S&P Global
Ratings

RatingsDirect®

Summary:

Cypress Elementary School District, California; Appropriations; General Obligation

Primary Credit Analyst:
Cody J Nelson, San Francisco 415-371-5022; cody.nelson@spglobal.com

Secondary Contact:
Li Yang, San Francisco (1) 415-371-5024; li.yang@spglobal.com

Table Of Contents

Summary:

Cypress Elementary School District, California; Appropriations; General Obligation

Credit Profile		
Cypress Elem Sch Dist certs of part		
Long Term Rating	AA-/Stable	Upgraded
Cypress Elem Sch Dist GO bnds		
Long Term Rating	AA/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AA' from 'AA-' on Cypress Elementary School District, Calif.'s existing general obligation (GO) debt outstanding. At the same time, S&P Global Ratings raised its long-term rating to 'AA-' from 'A+' on the district's series 2013 certificates of participation (COPs). The outlook is stable.

The rating action is based upon the district's significantly improved available fund balances to a level that we view as very strong or above 25% of general fund operating expenditures, with expectations to remain at or near the current level along with strong growth within the local tax base.

GO and 2013 COP security

The bonds are secured by revenue from the district's unlimited ad valorem property tax pledge, which obligates the district to annually levy taxes on taxable property within the district without limitation as to rate or amount such that legally available funds are sufficient to make principal and interest payments. The Orange County Board of Supervisors has the power and obligation to levy these taxes at the district's request for the bonds' repayment. We currently rate the district's election of 2008A, series 2011B, election of 2008B, and series 2015 refunding bonds.

The series 2013 COPs represent an interest in lease payments to be made by the district as lessee to the Cypress School District Public Financing Corp., as lessor, for the use of Juliet Morris Elementary School. The district has covenanted to budget and appropriate lease payments during the life of the obligations and to maintain a debt service reserve fund at the least of 1.25x aggregate annual lease payments, maximum annual lease payments, or 10% of net proceeds of the certificates. The trust agreement associated with the COPs allows the district to satisfy the reserve requirement with a credit facility, but we believe that debt service occurring four months after the beginning of the district's fiscal year also partially mitigates the risk of late budget adoption. In addition, the improvements on the property meet our criteria for seismic risk during the life of the certificates and the district has covenanted to maintain 24 months of rental interruption insurance to partially mitigate abatement risk. As a result of the risk associated with appropriation-related obligations, we notch the rating on the COPs one-notch below the GO rating.

The 'AA' ratings reflect our opinion of the district's:

- Broad and diverse local economy with strong and very strong income and wealth indicators;

- Maintenance of a very strong available fund balance position with very strong recent performance;
- Good financial management policies and practices; and
- Stabilized to potentially growing enrollment trend.

Partly offsetting the above strengths, in our view, is the district's:

- Limited revenue generation outside of the state's enrollment-driven funding formula;
- Debt amortization that we consider average, as about 48% of its debt is expected to be paid off within 10 years; and
- Relatively low state pension funded level, which could lead to future pressure on its operating performance.

Economy, incomes, and district overview

The six-square-mile district in Orange County serves about 49,000 people and is centered upon its namesake, Cypress, approximately 25 miles southeast of downtown Los Angeles and 11 miles west of Anaheim. The district serves a relatively affluent residential community that includes sections of La Palma and Buena Park. The district's proximity to the Los Angeles–Orange County regional economy has led to good to strong economic growth within the district. As a result of the district's access to the Los Angeles–Orange County metropolitan statistical areas (MSA), we consider the district's income levels to be very strong to strong, as evidenced by median household effective buying income (EBI) of 143% of the national level and per capita EBI at 109% of the national level. For comparison, the Los Angeles city median household EBI is approximately 94% or 490 basis points below the district's median household EBI.

Tax base

The district's assessed value (AV) trend remains very positive, as the recently released AV of $6.36 billion in fiscal 2018 is approximately 4.8% above the fiscal 2016 figure and is now about $1.4 billion (or 29%) above the district's fiscal 2012 figure of $5.07 billion. This AV year continues the district's trend of strong to stable AV growth as the district has six consecutive years of AV growth that varies between 1.0% and 5.2% annually. We also note that the district's historical AV is fairly resilient as the district only shed about 1.4% (or about $74 million) of its tax base during the height of the economic recession or a figure below the regional averages for the period.

A key factor sustaining the district's stable AV trend is its tax base concentration in residential AV contributors, as the category typically provides about three-quarter of the district's total AV; led by single-family residences at 66% of the entire tax base. Other tax base figures to note include the district's market value per capita of approximately $130,000, or a level that we view as very strong; and the district's top 10 taxpayers as a percent of total AV reaching only 7.9%, or a level that we view as very diverse.

Looking ahead, we are anticipating continued AV growth at or near the historical trend. Overall, we are forecasting stable-to-positive growth for the western U.S. pacific states as continued home-price appreciation, continued strength within the region's housing starts, and vibrant regional economies has helped boost local government tax receipts throughout much of the region, including the AV results for the Cypress Elementary School District. As a result, we expect the broader macroeconomic forces to support our view and expectation of a stable-to-positive AV result within the near-term future. For additional information, please refer to our "U.S. State And Local Government Credit Conditions Forecast" (published Nov. 1, 2017, on RatingsDirect)."

