S&P Global
Ratings

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Summary:

Piedmont Unified School District, California; General Obligation

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Summary:

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US$26.0 mil GO bnds (Election Of 2016) ser 2017A due 08/01/2046		
Long Term Rating	AA+/Stable	New
US$15.4 mil GO rfdg bnds ser 2017 due 08/01/2034		
Long Term Rating	AA+/Stable	New
Piedmont Unif Sch Dist GO bnds		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Piedmont Unified School District, Calif.'s series 2017A (election of 2016) general obligation (GO) bonds and series 2017 GO refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the district's GO debt outstanding. The outlook is stable.

Revenue from unlimited ad valorem taxes levied on taxable property in the district secures the GO bonds. The Alameda 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 such taxes, when collected, into the bonds' debt service fund. We understand that the district is issuing the series 2017A GO bonds to replace and upgrade school facilities, while the 2017 refunding bonds will enable the district to achieve interest expense savings relative to the district's series 2006C GO bonds.

The rating reflects our view of the district's:

- Very strong local economy that participates in the greater San Francisco Bay Area regional economy;
- Parcel tax, foundation, and other local revenue that generate significant revenue above the state per pupil funding formula; and
- Historically stable enrollment levels, with management projecting stability through fiscal 2019.

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

- Practice of maintaining reserves that have been historically good-to-strong but below the level of national peers at the current rating, and
- Lack of flexibility to increase revenue without the lead time of obtaining voter or community buy-in.

Economy

Piedmont Unified School District serves an estimated population of 11,030. Median household and per capita effective buying income in the district are very strong at 319% and 317% of national levels, respectively. At $368,544 per capita, the 2017 market value totaling $4.1 billion is, in our opinion, extremely strong. Assessed value (AV) has grown by a

total of 14.4% during the past two fiscal years. Roughly 2.1% of AV comes from the 10 largest taxpayers, representing a very diverse tax base, in our opinion.

Coterminous with its namesake city, which is an enclave surrounded by the central Bay Area city of Oakland, the district serves an upscale, predominantly residential community. We believe that the district's strong academic reputation plays a material role in residential property values relative to comparable proximate properties in Oakland, but we note that unlike other high-income districts in the state that have commercial components to their tax base, Piedmont Unified does not generate local revenue in excess of the formula-determined amount. These districts, known as "basic aid" or "local funding" districts, keep virtually all of the local property tax revenue and receive little to no general funding from the state, resulting in revenue that is less vulnerable to state budget cuts or declines in ADA. The district's service area is built out, but we expect AV growth to continue in some form as a result of buoyant regional demand for high-priced homes in the Bay Area and note that the district did not experience an AV loss at the end of the Great Recession.

Finances

The district's funding is based primarily on average daily attendance (ADA), grade levels served, and share of students served that are English language-learners, low- to moderate-income, or foster youth. Most school districts are funded through a combination of state general fund revenue and local property tax revenue, up to the amount determined by formula. For these districts, increases or decreases in ADA can lead to corresponding movements in general purpose funding under the formula. In 2017, ADA came in at 2,632 students. ADA increased overall from 2013 to 2017.

The district's available fund balance of $3 million was good, in our view, at 7.3% of general fund expenditures at fiscal year-end (June 30) 2016. The district reported a surplus operating result of 3.4% of expenditures in 2016.

Although the district lacks formal flexibility to increase revenue outside of the state's per ADA funding framework, we view the district community's wealth and demonstrated willingness to support operations as representing a material source of revenue flexibility. The most significant evidence of this in recent years was the successful clearance of a two-thirds majority threshold to approve an emergency parcel tax, Measure E, in 2009 to offset a downcycle in state funding. By the time this annual infusion of the equivalent of about 3% of general fund expenditures sunset in 2013, state funding had started another upward cycle. Current state revenue projections suggest a leveling-off in school aid growth by fiscal 2018.

