

CREDIT OPINION

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Garden Grove Unified School District, CA

Update to credit analysis

Summary

[Garden Grove USD, CA's](#) (Aa3 stable issuer rating, Aa2 GOULT rating) credit profile benefits from its adequate financial position that is bolstered by considerable reserves outside of its operating funds and a conservative management team with plans to add to current reserve levels. The district has below average income levels with healthy full value per capita though declining enrollment could pressure district budgets in the future. The district's above average leverage ratio and average fixed costs are also factored into its credit profile.

Credit strengths

- » Robust cash and reserves across the organization
- » Established history of operating results exceeding budget
- » Strong local support for education

Credit challenges

- » Declining enrollment
- » Recent reduction in operating reserves

Rating outlook

The stable outlook reflects the expectation that management will continue to make the necessary budget adjustments in order to maintain healthy reserve levels during a long trend of declining enrollment.

Factors that could lead to an upgrade

- » Transition to increasing enrollment
- » Sustained and material improvement to cash and reserves
- » Significant strengthening of resident wealth

Factors that could lead to a downgrade

- » Material deterioration of reserves across the organization
- » Significant growth to debt, pension and OPEB liabilities or fixed costs

Key indicators

Exhibit 1

Garden Grove Unified School District, CA

	2017	2018	2019	2020	Aa Medians
Economy					
Resident income	91.3%	92.5%	92.1%	N/A	121.7%
Full value (\$000)	\$24,326,539	\$25,658,195	\$27,087,782	\$28,284,060	\$3,848,156
Population	285,167	283,488	280,812	N/A	29,777
Full value per capita	\$85,306	\$90,509	\$96,462	N/A	\$104,849
Enrollment	44,223	43,163	42,298	41,423	4,489
Enrollment trend	N/A	-2.2%	-2.2%	-2.2%	-0.1%
Financial performance					
Operating revenue (\$000)	\$556,778	\$564,381	\$611,246	\$757,607	\$73,583
Available fund balance (\$000)	\$102,793	\$101,011	\$99,015	\$86,835	\$18,249
Net cash (\$000)	\$172,399	\$147,073	\$114,263	\$60,201	\$22,186
Available fund balance ratio	18.5%	17.9%	16.2%	11.5%	25.4%
Net cash ratio	31.0%	26.1%	18.7%	7.9%	30.4%
Leverage					
Debt (\$000)	\$331,921	\$331,304	\$399,544	\$405,887	\$49,675
ANPL (\$000)	\$1,562,868	\$1,538,426	\$1,458,273	\$1,746,241	\$96,635
OPEB (\$000)	N/A	\$170,369	\$171,500	\$173,246	\$12,399
Long-term liabilities ratio	N/A	361.5%	332.0%	306.9%	284.4%
Implied debt service (\$000)	\$18,130	\$24,655	\$24,411	\$29,131	\$3,456
Pension tread water (\$000)	\$55,453	\$62,530	\$62,342	\$63,775	\$3,192
OPEB contributions (\$000)	N/A	\$5,220	\$5,561	\$5,629	\$507
Fixed-costs ratio	N/A	16.4%	15.1%	13.0%	11.6%

For definitions of the metrics in the table above please refer to the [US K-12 Public School Districts Methodology](#) or see the Glossary in the Appendix below. Metrics represented as N/A indicate the data were not available at the time of publication. The medians come from our most recently published [K12 Median Report](#).

Sources: US Census Bureau, Garden Grove Unified School District, CA's financial statements and Moody's Investors Service

Profile

Garden Grove Unified School District is located in [Orange County](#) (Aa1 stable) in southern California, approximately 25 miles southeast of downtown [Los Angeles](#) (Aa2 stable). In 2021, the district's enrollment was 40,124.

Detailed credit considerations

Economy: long-term economic growth expected following steep pandemic led declines; declining enrollment expected to continue

The district's economy is tied to the Los Angeles and Orange County metro areas, which have taken a big hit during the pandemic but are expected to recover and continue to grow in the long-term. The Los Angeles and Orange County economies were hit hard by the reduction in tourism, global trade and film production, though in the long-term these industries are expected to make a full recovery and will provide the building blocks for a return to growth.

Given the district's proximity to Disneyland, the reduction in tourism has hurt the local economy as visitor volumes to the region have drastically decreased. We anticipate that post-pandemic the area will once again draw tourists and that until that happens the diversity of the area economy will help sustain growth. Continued appreciation of property values has helped push full value per capita up to \$105,542 which offsets the district's lower than average median household income that sits at 92.1% of the US. Full value in the district grew at a strong 4.8% in 2021 and has grown at 5.2% over the last five years and is anticipated to continue to grow driven by turnover of residential properties that are valued considerably lower than sales prices. In the city of Garden Grove (58% of the district) the median home value is approximately \$361,000 while median sales prices are \$660,000 and as high as \$905,000 in other parts of the district as of November 2020.

