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Ratings

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Summary:

Portola Valley School District, California; General Obligation

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Credit Profile		
US$39.5 mil election of 2018 GO bnds ser 2020B due 08/01/2044		
Long Term Rating	AA+/Stable	New
Portola Vy Sch Dist GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Portola Valley School District, Calif.'s $39.5 million 2018 election series 2020B general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the district's series 2019A GO bonds (election of 2018) and series 2020 GO refunding bonds (delayed delivery). The outlook is stable.

An unlimited property tax pledge on all taxable property within the district secures the bonds. The 2020B proceeds will be used to finance the acquisition, construction, modernization and equipping of the district's sites and facilities, to pay the cost of issuing the bonds.

Credit Overview

In recent history, the district has demonstrated constant growth in both its local economy and finances. Increases in residential property in the area contributed to steady growth in assessed value (AV). Growth in property value, coupled with declining enrollment has provided favorable budgetary conditions for the district since it has a tax base that generates property taxes above that which it otherwise would receive under the state funding formula. The district has benefited from stable revenues which have contributed to strong financial results and the maintenance of very strong available reserves. Management doesn't anticipate major cost pressures in the near term, leading us to expect the district to maintain very strong available reserves. The stable outlook reflects our expectation the district will be able to maintain very strong available fund balance.

Although our rating outlook is generally for two years, we see some increased uncertainty because of the COVID-19 pandemic and the recent recession during the next 12 months.

We will monitor economic conditions, particularly for uncertainty related to COVID-19 and uncertain state aid as a result of state budgetary pressures. For more information on the coronavirus' effect on U.S. public finance, see "U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect.

The rating further 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, and sustained foundation donations;
- 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.

Environmental, social, and governance factors

The rating incorporates our view regarding the health and safety risks posed by COVID-19. We consider the district's social risks to be in line with sector standards and we do not view COVID-19 as having a uniquely strong effect on this credit compared with other school districts. We view the district as having elevated environmental risk given its exposure to seismic events and a service area that includes a forested area subject to wildfires. We view the district's governance risks as being in line with the sector.

Stable Outlook

Downside scenario

We could lower the rating if the district's available general fund position declines materially in the absence of what we viewed as a credible plan to rapidly restore balance operations and at least strong reserves.

Upside scenario

Although we view a higher rating in the intermediate term as unlikely due to the district's debt profile, we could raise the rating during the next two years if the district's reserves continue to grow and the district strengthens its institutionalized policies and practices as inventoried in our financial management assessment.

Credit Opinion

Economy

The district serves an affluent residential area in the mountains above Silicon Valley and 37 miles south of San Francisco. The district is located in San Mateo County, and serves an estimated population of 6,926 from multiple places such as the Town of Portola Valley, a portion of the Town of Woodside, and small portion of unincorporated San Mateo County. It provides education to students from grades from TK-8 and operates two schools. Its median household effective buying income (EBI) is among the highest districts with debt we rate, at 373% of the national level and its per capita EBI at 363%, respectively, which we view as very strong.

These EBI levels are particularly high among districts without substantial commercial or industrial presence. The robust real estate market has been a substantial contributing factor in the district's assessed value (AV) growth of 11.3% since 2019 to $6.1 billion in 2021. Underlying this resiliency are the long-term parcel-level effects of Proposition

13, which state voters approved in 1978 and which set values at their 1976 levels, after which they could grow by 2% per year until they were sold. We suspect that the mature nature of the district's service area means that many properties could see their market values decline without triggering drops in AV.

The district's $6.1 billion market value in 2021 extremely strong, in our view, at $875,595 per capita. Roughly, 6.6% of assessed value comes from the 10 largest taxpayers, representing a very diverse tax base in our opinion.

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 52% of revenue ($8.3 million) above what it would otherwise receive, and we think recent growth played a role in the district's sustaining balanced operations in recent years. 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 over the last three years and a new superintendent in 2019. For fiscal 2018, the district reinforced its available financial position, 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. (We think the latter policy will help the district avoid the need to issue tax and revenue anticipation notes to manage intra-year cash flow needs.)

