S&P Global Ratings

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Summary:

Arvin Union School District, California; General Obligation

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Summary:

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Credit Profile		
US$2.99 mil GO bnds (Election Of 2018) ser 2020B dtd 08/04/2020 due 11/01/2049		
Long Term Rating	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' long-term rating to Arvin Union School District, Calif.'s $2.99 million series 2020B (election of 2018) general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'A' underlying rating (SPUR) on the district's GO bonds outstanding. The outlook is stable.

Inclusive of this debt, the district will have about $28.9 million in direct governmental debt at the end of fiscal 2020.

Revenue from unlimited ad valorem taxes levied on taxable property within the district secures the GO bonds. The county's board of supervisors has the power and obligation to levy these taxes at the request of the district for the bonds' repayment. The bond proceeds will be used to finance the construction, acquisition, furnishing, and equipping of district facilities.

Credit overview

While the full economic and financial pressures posed by the COVID-19 pandemic remain unknown, we believe the district's strong financial position, maintenance of very strong available general fund balances, and stable enrollment trend position the district well to mitigate adverse effects that it may experience during this recession. In our opinion, the local economy is weak with low-to-adequate incomes compared with national levels, tax base concentration, and above-average unemployment rates. However, the district's assessed value (AV) has grown annually at an average rate of approximately 8% since 2000 and the district's strong financial position mitigates the district's weak local economy. We understand the district has no plans to spend down with the goal to maintain or, if possible, build its available reserves. In our opinion, the district's maintenance of very strong available fund balances, stable enrollment trend, and lack of spending plans will help it maintain financial stability over the outlook period. Our outlook period is generally two years, but we see significant risks as a result of the COVID-19 pandemic and U.S. recession over the next six to 12 months.

In response to the risk of spreading coronavirus, all school districts across the state, closed facilities and transitioned to distance learning. We understand that the California state legislature passed Senate Bill (SB) 117, which holds schools harmless by setting school funding for the remainder of fiscal 2020 based on the Feb. 29 attendance count. We will continue to monitor current economic conditions, particularly uncertainty related to COVID-19 and the anticipated state aid declines as a result of state budgetary pressures as outlined in the state's May Revision to the Governor's Budget, published on June 3, 2020 on RatingsDirect. For more information on the coronavirus' effect on U.S. public finance, see the reports "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020, and "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020.

The rating reflects our view of the district's:

- Standard management policy and practices under our financial management assessment methodology,
- Moderate overall debt burden, and
- Adequate-to-low income indicators, and
- Slow amortization of direct debt over the next 10 years.

Environmental, social, and governance (ESG) factors

We analyzed the district's environmental, social, and governance risks relative to its economy, management, financial measures, and debt and liability profile. Our rating incorporates our view regarding the social and governance risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the district's environmental, social, and governance risk to be in line with our view of the sector standard. Although the district has elevated exposure seismic risks, we believe that strong state building codes have helped substantially manage the risks.

Stable Outlook

Downside scenario

Given the rapidity and severity of the recession's onset, we could lower the rating if the district experiences significant financial pressure on general fund operations and draws on its available reserves to levels that no longer provide the district budgetary flexibility.

Upside scenario

We see a higher rating as unlikely during the outlook period given the severity of the recession and the likelihood that operating revenue growth is unlikely to grow substantially during the next two fiscal years while public health measures continue to complicate operations. However, we could raise the rating if the district's local economy diversifies and improves, particularly in local incomes, while the district maintains very strong available reserves.

Credit Opinion

Economy

Arvin Union School District serves an estimated population of 20,882 and is about 19 miles southeast of Bakersfield, located in the southern portion of the Central Valley. The district encompasses Arvin and certain other unincorporated areas of southeastern Kern County. The local economy is largely based on agriculture, but district residents have access to employment opportunities in Bakersfield.

Although AV experienced declines during the recession, in fiscal 2017 it surpassed its pre-recession level. We consider AV strong at $1.5 billion, or $72,535 per capita. Roughly 47.9% of AV is associated with the 10 largest taxpayers, representing a concentrated tax base, in our opinion. About half of this concentration is attributed to the Pastoria

Energy facility (21% of AV), which opened in 2005 and generates power from naturally occurring steam vents. Other large taxpayers include the National Cement Co. of California (9.1% of AV), the Tejon Ranch (6.4%), and Anthony Vineyards Inc. (3.7%).

In our opinion, median household effective buying income is adequate at 71% of the national level, but per capita effective buying income is low at 36%. The district's agrarian economy can lead to substantial swings in employment rates, with unemployment reaching nearly 40% in fiscal 2010 before dropping to 7.9% in fiscal 2019. This represents an unemployment rate roughly twice the state and national averages. While the county unemployment rate has been historically above average compared with the state and national rates, we expect the unemployment rate to rise significantly in the near term based on the sharp decline in economic activity resulting from social distancing efforts. We note, however, that these shifts in employment have not contributed to significant changes in the size of the local population.

