S&P Global Ratings

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Summary:

West Contra Costa Unified School District, California; General Obligation

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Table Of Contents

Summary:

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Credit Profile		
US$231.765 mil GO rfdg bnds ser 2020 due 08/01/2045		
Long Term Rating	AA-/Negative	New
West Contra Costa Unif Sch Dist GO (FGIC) (National)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to West Contra Costa Unified School District (USD), Calif.'s 2020 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the district's existing GO bonds. The outlook is negative.

Revenue from unlimited ad valorem taxes levied on property within the district secures the district's GO bonds. The Contra Costa County Board of Supervisors has the power and obligation to levy these taxes at the district's request for the bonds' repayment. The 2020 bonds will be issued in the par amount of approximately $231.8 million and will refinance the district's series 2010A, 2010B, 2011, 2012, and 2012A GO bonds outstanding for interest cost savings. We note that the bonds to be refunded are subject to change.

Credit overview

The district benefits from its access to and participation in the broader San Francisco Bay Area economy, which has supported our view of strong economic indicators. However, like much of the region, the district has experienced a negative enrollment trend, which has contributed to recent and projected operating deficits and a deterioration in its reserve position. We understand the district will likely utilize a portion of its available reserves and accumulated other postemployment benefit (OPEB) trust assets to fill the 2020 deficit, bringing the reserve balance to less than the informal policy level of 6% of expenditures. Management has highlighted plans to reduce costs with the 2021 budget to align recurring revenue and expenditures, including staff reductions and various expenditure cuts. However, the negative outlook reflects our view of the district's budgetary challenges, emphasized by the magnitude of the projected 2020 deficit. The outlook also reflects our view that reserves may fall to levels incommensurate with the current rating, as well as our opinion of the district's comparatively high debt burden, anticipated difficulties in strengthening reserves given the size of the deficit, and slowing economic growth.

Additionally, we note that the district, like much of the state, has closed its schools through April 6, 2020, due to the COVID-19 pandemic. The legislature has passed Senate Bill 117, which states that districts will be held harmless for enrollment declines during this time. As a result, we do not expect the closures to significantly affect the district's finances. For more information on the coronavirus' effect in U.S. Public Finance, please see our report titled "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (March 5, 2020).

The ratings reflect our view of the district's:

- Strong local economy with extremely strong wealth and above-average income indicators and participation in the broad and diverse San Francisco Bay Area economy;
- Additional revenue flexibility provided through the voter-approved assessment district program and parcel tax, which was recently extended for a 10-year period; and
- Good financial management policies and practices.

Partly offsetting the above strengths, in our view, are the district's projected budgetary deficits, declining reserve position, and comparatively high debt burden and debt service carrying charges.

Negative One-Year Outlook

Downside scenario

The negative outlook reflects our view that there is a one-in-three likelihood that we could lower the ratings over the outlook horizon.

All else equal, should the district fail to align recurring revenue and expenditures with its 2021 or 2022 budgets and should the district realize a negative reserve position, we could lower the ratings by one or more notches.

Upside scenario

We could revise the outlook to stable if the district is able to develop a structurally balanced budget in fiscal 2021 and if its multiyear projections highlight growth in available reserves.

Credit Opinion

Economy

West Contra Costa USD serves an estimated population of 253,537 in the cities of El Cerrito, Hercules, Pinole, Richmond, and San Pablo, as well as several unincorporated communities and unincorporated areas in western Contra Costa County. Given the district's location roughly 15 miles northeast of San Francisco, residents have access to the large and diverse employment base throughout the San Francisco Bay Area. The local economy is primarily residential, and includes a sizable industrial and commercial component. In our opinion, median household effective buying income is strong at 119% of the national level and per capita effective buying income is good at 105%.

The district's assessed value (AV) has grown steadily since fiscal 2014, reflective of what we believe to be a robust housing market recovery, and increased by an average annual rate of 6.4% over the past five years to $33.6 billion in 2020. At $132,462, the district's market value per capita is extremely strong, in our view.

