S&P Global
Ratings

RatingsDirect®

Summary:

Portola Valley School District, California; General Obligation

Primary Credit Analyst:
Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@spglobal.com

Secondary Contact:
Brian Phuvan, San Francisco (1) 415-371-5094; brian.phuvan@spglobal.com

Table Of Contents

Summary:

Portola Valley School District, California; General Obligation

Credit Profile		
US$10.0 mil election of 2018 GO bnds ser 2019A due 08/01/2045		
Long Term Rating	AA+/Stable	New
US$3.585 mil 2020 GO rfdg bnds (delayed delivery) due 08/01/2031		
Long Term Rating	AA+/Stable	New
Portola Vy Sch Dist GO		
Long Term Rating	AA+/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AA+' from 'AA-' on Portola Valley School District, Calif.'s general obligation (GO) bonds. At the same time, S&P Global Ratings assigned its 'AA+' long-term rating to the district's series 2019A GO bonds (election of 2018) and series 2020 GO refunding bonds (delayed delivery). The outlook is stable.

The rating action reflects our view of the district's maintenance of balanced operations and our expectation that it will maintain at least strong reserves for the foreseeable future given a recent enhancement to its reserve policy and long-standing revenue advantages associated with its economic characteristics. Based on the district's rapid recovery after its available general fund balance dropped to negative in fiscal 2012 and budgetary discipline across changes in political and administrative leadership since then, we think the risk of another drop in reserves has substantially receded. Moreover, we could raise the rating further in the coming years if the district is able to secure more reliable supplemental operating revenue, such as through a permanent parcel tax that is adjusted for inflation, and if its reserves rise further to approximate the median ratio in the state for 'AAA' rated districts (27% of expenditures) during a recession scenario.

The district will have about $25.6 million in governmental debt at the end of fiscal 2019.

Security and use of proceeds

Revenue from unlimited ad valorem taxes levied on taxable property within the district secures the GO bonds. The district will use the series 2019A proceeds to replace, upgrade, and add facilities at its two elementary schools under a $49.5 million GO authorization its voters approved in November 2018. The district will use the series 2020 proceeds to achieve net present value interest savings of about 5% of principal using a slightly faster amortization schedule.

Credit overview

The rating reflects our view of the district's:

- Service area in the San Francisco Bay Area with economic indicators that are among the strongest in the U.S., including a median household effective buying income 3x the national level;

- Ability to realize revenue well above the state funding formula from its strong property tax base, voter-approved parcel tax, and sustained foundation donations;
- Formal policy to maintain an available general fund balance of at least 12% of expenditures, which we consider strong, to manage cash flow challenges associated with property tax receipt seasonality and to manage the potential for the next downturn to negatively affect revenue; and
- Low debt burden relative to property values.

Partly offsetting the above strengths, in our view, are:

- Reserves that are below medians in the state at all rating levels; and
- Exposure to potential parcel tax revenue loss if voters do not approve a renewal, although we understand that the district has clearly identified which services the parcel tax funds and would be in a position to cut back on such services should it lose this funding.

Economy

The district serves an affluent residential area in the mountains above Silicon Valley and 37 miles south of San Francisco. Its median household effective buying income is among the highest among districts with debt that we rate, at 296% of the national level, and its per capita market value, at $792,500, is stratospheric among districts without a substantial commercial or industrial presence. We understand that land use restrictions make growth unlikely but, based on a state constitutional restriction on assessed valuation (AV) growth to 2% per year without a sale, we think the district's $5.4 billion AV likely understates market value to a substantial degree. Unlike most in the state, the district did not sustain an AV loss at the end of the Great Recession and aggregate AV has increased 45% since the district's value growth paused in fiscal 2011.

Finances

Increases in AV have a direct effect on the district's operating revenue given the district's ability to realize revenue above the state's average-daily-attendance-based funding formula, a situation known as "community funding" (and previously as "basic aid"). Management reports that the district realizes the equivalent of 46% of revenue ($7.2 million) above what it would otherwise receive, and we think recent growth has played a role in the district's sustaining balanced operations in recent years.

We think the district has substantially addressed the factors that led to the fiscal 2012 drop in reserves to the equivalent of negative 1% of expenditures. We understand that the district was struggling to make expenditure reductions to close a budgetary gap and made this challenge worse by incorrectly recording foundation revenue. The district replaced its senior administrative leadership in fiscal 2012 and its available general fund balance bounced back to 8% of expenditures in fiscal 2013. The district's property tax base has since generated further revenue growth, and reserves have hovered within our strong range of 8% to 15% of expenditures, concurrent with a full change in board membership and a new superintendent in 2015. For fiscal 2018 the district reinforced its available financial position by policy, with the adoption of a two-prong reserve policy totaling 12% of budgeted expenditures, with 4% set aside for economic uncertainty (the formal state requirement for a district of its size) and 8% to manage the cash flow challenges associated with tax receipt seasonality. (This latter policy may allow the district to suspend issuing tax and revenue anticipation notes.)