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Declining enrollment has been a consistent issue for the district and is expected to continue for the foreseeable future. Demographic shifts within the district and across the state have led to steady declines in enrollment over the past 15 years as the percentage of the population that are school age kids has declined from 20.2% in 2000 to 16.1% in 2019. Recent drops in enrollment have been in the 1.5% to 2.3% range over the past five years. Due to the pandemic the district's normal student decline was slightly higher at 3.1% which the district notes were predominantly at the lower grade levels and kindergarten. The district does anticipate some of the lost enrollment to come back post pandemic. Positively, districts in California will be able to hold their funded average daily attendance at 2019 levels through the current fiscal year.

Financial operations: adequate financial position bolstered by considerable reserves outside of the general fund

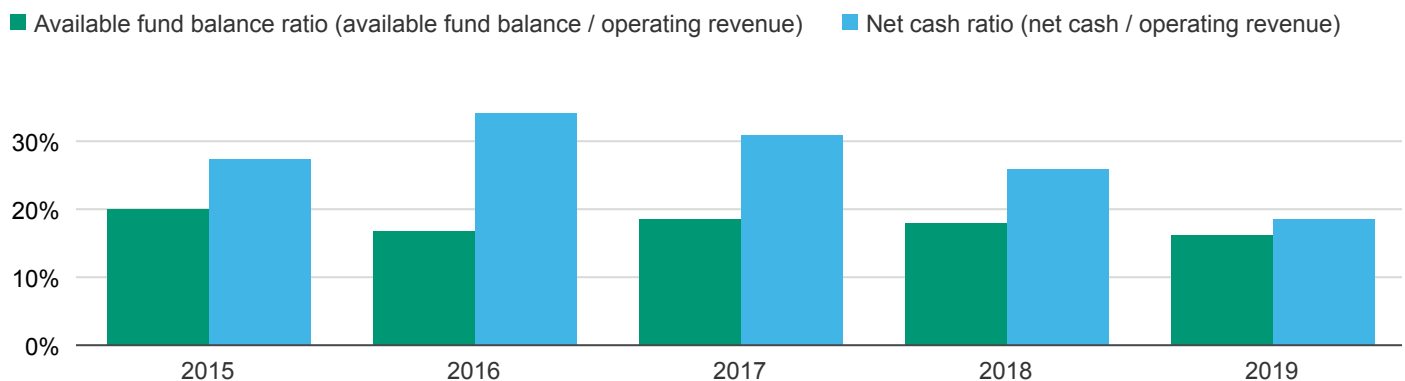
The district's financial position was satisfactory in 2020 and is expected to improve as management enacts its plan to build reserves. Historically conservative budgeting has led to the district projecting large deficits only to erase those through better than expected operations, we expect this pattern to continue.

Despite some recent reductions in operating fund balance, the district's overall reserve picture remains sufficient for the rating category. Fiscal year 2020 ended with a deficit of \$11.8 million in the operating funds (general and debt service funds) driven primarily by a transfer out to the district's fund 40 special reserve for capital outlay, absent the transfer the district finished the year with revenue approximately \$15 million better than expenditures. The draw in 2020 pulled available operating fund balance down to \$86.8 or 14.6% of revenue, a level that is narrow for the rating category. Given the district's large amount of reserves in funds outside of its operating funds this current reserve level is adequate for the rating category, though erosion of the district's finances past this level could put pressure on the district's credit profile.

For fiscal year 2021, the district's second interim report indicates a deficit in the general fund of \$16.8 million, though we anticipate that the district will outperform this number given their strong historical track record and the anticipation of considerable coronavirus relief funding. The management team's historical practice is to conservatively budget revenue and expenditures with large deficits projected in the adopted budget and interim reports while actual operating results are either positive or far less negative than projected. Over the previous four fiscal years, the district has outperformed its interim report projections by an average of \$44.4 million each year. In addition to the yearly outperformance of projections, the district has been the recipient of \$55.8 million in coronavirus relief funds and will be receiving an additional \$49 million in ESSER II, \$34 million in state AB 86 funds, and an expected \$108 million in ESSER III to help with health and safety, distance learning and learning loss that has not been accounted for in the current projections. Additionally, the district management team expects that beginning with the current fiscal year, 2021, that they will be adding to reserves with the goal of getting the general fund balance to approximately 17% of expenditures.