We consider the tax base very diverse, with the 10 largest taxpayers--a mix of industrial, retail, and residential properties--accounting for nearly 12% of AV. Chevron USA Inc., the leading taxpayer, represents 9.4% of total AV. Chevron's AV has exhibited some volatility in the past, which has led to fluctuations in the district's tax base. Most recently, in 2014, the district's tax base declined by 6% as a result of an assessment readjustment of Chevron stemming from a fire at the refinery and a reassessment resulting from a prior error by the county. In an effort to create more predictability in AV by minimizing swings in the AV of the large taxpayer, the county and Chevron have agreed to an annual meet-and-confer process to determine Chevron's AV, a process we believe will help reduce some of the volatility in the district's AV.

Finances

General purpose funding for California school districts is determined by a formula 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. Overall, the district's ADA has declined 2.7% over the past five fiscal years and stood at 27,004 in fiscal 2019, which was a less than 1% increase from the prior year. Management attributed the recent gradual decline to the opening of several new charter schools within the district and a slowing birth rate. To date, the district's ADA has declined by about 1% in 2020 to 26,271, but management anticipates flat enrollment moving forward. Additionally, under the state funding formula (the Local Control Funding Formula), districts are projected to receive additional supplemental grant funding for high-need populations. The district reports that about 74% of its enrollment qualifies for such funding.

The district ended fiscal 2017 with a slight surplus after budgeting for a deficit. However, state funding has not kept up with expenditure increases, and state-mandated raises--including a 3.26% cost-of-living adjustment for fiscal 2020, other increases in compensation to remain competitive, and declining enrollment--produced a tenuous financial environmental starting in fiscal 2018. In terms of revenue, with changes to California State Teachers' Retirement System (CalSTRS) and California Public Employees' Retirement System (CalPERS) employer contribution rates, approximately 70% of new local control funding formula revenue has gone toward pension contributions.

The district realized operating deficits in 2018 and 2019, and is projecting a deficit of about $20 million in fiscal 2020 based on its second interim report. We note that the district's second interim report reflects a smaller deficit than the original budget to in part to an increase in operating revenue and $13 million reduction in general fund expenditures. The district's first and second interim reports for fiscal 2020 were qualified, indicating that, based on current projections, the district may not meet its financial obligations for the current and two subsequent fiscal years. To fill the gap in 2020, the district plans to utilize as much as $15.6 million from its OPEB trust to offset a like amount of OPEB pay-as-you-go contributions and will fill the remaining balance from reserves.

The deficit in 2019 reduced reserves to 10% of expenditures. In fiscal 2020, the projected use of reserves will likely draw down the available reserve position to about 5% of expenditures, after accounting for the one-time use of the OPEB trust. Without the use of the OPEB trust, the unassigned balance would likely end with a negative balance.

To balance the fiscal 2021 budget and to attempt to restore reserves, management highlighted a strategy to reduce expenditures, including contracted services and other non-salary, general fund items. The district also plans to work with its collective bargaining units to identify personnel cost savings and has identified significant layoffs. The district indicated that it will have about $48 million in cuts to make within the next year in order to achieve balanced operations. We believe the current stage of the economic cycle exacerbates this pressure. This is highlighted by S&P

Global Ratings' forecast of a global recession occurring this year, as reflected in our report "COVID-19 Macroeconomic Update: The Global Recession Is Here And Now," published on March 17, 2020.

Based on current multiyear projections, the district expects to end fiscal 2021 with a slight surplus, credited to the significant expenditure cuts currently underway. Should the district be unsuccessful in implementing the planned expenditure reductions, we note that the fund balance position will continue to decline. The state requires minimum available reserves equal to 3% of expenditures, and failure to maintain this balance may result in a "negative" status determination by the state. If this scenario is to occur, we could lower the ratings by one or more notches.