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. This share is known as the district's "unduplicated count." 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. Districts with higher unduplicated count received additional funding from the state that increases financial flexibility but also entails mandated spending to increase or improve services for targeted students in proportion to supplemental funding. The district's unduplicated count is 97% and its ADA count is stable with 2,980 for fiscal 2020. ADA is budgeted at 2,987 for fiscal 2021 and its multiyear projections show ADA at 2,937 for fiscal years 2022 and 2023. According to management, those projections are conservative and show a worst-case scenario.

In our opinion, the district has maintained a strong financial position and very strong available general fund balances with two modest deficits in fiscal years 2017 and 2018 as a result of increases in salaries and benefits and a one-time textbook adoption. The most recent, audited fiscal 2019 results show an operating surplus that is modest at about $348,000, or 0.8% of operating expenditures, and available general fund balances remain, in our view, very strong at 16% of operating expenditures, or approximately $7 million.

For fiscal 2020, the district estimated actual results show a surplus of $2.2 million, or 5.5% of operating expenditures, and available fund balances of approximately $9.9 million, or, in our view, a very strong 24%. The surplus was a result of cost savings of approximately $2 million on expenses from the lack of summer school and janitorial services because of school closures from the COVID-19 pandemic. We understand that the district's students and teachers were provided with the necessary technology to facilitate distance learning and that the district was able to provide Wi-Fi hotspots as well.

Uncertainty remains regarding the magnitude of the reduction in state Local Control Funding Formula funding as well as state aid deferrals for the next several years. For fiscal 2021, management continues its conservative approach and budgets for a modest deficit of $629,000, or 1.5% of operating expenditures, with plans to maintain its available fund balances and have no one-time spending. However, the district expects to outperform its budget for fiscal 2021 because the budgeted deficit includes the May Revision update and because the district could offset expenses with approximately $1 million to $2 million in funds that it expects to receive under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, but the district did not include these funds in budgeted revenue. In our opinion, the district's conservative budgetary practices, lack of spending plans, and intention of maintaining available fund balances will allow it to mitigate potential state funding shortfalls and maintain its financial position for the next fiscal year.

Management

We consider the district's management practices standard under our financial management assessment methodology, indicating our view that the finance department maintains adequate policies in some but not all key areas. Highlights include:

- Requirement to provide revenue and expenditures projections and underlying assumptions, which include ADA changes, contract settlements, and cost-of-living adjustments (the district uses historical data to forecast revenue and expenditures and relies on guidance from its financial oversight agency to forecast state revenue assumptions);
- Budget-to-actual results presented to the board on interim basis: first interim, second interim, and estimated/budget adoption during the year, and additional budget items throughout the year;
- Financial forecast for the current and subsequent two fiscal years;
- Lack of an updated formal capital plan;
- Mandatory investments in a county pool, which is managed under a comprehensive policy and quarterly reports to the board by management on holdings and performance;
- A debt policy, in compliance with California Senate Bill 1029, that defines debt issuance guidelines for areas such as amount, oversight, structure, timing, and type, but lacks specific numerical constraints; and
- Formal board policy to maintain 17% minimum unassigned fund balance policy, tied to protection against revenue shortfalls or unpredicted one-time expenditures, which the district expects to meet in fiscal 2019.

Debt

In our view, the overall net debt burden is moderate at $2,819 per capita and at 3.9% of market value, including the series 2020B GO bond issuance. The carrying charge was low, in our view, with debt service accounting for about 3.5% of total governmental expenditures in fiscal 2019. We consider debt amortization slow, with approximately 29% of principal debt scheduled to be retired within 10 years. The district has no additional debt plans in the next two years and plans for no alternative financed debt such as direct purchase or private placement bonds.

Pension and other postemployment benefit (OPEB) liabilities

We do not view pension and OPEB liabilities as a near-term source of credit pressure for the district despite lower funding levels and our expectation that costs will increase.

While the district's pension contributions for 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.

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

- California State Teachers' Retirement System (CalSTRS), a multiple-employer defined benefit plan: 73% funded with a net pension liability of $24.4 million
- California Public Employees' Retirement System (CalPERS), a multiple-employer defined benefit plan: 70% funded with a net pension liability of $11.4 million
- A single-employer defined benefit plan for OPEB: 0% funded with a net OPEB liability of $24.5 million

In fiscal 2019, the district paid its full required contribution of $3.6 million, or 6.9% of total governmental expenditures, toward its pension obligations, as well as $1.7 million, or 3.4% of total governmental expenditures, toward its OPEB obligations. The district's actual 2019 statutorily required CalPERS contributions fell short of static funding progress. The statutory funding plan requires the state, which is responsible for about a third of all districts' pension liabilities, as well as districts to increase their contribution rates through 2021 to achieve full funding by 2046.

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 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% could lead to contribution volatility.

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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of June 23, 2020)		
Arvin Un Sch Dist GO (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Arvin Un Sch Dist GO (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Arvin Un Sch Dist GO (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Arvin Un Sch Dist GO (BAM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Ratings Detail (As Of June 23, 2020) (cont.)		
Arvin Un Sch Dist GO (MAC)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Arvin Un Sch Dist GO (MCA)		
Unenhanced Rating	A(SPUR)/Stable	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.