Exhibit 2

Fund balance and cash balance as percentage of operating revenues



Source: Issuer financial statements; Moody's Investors Service

Liquidity

The district's liquidity in 2020 declined from historically healthy levels due to deferrals in state aid. At year end the district had \$60.2 million or 10.1% of operating revenue. The district did not need to do cash flow borrowing during 2020 and has not had to in 2021 due to the robust reserves outside of the general fund most notably \$169.1 million in the self-insurance fund and \$96.3 million in the special reserve for capital outlay fund. Inclusive of all of these funds, the district's available cash balance is approximately \$336.6 million or 44.4% of operating revenue.

Leverage: moderate leverage; modest debt and elevated pension liability

The district's long-term liabilities ratio will remain elevated, largely driven by its above-average adjusted net pension liability (ANPL). Fixed costs are manageable at 16.5% and largely comprises the district's implied debt service with yearly costs expected to rise to approximately 17% after this current issuance. The district continues to have strong voter support for its capital program; the district had over 76% voter approval for its most recent bond measure. After its upcoming bond offering, the district will have \$76 million in authorized unissued GOULT debt that it plans to access in 2024.

Legal security

The district's general obligation bonds are secured by an unlimited property tax pledge of all taxable property within the district's boundaries. The portion of the district's ad valorem property tax levy restricted for debt service is collected, held and transferred directly to the paying agent by [Orange County](#) (Aa1 stable) on behalf of the district.

Debt structure

All of the district's long-term debt is fixed rate and consists of general obligation bonds. The final maturity is 2050.

Debt-related derivatives

The district does not have any debt-related derivatives.

Pensions and OPEB

The district participates in CalPERS and CalSTRS multi-employer defined benefit pension plans and has an above-average adjusted net pension liability (ANPL), a significant component of overall leverage. The district's ANPL is much higher than reported pension liabilities because the market interest rates we use to value pension liabilities are far lower than reported discount rates.

In fiscal 2020, the district's combined pension contributions of \$58.2 million fell short of Moody's "tread water" indicator of \$63.8 million, or the contribution needed to keep pension liabilities from growing under reported assumptions, leaving a gap of \$5.6 million or 0.9% of operating revenue. Contributions falling below the "tread water" level indicate that pension liabilities will continue to grow.

The district's adjusted net OPEB liability is manageable at \$173.2 million or 0.23 times operating revenue. The district funds its OPEB on a pay-as-you-go basis.

Exhibit 3

Adjusted pension liabilities notably higher than reported pension liabilities due to Moody's adjustments

Garden Grove USD, CA liabilities

\$ thousands	2018	2019	2020
Net direct debt	\$331,304	\$399,544	\$405,887
Net pension liability, reported basis	\$549,551	\$564,451	\$570,299
<i>Discount rate</i>	<i>7.10%</i>	<i>7.10%</i>	<i>7.10%</i>
Net OPEB liability, reported basis	\$182,654	\$175,340	\$173,279
Adj. net pension liability	\$1,538,426	\$1,458,273	\$1,746,241
<i>Discount rate</i>	<i>3.87%</i>	<i>4.14%</i>	<i>3.51%</i>
Adj. net OPEB liability	\$170,369	\$171,500	\$173,246
Pension asset shock indicator	11%	8%	5%
Pension assets, % of revenue	228%	226%	193%
Shock return level	-11%	-11%	-13%
Expected investment return volatility	14%	13%	12%

*Adj. NOL not available pre-GASB 75

Source: District audits and Moody's Investors Service

ESG considerations

Environmental

Environmental considerations are not a material driver of the district's credit profile. The data of Moody's affiliate, Four Twenty-Seven, indicates high risk for water stress in Orange County, where the district is located. However, Orange County Water District, which serves most of the residents in the county, has healthy levels of water storage and management has comprehensive strategic plans to address drought.

Social

The impact of the coronavirus also represents a social consideration given the substantial implications for public health and safety, however we do not see it as a material credit risk for Garden Grove Unified School District. In fiscal 2021, the state is funding school districts based on last year's Average Daily Attendance level, effectively holding the district harmless for enrollment losses in the current year. In addition, the district has received CARES Act funding to help cover costs related to the pandemic.

Governance

The district benefits from an experienced management team, with actual performance typically exceeding budgeted projections. Additionally, the team has been adept at maintaining resources across the organization at levels that protect it from fluctuations in state aid.