The district's financial performance has been balanced in recent history, with positive general fund results in three of the previous audited years. Most recently, in fiscal 2020, the district ended with a surplus of $1.2 million, or 8.0% of expenditures. With these results, the district has been able to maintain very strong available reserves, with the most recent available fund balance of $2.2 million, or 15% of expenditures. The district estimates an available fund balance of $3.4 million, or 23% of expenditures for fiscal 2021. For fiscal 2020, the district anticipates an additional surplus due to the overall reduction in expenditures as a result of lower utilities, transportation, and substitute teacher costs associated with school closures. Management indicated the district has made cuts in the past 2-3 years by reducing staff, implementing hiring freezes and not increasing salaries, with savings of approximately $1.2 million. The school foundation provides approximately $1.1 million a year in funding for school related expenditures. For fiscal 2021, the district has started the year with distance learning, and has incorporated any cost associated with the transition to in-person learning.

Management

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

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 $13,650, but we believe that the district's wealth and income indictors make this ratio unrepresentative of the district's debt burden. More meaningful, in our view, is its 2.1% ratio relative to market value, which we consider low. Debt carrying charges, the vast majority of which a dedicated property tax supports, are moderate, in our view, at 10.3% of governmental expenditures for fiscal 2019. The district has $7.6 million in privately placed GO debt, which we do not consider material contingent liquidity risk.

Pension and other postemployment benefit (OPEB) highlights:

We do not view pension and OPEB liabilities as a near-term source of credit risk for the district, despite lower funding levels and our expectation that costs will increase. While the district's pension contributions are set to increase for the next few years, the statutory funding policy for the district's larger pension plan mitigates the risk of dramatic cost escalation contributions, because the state is required to absorb most of any needed future cost increases. While the district is not making full actuarially determined contributions toward its OPEB liability, the district's legal flexibility to alter OPEB benefits limits adverse credit effects from its OPEB liability.

The district participates in the following plans as of June 30, 2019:

- California State Teachers Retirement System (CalSTRS): 72.6% funded with a net pension liability of $11.1 million.
- California Public Employees Retirement System (CalPERS): 70.1% funded with a net pension liability of $4.1 million.
- Single-employer OPEB plan: 0% funded with a net OPEB liability of $1.4 million.

The district paid it full contribution of $1.4 million toward its pension obligations in fiscal 2019, or 8.0% of total governmental expenditures.

Largely as a result of one-time supplemental state contributions, total actual 2019 CalSTRS contributions exceeded static funding, making some progress in reducing liabilities, but fell short of our assessment of minimum funding progress. The statutory funding plan requires the state, which is responsible for about a third of districts' unfunded pension liability, to raise funding by as much as 0.5% per year through 2046, and requires districts to increase contribution rates each year through 2021, to achieve full funding by 2046. In fiscal 2021, the state redirected its supplemental contribution to instead reduce employer contributions for the year. Given that the legal discretion for CalSTRS to increase rates caps district contributions only slightly above the 2021 level, we believe the state would absorb most rate increases, if necessary, beyond the current schedule. This limits the risk of future cost increases to districts. However, if actuarial assumptions are not realized, existing authority to increase state contributions may not be sufficient to eliminate new unfunded liabilities generated before 2046 without additional increases to district contribution rates beyond the existing legal limit.

We see CalPERS' recent adoption of a 20-year, level-dollar amortization approach for new gains and losses as a turning point, in that contribution increases from a shorter amortization period will provide faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability. However, we believe costs will continue to increase for the next several years to retire existing unfunded liability, much of which is amortized over 30-year periods using a level-percent-of-payroll approach. In our view, the discount rate of 7.15%, which is well above our pension guidance of a 6.0% assumed earnings rate, could lead to contribution volatility.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- The U.S. Economy Reboots, With Obstacles Ahead, Sept. 24, 2020