation

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Summary:

San Carlos School District, California; General Obligation

Credit Profile		
US$36.001 mil GO bnds (Election Of 2012) ser 2015 due 10/01/2046		
Long Term Rating	AA/Stable	New
US$11.655 mil GO rfdg bnds ser 2015 due 10/01/2025		
Long Term Rating	AA/Stable	New
San Carlos Sch Dist GO (ASSURED GTY)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) to 'AA' from 'AA-' on San Carlos School District, Calif.'s existing general obligation (GO) bonds due to the district's consistently strong finances, coupled with projected very strong reserves and budgetary flexibility. At the same time, Standard & Poor's assigned its 'AA' long-term rating to the district's series 2015 (election of 2012) GO bonds and series 2015 GO refunding bonds. The outlook is stable.

The ratings further reflect our view of the district's:

- Very strong income and wealth indicators, supported by its location in the Silicon Valley and proximity to San Francisco;
- Stable average daily attendance (ADA), which drives operating revenues under the state funding formula; and
- Above-average financial flexibility by state standards due to a voter-approved parcel tax that generated approximately 8.6% of expenditures in fiscal 2014.

Partly offsetting the above strengths is our view of the district's high debt burden on per capita basis, although it is low as a percentage of market value, and the district's reliance on state funding.

Unlimited ad valorem taxes levied on taxable property within the district secure the GO bonds. The San Mateo County Board of Supervisors has the power and obligation to levy these taxes at the district's request for the bonds' repayment. The county is required to deposit these taxes, when collected, into the bonds' debt service fund. We understand that the series 2015 GO bonds are being issued to finance specific construction, repair, and improvement projects, and the series 2015 GO refunding bonds are being issued to refund a portion of the district's outstanding 2005 GO refunding bonds.

In our opinion, financial performance has been strong in recent years, as the district posted consecutive surpluses during the past four audited years. The district ended 2014 with a $148,000 surplus and an available fund balance of $3.6 million, or 12.5% of expenditures, which we consider strong. Unaudited fiscal 2015 results reverse the trend with a deficit of $769,000, however, this was due to an $859,000 overpayment from the state to the district for its charter schools. After being notified that it would have to pay the money back to the state, the district recorded this sum as an expense payable in fiscal 2015 to be paid back in fiscal 2016. We do not believe this is a reflection of management or a trend as the district did not know this money would be taken back by the state. The district projects to end fiscal 2016 with a $1.7 million surplus, bringing available reserves up to 21.7% of expenditures, which we consider very strong. The district's liquidity is very strong in our opinion, with total government cash equivalents equal to 45% of total governmental fund expenditures in fiscal 2014.

We note that changes to state law may alter the financial management landscape for California school districts, including San Carlos School District, that have a consistent track record of maintaining fund balances in line with levels we view as strong to very strong. Its reserve level, which we consider strong, contributes to our view of its fiscal capacity to absorb unanticipated fiscal strain and, thus, to our rating. Under the new law, the maximum amount of reserves the district can retain is twice its minimum reserve requirement or 6% of budgeted general fund expenditures. If the law becomes operational and ultimately compels the district to spend down a portion of its combined assigned and unassigned general fund balances, this could affect our view of the district's credit quality, although we would first evaluate management's response. (For more information, see "Recent Changes To A California Law On School Districts' Reserves Result In Neutral To Negative Credit Implications" published July 7, 2014, on RatingsDirect.)

Despite what we consider extremely strong wealth, the district is not a basic-aid district, a situation in which local property tax revenue exceeds what the district would otherwise receive under the state funding formula. Supplemental revenue sources, however, can cushion the budgetary effects of state funding fluctuations. The district has a long standing history of parcel tax voter approval, and recently voters approved a parcel tax increase that generates $2.5 million annually, or roughly 8.6% of the district's general fund expenditures, which expires in 2021. The district also benefits from independent foundation donations, which have consistently generated $2.6 million annually or approximately 9.0% of expenditures.

