FitchRatings

RATING ACTION COMMENTARY

Fitch Rates San Joaquin Delta Community College Dist., CA 2021 Refunding GOs 'AA-'; Outlook Stable

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Fitch Ratings - San Francisco - 01 Apr 2021: Fitch Ratings has assigned a 'AA-' rating to the following San Joaquin Delta Community College District, California bonds:

--$69 million general obligation (GO) refunding bonds, series 2021.

In addition, Fitch affirmed the following ratings:

--Election of 2004 GO bonds, series 2018D at 'AAA';

--GO Refunding bonds, series 2020 at 'AA-';

--2015 GO refunding bonds series A (2018 crossover) and series B at 'AA-';

--Issuer Default Rating (IDR) at 'AA-'.

The distinction between the 'AAA' rating on the 2018D bonds and the 'AA-' on the other GO bonds reflects Fitch's assessment that the 2018D bonds are 'pledged special revenues' backed by legal opinions provided by the district and therefore bondholders of this series

Feedback

are legally somewhat insulated from any operating risk of the district. Fitch did not receive legal opinions for the other GO bonds and therefore caps those ratings at the district's IDR.

The Rating Outlook is Stable.

The bonds are expected to price through negotiated sale the week of April 12. Proceeds will be used to advance refund a portion of the district's 2015A GO refunding bonds.

SECURITY

The bonds are supported by a pledge of unlimited ad valorem property taxes levied on all taxable property in the district.

IDR ANALYTICAL CONCLUSION

The 'AA-' IDR and GO ratings on the district's 2008B, 2015A, 2015B, 2020 and 2021 bonds reflect a track record of balanced operations, low liabilities, considerable expenditure flexibility and somewhat limited revenue framework. While the district has no ability to independently raise revenues, the district has solid ability to offset declines in state funding by reducing the number and hours of classes commensurately, which it can do by immediately reducing the number of adjunct professors. As a result, Fitch expects continued balanced operations and stable reserves.

DEDICATED TAX ANALYTICAL CONCLUSION

The 'AAA' unlimited tax GO rating on the 2018D bonds is based on a dedicated tax analysis, as well as a legal structure of the bonds, which Fitch views as sufficiently strong to warrant a rating of up to five notches above the district's IDR. Fitch has been provided with legal opinions by district counsel that provide a reasonable basis for concluding that the tax revenues levied to repay the bonds would be considered "pledged special revenues" in the event of a district bankruptcy. The 'AAA' 2018D GO bond rating and Stable Rating Outlook consider the strength and growth prospects of the tax base, as well as the legal structure of the bonds

(SEE BELOW FOR DEDICATED TAX ANALYSIS)

ECONOMIC SUMMARY

The district's Central Valley service area was historically dominated by agriculture but has experienced increasing diversification and population growth due to its relative affordability and access to the San Francisco Bay Area and Sacramento employment opportunities.

IDR KEY RATING DRIVERS

Revenue Framework: 'a'

District revenues have outpaced GDP and inflation but recent declines in enrollment may pressure future performance. The district's independent legal ability to raise revenues is limited by state control over tuition rates and constitutional provisions requiring voter approval for tax increases.

Expenditure Framework: 'aa'

Based on current spending patterns, Fitch expects that the natural rate of expenditure growth will be in line with to marginally above revenue growth. The district has solid ability to adjust spending to match revenues due to its control over part-time staffing levels, which can fluctuate with demand or state funding of enrollment.

Long-Term Liability Burden: 'aaa'

The district participates in two adequately funded state-run pension plans and funds the bulk of its capital needs from voter-approved property tax levies, resulting in long-term liabilities that are a low burden on resources.

Operating Performance: 'a'

The district retains adequate gap-closing ability relative to revenue declines anticipated in a moderate recession due to a combination of reserves and solid expenditure cutting flexibility. Budget management is conservative and is supported by state oversight and monitoring.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade on the IDR and GO Bonds:

--An improved operating performance assessment due to increased general fund reserves relative to the district's revenue volatility.

Factors that could, individually or collectively, lead to negative rating action/downgrade on the IDR and GO Bonds:

--An inability of the district to maintain satisfactory financial flexibility, including reserves sufficient to withstand ongoing revenue volatility, largely driven by fluctuations in enrollment;

--Failure to implement available policy measures that offset risks associated with a return to economic contraction consistent with Fitch's coronavirus downside scenario, resulting in erosion of the district's gap-closing capacity.

Factors that could, individually or collectively, lead to positive rating action/upgrade on the 2018D GO Bonds:

--Not applicable. The bonds are rated at the highest level.