California school districts that rely on state aid to achieve full, equalized funding according to the state budget have an Institutional Framework score ¹ of A. Operating revenue is determined by the state controlled Local Control Funding Formula (LCFF) which establishes base grant and supplemental funding amounts. Districts' share of the 1% local property taxes authorized by the state constitution are deducted from amounts owed by the state, equalizing payments across districts. LCFF revenue is based on average

daily attendance and declines in enrollment can result in funding reductions. While state funding has increased in recent years, during weak economic periods the state has reduced and deferred payments. Districts' ability to raise additional revenue is limited to voter-approved parcel taxes.

Rating methodology and scorecard factors

The US K-12 Public School Districts Methodology includes a scorecard, a tool providing a composite score of a school district's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare school district credits.

The difference between the scorecard output and the district's public rating reflects the district's significant resources available to pay for debt service and operations that are not accounted for in Moody's operating fund calculations. The rating also considers the district's strong support for local education with the last bond election being approved by 76% of voters.

Exhibit 4

Garden Grove Unified School District, CA

	Measure	Weight	Score
Economy			
Resident Income (MHI Adjusted for RPP / US MHI)	92.1%	10.0%	A
Full value per capita (full valuation of the tax base / population)	105,542	10.0%	Aa
Enrollment trend (three-year CAGR in enrollment)	-2.2%	10.0%	Baa
Financial performance			
Available fund balance ratio (available fund balance / operating revenue)	11.5%	20.0%	A
Net cash ratio (net cash / operating revenue)	7.9%	10.0%	Baa
Institutional framework			
Institutional Framework	A	10.0%	A
Leverage			
Long-term liabilities ratio ((debt + ANPL + adjusted net OPEB) / operating revenue)	314.9%	20.0%	A
Fixed-costs ratio (adjusted fixed costs / operating revenue)	13.0%	10.0%	Aaa
Notching factors			
No notchings applied			
Scorecard-Indicated Outcome			A2
Assigned Rating			Aa3

Sources: US Census Bureau, Garden Grove Unified School District, CA's financial statements and Moody's Investors Service

Appendix

Exhibit 5

Key Indicators Glossary

	Definition	Typical Source*
Economy		
Resident income	Median Household Income (MHI), adjusted for Regional Price Parity (RPP), as a % of the US	MHI: American Community Survey (US Census Bureau) RPP: US Bureau of Economic Analysis
Full value (\$000)	Estimated market value of taxable property accessible to the district	State repositories, district's audited financial reports, offering documents or continuing disclosure
Population	Population of school district	American Community Survey (US Census Bureau)
Full value per capita	Full value / population of school district	
Enrollment	Student enrollment of school district	State data publications
Enrollment trend	3-year Compound Annual Growth Rate (CAGR) of Enrollment	State data publications; Moody's Investors Service
Financial performance		
Operating revenue (\$000)	Total annual operating revenue in what we consider to be the district's operating funds	Audited financial statements
Available fund balance (\$000)	Committed, assigned and unassigned fund balances in what we consider to be the district's operating funds	Audited financial statements
Net cash (\$000)	Net cash (cash and liquid investments minus short-term debt) in what we consider to be the district's operating funds	Audited financial statements
Available fund balance ratio	Available fund balance / Operating Revenue	Audited financial statements
Net cash ratio	Net Cash / Operating Revenue	Audited financial statements
Leverage		
Debt (\$000)	District's direct gross debt outstanding	Audited financial statements; official statements
ANPL (\$000)	District's pension liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
OPEB (\$000)	District's net other post-employment benefit (OPEB) liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
Long-term liabilities ratio	Debt, ANPL and OPEB liabilities as % of operating revenue	Audited financial statements, official statements; Moody's Investors Service
Implied debt service (\$000)	Annual cost to amortize district's long-term debt over 20 years with level payments	Audited financial statements; official statements; Moody's Investors Service
Pension tread water (\$000)	Pension contribution necessary to prevent reported unfunded pension liabilities from growing, year over year, in nominal dollars, if all actuarial assumptions are met	Audited financial statements; Moody's Investors Service
OPEB contributions (\$000s)	District's actual contribution in a given period, typically the fiscal year	Audited financial statements; official statements
Fixed-costs ratio	Implied debt service, pension tread water and OPEB contributions as % of operating revenue	Audited financial statements, official statements, pension system financial statements

*Note: If typical data source is not available then alternative sources or proxy data may be considered. For more detailed definitions of the metrics listed above please refer to the [US K-12 Public School Districts Methodology](#).

Source: Moody's Investors Service

Endnotes

- The institutional framework score categorically assesses whether a district has the legal ability to raise the bulk of its operating revenue at the local level or if the state determines the bulk of its operating revenue. Beyond the local versus state categorization, the strength of the institutional framework score is a measure of the district's flexibility in raising additional locally determined operating revenue. See [US K-12 Public School Districts Methodology](#) for more details.

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