Located in the southern portion of San Mateo County, midway between San Francisco and San Jose, the four-square-mile kindergarten through eighth-grade district serves a population of roughly 27,000 residents and is largely coterminous with the city of San Carlos. During the recession, assessed value (AV) only declined by 1.0% in fiscal 2011; since then, AV has increased to $7.8 billion in 2016, a 7.2% increase over the previous year's figure of $7.3 billion. This translates to $285,071 per capita, which we consider extremely strong. The district also has, in our view, very strong median household and per capita effective buying incomes at 209% and 239%, respectively, of the national levels. In 2014, San Carlos' unemployment rate rose by 0.6% to 4.2%; however, its unemployment rate remains significantly lower than both the state and national rates of 7.5% and 6.2%, respectively.

The district's ADA, which includes four elementary schools and two middle schools, dipped by 6.7% in fiscal 2012. Since, ADA has stabilized as the district posted a marginal decline of only 0.1% in fiscal 2013 and then an average annual growth of 1.7% in fiscals 2014 and 2015. We understand the district expects further growth of 2.8% to 3,092 students in fiscal 2016. Management has indicated that capacity will be about 4,000 once it completes its planned facilities expansion and modernization.

We revised our view of the district's financial management practices to "standard" from "good" under our Financial

Management Assessment methodology, indicating that the finance department maintains adequate policies in some, but not all, key areas. This revision reflects our view of the district's long-term financial planning and budget reporting policies, which are not reported beyond state guidelines. Key management practices and policies include revenue and expenditure projections that are based off of three years of historical data and a formal investment policy with monthly investment holdings and earnings reports to the board. The district has a facilities master plan, but it does not maintain a debt management policy and has failed to consistently adhere to its reserve policy of 17% of expenditures.

With this issuance, the district will exceed its available bonding capacity of $12 million. The district has requested a bonding capacity waiver from the State Board of Education, from which it expects approval. This would increase its statutory debt limit factor by 0.3%, bringing available bonding capacity to $43.4 million. After this issuance, combined direct and overlapping debt supported by district taxpayers stands at a high $8,952 per capita, but we believe it is somewhat offset by the district's very strong income profile. We consider the district's debt burden as a percent of market value low at only 3.1%. Debt service costs represented 10% of district expenditures in fiscal 2014, a level we consider moderate. Principal amortization is slow, with only 28% of debt due to be retired within 10 years.

The district participates in the State of California Teachers Retirement System and the State of California Public Employees Retirement System and contributed a combined $1.7 million in fiscal 2014. This represents its full required contribution and 4.5% of government-wide noncapital expenditures. The district offers other postemployment benefits (OPEB), which it funds on a pay-as-you-go basis. In 2014, the district contributed $104,000 toward its OPEB expenses, compared with an annual OPEB cost of $876,000. As of February 2014, the district had an unfunded actuarial accrued liability of $5.3 million.

Outlook

The stable outlook reflects our expectation that the rating will not change during the two-year outlook horizon. We expect the district will maintain a financial position that we consider strong relative to peers' as it continues to benefit from the affluent tax base and its participation in the San Francisco Bay Area.

Upside scenario

We do not expect to raise the rating during the two-year outlook horizon due to the district's reliance on state funding; however, a higher rating is possible if the district's funding sources were to diversify, therefore decreasing dependency on the state, and the district's tax base were to grow enough to back it away from the tax rate limit for debt issuance.

Downside scenario

We do not expect to lower the rating due to the district's community support through parcel taxes and foundation support; however, a lower rating is possible if available reserves as a percentage of expenditures were to decline from its current level, which we consider strong, to less than 8%, a level we only view as good. We could also lower the rating if the district's bonding capacity restraints were to limit its ability to accommodate growth.

Related Criteria And Research

Related Criteria

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of October 14, 2015)		
San Carlos Sch Dist GO bnds		
Long Term Rating	AA/Stable	Upgraded
San Carlos Sch Dist GO bnds (Election of 2005) ser A dtd 05/11/2006 curr int due 10/01/2008-2019 cap apprec due 2020 2022 2024 2026 2030		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
San Carlos Sch Dist GO rfdg bnds		
Long Term Rating	AA/Stable	Upgraded
San Carlos Sch Dist GO (MBIA) (MBIA of Illinois)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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