Factors that could, individually or collectively, lead to negative rating action/downgrade on the 2018D GO Bonds:

--Significant and long-lasting decline in the district's tax base and economy;

--The district's IDR drops below the 'A' level.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Coronavirus Impacts on the District

As with other local governments, San Joaquin Delta Community College District has experienced the effects of coronavirus pandemic and the mitigation efforts that have taken place. For the classes that could be taught online, they were shifted to remote learning and resources were distributed to students and staff. The district still offers primarily online classes but has begun some in-person teaching again. Additional resources are also being enacted to increase outreach and support efforts for students.

As is expected, enrollment for Fiscal 2021 is down nearly 9% from Fiscal 2020 numbers. Due to distance learning, management reports mixed enrollment results with the largest declines experienced in classes that cannot be taught online, such as science labs and physical education courses.. In attempts to maintain enrollment in the classes that can be taught remotely, the district has used part of the $55.8 million from the various coronavirus relief packages to buy equipment and tools that students can check out from the library free of charge, and has also expanded student services. Like it has been for most if not all higher education institutions, the pandemic has introduced a high level of uncertainty regarding future enrollment.

Budget Information

Through a combination of tax increases, deferrals, and use of state reserves, state lawmakers were able to maintain education funding at Fiscal 2020 levels through Fiscal 2021. Subsequent pandemic relief bills from both the state and federal governments also provided financial assistance for mitigation efforts.

Due to the pandemic, the district's Fiscal 2020 audit has been delayed. According to the district's financial reports provided to the state, the unrestricted ending fund balance is projected to increase by nearly $5.4 million to $20.9 million (16.7% of total general fund expenditures and transfers out). Management reports no material changes are expected in the audit.

The Fiscal 2021 budget projects a $2.9 million increase in the district's general fund reserves to approximately $23.8 million (17.2% of general fund expenditures and transfers out). Management reports temporary savings due to lower travel and energy costs. Fitch believes the district will face some cost pressures from labor groups. Additional expenditures are expected in order to retain and attract students. Fitch expects the district to address these pressures while adhering to the district's 10% minimum general fund reserve policy.

Going forward, Fitch believes the district is prepared to withstand some level of financial stress in the coming months. Fitch expects the district will use its available budgetary tools to act quickly in addressing any negative effects from the lower enrollment as a result of the pandemic. An inability to adjust its expenditures with changes in revenues could put negative pressure on the rating.

ECONOMIC RESOURCE BASE

The district serves a 2,300 square mile service area in California's Central Valley, including San Joaquin County and small portions of Alameda, Calaveras, Sacramento and Solano counties. With an estimated population of more than 800,000, the district provides educational services to approximately 16,500 full-time equivalent students. Services are provided at the district's main campus in the city of Stockton and its learning centers in Mountain House and Manteca.

IDR CREDIT PROFILE

REVENUE FRAMEWORK

State aid and local property taxes provide the majority of district revenues, which are largely determined by a formula based on enrollment and overall state revenues. Recent changes to the formula, known as the Student Centered Funding Formula (SCFF), reallocated approximately 20% of available state funding to grants based on low-income student population, and approximately 10% for student achievement after attending the community college. The rest of the funding is primarily based on a three-year average of full-time enrolled students.

Historical revenue growth has exceeded inflation, but was below U.S. economic performance. Fitch expects similar revenue performance going forward based on the district's strengths in regards to the SCFF and the district's proportion of low-income students. Conversely, enrollment, which tends to be countercyclical to the economy, has dropped in recent years, placing some pressure on future revenue growth. Fitch expects the negative impacts from the recent enrollment loss to be somewhat mitigated due to funding levels based on a three-year enrollment average and expected increases in state per-pupil funding.

The new funding formula creates some uncertainty over the future revenue prospects, which is mitigated slightly as districts would be held harmless for the next three years if future revenues were to decline based on the formula. The district is currently not being held harmless. Fitch will continue monitoring the situation as more data becomes available. A significant slowing in revenue growth beyond current expectations could put pressure on the revenue framework assessment.

Like other California local governments, the district's independent legal ability to raise revenues is limited by state constitutional provisions which require voter approval for tax increases. In addition, tuition rates for California community colleges are set at the state level, with no local ability to make adjustments.

EXPENDITURE FRAMEWORK

Expenditures are dominated by labor costs, particularly spending on faculty salaries, healthcare benefits and required pension contributions.

Based on current spending practices, Fitch expects the natural pace of expenditure growth to be in line with to marginally above anticipated revenue growth.