Finances and enrollment

Like many school districts in the state, the district was the recipient of one-time funds as a result of cumulated mandated cost reimbursement, among other one-time funds. As a result, the district recalibrated its available fund balances to its current level 30% ($11 million) of general fund operating expenditures, or a level that we view as very strong as of the district's most recent audit (fiscal 2016). In addition, the district's unaudited actuals for fiscal 2017 show relative stability to about 28% ($10.9 million) of general fund operating expenditures. Looking ahead to the fiscal 2018 budget, we note that the district is planning for a $1.4 million deficit. Based on our conversation with the district and our view of its positive track record of upward budget-to-actual revisions, we expect the district to conclude fiscal 2018 with a stable to potentially positive net result as the district has not identified any significant one-time outlays that could reduce fund balances.

To note, the district is generating additional revenue outside of the state funding formula in the form of rental income from a district-owned property under the management of a local property management company. In total, the fees generate about $1 million annually or about 2.4% of total general fund revenues. While minor, this revenue source is a slight credit positive as it insulates a portion of the district's revenue from fluctuations in the state funding formula.

The district's average daily attendance (ADA), a key revenue driver of state aid funding for a California school district, is stabilizing as the historical inter-year volatility was due in part to regional demographic challenges. Looking ahead, the district is planning for potential ADA increases. Should the district realize ADA growth, it would be one of the few districts in the Los Angeles County and Orange County region to post ADA growth. The current ADA figure for fiscal 2017 is about 3,850.

Financial Management Assessment (FMA)

We consider the district's management practices good under our FMA methodology, indicating our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Key management practices and policies include realistic and well-grounded revenue and expenditure assumptions and frequent board review of budget-to-actual performance. As per state requirements, the district makes two-year financial planning projections beyond the current year. The district maintains an internal fund balance target of about 19% and current practice is above the target. The district's fund balance reserve policy is bolstered by the state framework, which sets a minimum baseline of no less than 3% of operating expenditures. The district does not maintain a debt management policy. The district maintains a master facilities plan that looks out five years and is updated at least annually. Finally, the district invests exclusively through the county's local government investment pool and defers to the county investment policy.

Debt, pension, and other postemployment benefits (OPEB)

In our view, the overall net debt burden per capita and overall net debt as a percent of market value is and low, at about $2,157 per capita and 1.7% of market value. Carrying charges are typically low, in our view, with debt service usually accounting for about 4.0% of governmental expenditures. Finally, we consider debt amortization to be average, with officials planning to retire about 44% of debt within 10 years. The district does not have direct purchase debt on its balance sheet.

The two largest public pension systems in the U.S.--California Public Employees' Retirement System (CalPERS) and

California State Teachers' Retirement System (CalSTRS)--both have committed to lowering their discount rates without changing their funds' asset allocations. These reductions have significant implications for state and local budgets, increasing both the unfunded liability and total contributions required while lowering the funded status for all fund participants.

The district participates in both CalPERS and CalSTRS and in fiscal 2016, the district paid its full annual required contribution (ARC) equating to 3.3% of total governmental expenditures to both plans. With lowered discount rates we are anticipating this ratio to increase and potentially add stress to the district's financial profile. We note that the district's budget and multi-year projections include pension contribution increases. In addition, the district funds other postemployment benefits (OPEBs) through pay-as-you-go financing. In fiscal 2016, the district's OPEB contribution represented 60.4% of its ARC or 0.5% of total governmental funds expenditures. Altogether the district's pension and OPEB obligations account for 3.8% of total governmental fund expenditures for the period.

For more information regarding CalPERS and CalSTRS, please refer to our 'California Pension Giants Lower Their Discount Rates To Preserve Long-Term Plan Sustainability', published March 15, 2017, on RatingsDirect.

Outlook

The stable outlook on the underlying rating reflects our expectation that the district's available fund balance levels will remain at a very strong level or above 25% of general fund operating expenditures. The stable outlook also reflects our expectation that the district's enrollment will remain at least stable. As a result, we do not expect to change the rating within our two-year outlook horizon.

Upside scenario

We could raise the rating if the district were to significantly raise and maintain available fund balances at a level in line with its higher-rated peers while concurrently generating a meaningful portion of the district's general fund revenues outside of the state funding formula, all other factors remaining equal.

Downside scenario

We could lower the rating if the district's available fund balances were to fall to a level in line with lower-rated peers. We could also lower the rating if the district's economic indicators were to materially weaken, if ADA were to decline, if the district's debt profile were to significantly weaken, or if the district were not able to produce a balanced budget for consecutive years.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Nov. 1, 2017
- California Pension Giants Lower Their Discount Rates To Preserve Long-Term Plan Sustainability, March 15, 2017

Ratings Detail (As Of December 19, 2017)		
Cypress Sch Dist GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Ratings Detail (As Of December 19, 2017) (cont.)

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.