Management reports that the district seeks to avoid building up large reserves, as evidenced by the district's draws on its available general fund balance in fiscal years 2013 through 2015 to 7.3% of expenditures from a peak of 15.6% of expenditures, and its estimates show the balance edging down further to 6.0% for fiscal 2017. We understand that this ensures that existing resources are deployed for educational services, and we do not view this recent trend as indicative of a structural imbalance. This is based on the district's track record of consistent receipt of community donations and endowment contributions amounting to 10% of expenditures for fiscal 2016. We think that another temporary parcel tax or donations would likely be forthcoming should the state again start significantly cutting per pupil funding, although we also believe this would require a significant community outreach effort. The current parcel tax, which generates the equivalent of 23% of expenditures, dates back to 1985 and next sunsets in fiscal 2021.

In addition, we note that potential changes to state law may alter the financial management landscape for California

school districts, including Piedmont Unified School District, that have a record of maintaining strong-to-very-strong fund balances. The district's strong reserves support our view of its capacity to absorb episodes of unanticipated fiscal strain and, thus, support the rating. If the law becomes operational and ultimately compels the district to spend down a portion of its combined assigned and unassigned general fund balances, it 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.

Management

We consider the district's management practices good under our Financial Management Assessment (FMA) methodology, indicating our view that financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key management practices and policies include:

- Realistic and well-grounded revenue and expenditure assumptions for budget building;
- Compliance with a state interim reporting system, supplemented by four or five community updates during the fiscal year;
- Compliance with a state-required financial forecast of the current and subsequent two fiscal years;
- Lack of a track record of maintaining annually updated comprehensive capital plans with at least a five-year horizon, although state law required the district to create a master facilities plan associated with the recent GO debt authorization;
- Mandatory participation in the county investment pool, which has conservative investment guidelines, and a practice of providing quarterly updates on holdings and performance to the district board;
- Formal debt management policy that introduces good governance concepts but does not present significant numerical constraints on issuance; and
- Informal 4%-of-expenditures minimum reserve policy, to which the district has adhered and which exceeds the state's 3% minimum.

Debt

We consider overall net debt moderate at 3.8% of market value but high at $11,980 per capita. With 43% of the district's direct debt scheduled to be retired within 10 years, amortization is slower than average. The debt service carrying charge was 12.5% of total governmental fund expenditures excluding capital outlay in fiscal 2016, which we consider moderate.

We believe that the district's wealth and income indicators make the district's high per capita debt ratio affordable. The series 2017A represents the first $26 million exercise of the district's recently approved $66 million GO authorization, and management anticipates that the district will issue the next series under the authorization in 2019. Management has confirmed that the district has no direct purchase obligations outstanding.

Pension and other postemployment benefit liabilities

The district paid its full required contribution of $2.4 million, or 5% of total governmental expenditures, toward its pension obligations in fiscal 2016. In fiscal 2016, the district also paid $393,000, or 0.8% of total governmental expenditures, toward its other postemployment benefit (OPEB) obligations. Combined pension and OPEB carrying

charges totaled 5.8% of total governmental fund expenditures in 2016.

We expect that the district's annually required contributions (ARC) to the state-managed California State Teacher's Retirement System (CalSTRS) and the California Public Employees Retirement System (CalPERS) will rise in the coming years as both systems seek to improve their respective funding ratios. As the district's OPEB liability consists of a fixed dollar supplement for a closed pool of former employees, we expect this cost to shrink over time.

Outlook

The stable outlook reflects our view that the district will maintain good reserves and, if necessary, secure local supplemental funding to maintain structurally balanced operations and consistent services should the state enter a another period of a downturn in school funding during our two-year outlook horizon. We do not expect to change our rating during this period.

Upside scenario

We could raise our rating if the district's reserves rise significantly as a result of a policy goal to maintain a larger financial cushion to insulate its operations against future state funding fluctuations.

Downside scenario

We could lower our rating if the district's decline in its financial position continues, or if, in the context of high community expectations for service quality, we come to believe that the district is having difficulty maintaining structurally balanced operations in the event that maintaining strong community funding support becomes unexpectedly challenging.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- After Passing The Test, California's School Districts Can Expect Credit Resilience To Continue, Sept. 19, 2016
- California Pension Giants Lower Their Discount Rates To Preserve Long-Term Plan Sustainability, March 15, 2017

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