Fixed costs for debt service and retiree benefits were moderate at approximately 22% of fiscal 2019 operating expenditures (the last available audit). The district has solid ability to adjust spending through reductions in services and adjunct faculty. Approximately one-third of the district's teaching staff consists of adjunct professors, allowing for relatively rapid personnel reductions if needed. Additional expenditure flexibility is derived from the district's use of its operating budget to support capital needs and regular contributions towards other post-employment benefits (OPEBs) in excess of pay-go requirements.

LONG-TERM LIABILITY BURDEN

The combined burden of overall debt and direct unfunded pension liabilities (adjusted for Fitch's standard 6% rate of return assumption) is low at $3.3 billion, or about 8% of personal income. Overlapping debt accounts for the bulk of the burden with direct debt approximating 0.7% of personal income. Fitch expects the long-term liability to remain low given the district's population and income growth prospects.

The Fitch-adjusted pension liability is estimated to equal about $146 million, or 0.4% of personal income. The district participates in two statewide pension plans: the California State Teachers Retirement System (CalSTRS) and the California Public Employees Retirement System (CalPERS). Both systems have significant net pension liabilities. The issue is more acute for the teachers' plan, which dominates school district pension liabilities as CalSTRS required statutorily determined contributions that were significantly below actuarially determined levels for many years. The Fitch-adjusted ratio of assets to liabilities on an accounting basis for CalSTRS was 63% as of June 30, 2019. A multiyear effort to improve funded ratios has more than doubled contributions since 2014 and is expected to achieve contributions close to actuarially determined levels in fiscal 2021. Fitch's supplemental pension benchmark analysis suggests pension liabilities are likely to continue to rise even with the additional contributions, but less rapidly than in the past.

OPERATING PERFORMANCE

Fitch's Analytical Stress Test (FAST) model has been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. The model's baseline scenario indicates an approximately 18% drop in year one revenues, followed by an increase of 13% the following year. The downside scenario models a nearly 17% decline over two years in the downside scenario, which reflects a resurgence in the pandemic that results in a renewed economic contraction. FAST is not a forecast, but represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Actual revenue declines will vary from FAST results, which provide a relative sense of the revenue risk exposure of a particular entity.

Fitch believes the district retains adequate gap-closing ability relative to revenue declines. Fitch expects the district to maintain relatively balanced operations over the long term and general fund balances at approximately 10% of general fund spending, consistent with past operating results. The district's strong expenditure cutting flexibility provides it with an additional tool for addressing revenue shortfalls and would likely be its first step in the event of an unanticipated revenue decline. In the event of fiscal distress, district officials indicated several liquidity sources at the board's discretion, although there are some limitations to how some of these funds could be used.

The district maintained adequate reserves during the last recession with no material deferral of required spending. Budgets continue be balanced during the economic recovery and reserve levels have held stable. Additional oversight of the district's finances and operations is provided by the state chancellor for community colleges.

DEDICATED TAX KEY RATING DRIVERS

STRONG TAX BASE; LOW DEBT: The economic resource base supporting the 2018D GO bonds is diverse and has been reasonably stable through downturns. Recent growth has occurred at a healthy pace. The unlimited nature of the tax offsets any concern about tax base volatility. Overall debt is low relative to the economic resource base.

DEDICATED TAX CREDIT PROFILE

The specific security features of the 2018D GO bonds meet Fitch's criteria for rating special revenue obligation debt. Fitch believes bondholders backed by 'pledged special revenue' opinions are provided some additional protections from the operating risk of the district as expressed in its IDR.

Fitch sets a high bar for considering local government tax-supported debt to be secured by special revenues, which provide security that survives the filing of a municipal bankruptcy (in preservation of the lien) and benefit from relief from the automatic stay provision of the bankruptcy code. Fitch gives credit to special revenue status only if, in its view, the overall legal framework renders remote a successful challenge to the status of the debt as secured by special revenues under Section 902 (2) (e) of the U.S. Bankruptcy Code.

Fitch has identified a number of elements it considers sufficient to reduce the incentive to challenge the special revenue status given the definitions outlined in the bankruptcy code. These include clear restrictions on the use of pledged revenues for identified projects and clear separation from the entity's operations. Fitch has undertaken an extensive review of the statutory provisions that govern the use of the pledged property tax revenues. Those provisions, along with the legal documents governing the bond issuance, provide sufficient strength for Fitch to rate the district's 2018D GO bonds up to five rating notches above the district's IDR.

As a result, Fitch analyzes these bonds as dedicated tax bonds. This analysis focuses on the district's economy, tax base and debt burden. Fitch typically calculates the ratio of available revenues to debt service for dedicated tax bonds, but the unlimited nature of the tax rate pledge on the district's bonds eliminates the need for such calculations.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

San Joaquin Delta Community College District (CA)	EU Endorsed, UK Endorsed

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