Management

S&P Global Ratings considers the district's management practices good under our financial management assessment methodology, indicating our view that financial practices exist in most areas, but that governance officials might not formalize or regularly monitor all of them. Highlights of key policies and practices include the district's robust budgeting and budget amendment practices, including the utilization of several years of historical lookback and data from external resources. Management's forecasts include an informal additional two years beyond the state requirement of the current plus two future years, and are presented to the board for budgeting decisions. Management monitors its budget and presents the board with budget-to-actual performance four times annually. The district also maintains a formal facilities master plan, which identifies both cost estimates and potential funding sources for its list of prioritized capital needs through fiscal 2024 and is maintained by the district's separate facility and financing subcommittee. The district has adopted basic debt management policies and adheres to state investment policies, and the board reviews investment holdings and earnings annually at audit adoption. In addition to the 3% state minimum reserve requirement, the district has a reserve policy of maintaining a reserve for other than capital outlay of no less than 6% of expenditures, though we note it may not meet this target in fiscal 2020.

Debt

Inclusive of the current refunding, the district will have approximately $1.1 billion in net direct debt outstanding. The district's overall net debt is high, in our opinion, at $7,900 per capita and 6.0% of market value. We consider the district's debt service carrying charge, at 15.5% of 2019 expenditures excluding capital outlays, elevated compared with that of other districts in the state and nationally. Reduction in debt service charges is limited given the district's relatively slow amortization and utilization of capital appreciation bonds, with 30% of principal to be retired in the next 10 years. According to management, the district has $207.6 million in remaining GO authorization and may issue approximately $130 million in 2020 for various projects. The district also returned to voters in March 2020 for $575 million in additional GO debt authorization to be issued over the next 10 years, which management indicated is currently passing.

Pension and OPEB liabilities

We view pension and OPEB liabilities as a near-term source of credit pressure for the district given 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 given that the state is required to absorb a portion of future cost increases.

The district has recently exceeded its actuarially determined contributions toward its OPEB liability, allowing it to build a comparatively small trust. However, the district plans to spend down most of the accumulated trust assets in 2020 to finance pay-as-you-go expenditures.

West Contra Costa USD participates in the following plans:

- CalSTRS: 72.6% funded with a net pension liability of $217.7 million;
- CalPERS: 70.1% funded with a net pension liability of $124.2 million; and
- Single-employer OPEB plan with limited OPEB trust assets following their use in fiscal 2020. The 2019 OPEB liability stood at $220.3 million.

The district paid its full required contribution of $33.3 million toward its pension obligations in fiscal 2019, or 5.9% of total governmental expenditures. In addition, the district paid $21.3 million, or 3.8% of total governmental expenditures, toward its OPEB obligations in fiscal 2019. Combined pension and OPEB carrying charges totaled 9.7% of total governmental fund expenditures in 2019.

Largely due to 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. Looking forward, the statutory funding plan requires the state, which is responsible for about a third of districts' unfunded pension liability, to raise funding up to 0.5% per year through 2046; and districts to increase contribution rates each year through 2021, in order to achieve full funding by 2046. In addition, the state is scheduled to make additional one-time supplemental contributions of $1.1 billion in 2020 and $802 million in 2021. Given that legal discretion for CalSTRS to increase rates to address any new unfunded liability 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 current 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.

For more on our view of California school district pension liabilities, see our analysis "Thanks To A Strong Economy, California's School Districts Can Face Continued Pension Increases--Though Will This Last?", published Nov. 8, 2018, on RatingsDirect.

Related Research

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

Ratings Detail (As Of March 20, 2020)		
West Contra Costa Unif Sch Dist GO		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

Ratings Detail (As Of March 20, 2020) (cont.)		
West Contra Costa Unif Sch Dist GO		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO bnds		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO bnds (2010 Election)		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO bnds (2012 Election)		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO rfdg bnds		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO rfdg bnds (Federally Taxable 2019 Crossover)		
Long Term Rating	AA-/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (wrap of insured) (FGIC) (MBIA) (National) (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (ASSURED GTY)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (BHAC)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (FGIC) (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
West Contra Costa Unif Sch Dist GO (MBIA) (National) & (BAM)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.