We note that the district's reserves are now well above what it typically maintained in the late 2000s (3% on average), but the 11% of expenditures ($1.7 million) the district held at the end of fiscal 2018 was well below the median of 23% we find its 'AA+' rated peers in the state hold. Based on the district's projections through 2021, we anticipate that the district's reserves will approach the 'AA+' rating median in the medium term.

In addition to its ability to realize operating revenue above what it would otherwise receive under the state funding formula, the district receives the equivalent of 8% of revenue ($1.2 million) under a parcel tax that sunsets in 2021 and foundation revenue that tends to represent at least 6% of revenue in a given fiscal year. Management reports that the district aims to increase foundation giving in the coming years and, should it reach what is common among its neighbors, we think the district could double this amount. On balance, we see this supplemental revenue as a credit strength, with voters approving multiyear parcel taxes during the past three decades, with the most recent in 2013 at 69%, or slightly above the two-thirds supermajority requirement. We think foundation revenue is likely more volatile, but we understand that the district is careful to budget such revenue conservatively and, for both revenue streams, identify which services this revenue funds to provide a basis for cutting back such services in the event of revenue loss.

Management

We consider the district's financial management practices good under our financial management assessment methodology, indicating our view that practices exist in most areas although not all may be formalized or regularly monitored by governance officials.

Highlights of the district's policies and practices include:

- Robust budget-building process, with close monitoring of AV data from the county to build revenue assumptions, internal trend analysis, and a position control system that allows management to model the effects of labor contracts on expenditures;
- Use of a state-required financial forecast covering the current budget year and subsequent two fiscal years;
- Multiyear capital plans created in advance of GO authorization votes but not necessarily done annually;
- Mandatory use of the county investment pool, which has conservative investment policies, and monthly reporting to the board on holdings and performance;
- Internal debt policy that includes conceptual guidance but lacks what we consider material quantitative constraints; and
- Formal reserve policy consisting of the 4% of expenditures that the state requires for a district of its size for economic uncertainty and another 8% of expenditures to manage risks associated with community funded status, including uneven receipts during the fiscal year and the potential for a revenue loss in an economic downturn.

Debt

The district has one of the highest net direct debt ratios in the state relative to its population, at $13,500, but we believe that the district's wealth and income indicators make this ratio unrepresentative of the district's debt burden. More meaningful, in our view, is its 1.7% ratio relative to market value, which we consider low. Debt service carrying charges, the vast majority of which a dedicated property tax supports, are moderate, in our view, at 10% of governmental expenditures for fiscal 2018 and, we think, are unlikely to rise materially with the issuance of the series

2019A given a wraparound debt structure designed to maintain a level levy rate. The district intends to exercise the remaining $39.5 million under its November 2018 authorization in about 2021. Management has confirmed that the district has no alternative financing, such as private placement debt, outstanding or pending.

Pension and other postemployment benefits liabilities

The district's required pension contributions and actual other postemployment benefits (OPEB) contributions totaled 7.3% of total governmental fund expenditures, which we consider low, in fiscal 2018. Using reporting standards in accordance with Governmental Accounting Standard Board (GASB) Statement Nos. 67 and 68, the district's net pension liability for its defined benefit pension plans as of June 30, 2018 stood at $12.0 million for its California State Teachers Retirement System (CalSTRS) plan and $3.6 million for its California Public Employees Retirement System (CalPERS) plan. CalSTRS, its largest plan, maintained a funded level of 69% as of June 30, 2018, using its fiduciary net position as a percentage of the total pension liability, while CalPERS is funded at 72%. The district is required to make its full contributions to both of these plans each year. The district provides OPEB in the form of a capped medical, dental, and vision plan for employees with 10 years of service and a minimum age of 56, and for a five-year duration. It meets this obligation, which it most recently valued at $1.4 million, on a pay-as-you-go basis.

Outlook

The stable outlook reflects our view of the district's demonstrated resiliency and budgetary discipline since the period of stress earlier in the decade and that its formal commitment to maintain what we consider strong reserves position it to manage a slowdown in revenue growth, should it occur during our two-year outlook horizon. We anticipate that the district will realize continued property tax revenue growth in some form and foundation revenue at least approximating management's low-end estimates. We also believe that the projects that the November 2018 authorization will fund will reduce the potential need to draw on available reserves for maintenance or improvements. We don't expect to change our rating during the outlook period.

Upside scenario

We could raise the rating during the next two years if the district's growth in reserves substantially exceeds what it is projecting and if its revenue prospects substantially strengthen, such as from a permanent renewal of the parcel tax at a higher level and/or an unexpected large foundation endowment contribution that was likely to materially add to annual revenue.

Downside scenario

Notwithstanding our expectation of growth in reserves to very strong levels during the next two years, because the district's available financial position tends to be lower than that of similarly rated peers in the state, we see a decline in reserves as the key downside credit risk. We could lower the rating if the district's available general fund position drops to a level below the district's newly adopted reserve policy--particularly below our 8%-of-expenditures strong threshold--in the absence of what we viewed as a credible plan to rapidly restore compliance.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- Thanks To A Strong Economy, California's School Districts Can Face Continued Pension Increases--Though Will This Last?, Nov. 8, 2018
- Medians And Credit Factors: California Schools, Sept. 18, 2018