MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Rancho Santiago CCD's (CA) SFID G.O. bonds; negative outlook assigned

Global Credit Research - 02 Oct 2014

$71.0M new debt affected; ratings affirmed on outstanding parity debt

SANTA ANA COLLEGE IMPROVEMENT DISTRICT 1, CA
Community College Districts (Tax-backed)
CA

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Election of 2012, 2014 Series A		Aa2
Sale Amount	$71,000,000	
Expected Sale Date	10/13/14	
Rating Description	General Obligation	

Moody's Outlook

Opinion

NEW YORK, October 02, 2014 --Moody's Investors Service has assigned an Aa2 rating to the Santa Ana College Improvement District No. 1 of Rancho Santiago Community College District's (CA) General Obligation Bonds, Election of 2012, 2014 Series A totaling approximately $71.0 million. We have also affirmed the Aa2 rating on the district-wide outstanding general obligation parity bonds. The current bonds are being issued by Rancho Santiago Community College District on behalf of the Santa Ana College Improvement District No. 1 (improvement district). The current offering is secured by an unlimited ad valorem property tax pledge levied on properties within the boundaries of the improvement district only, and, while the current issue is on parity with the district-wide general obligation bonds, the bonds are not an obligation of the college district as a whole. Bond proceeds will be used to finance the construction and modernization of facilities located within the improvement district boundaries, largely associated with Santa Ana College. A negative outlook has been assigned to the district's ratings.

SUMMARY RATING RATIONALE

The Aa2 underlying rating on the improvement district reflects the district's large and diverse tax base that grew slightly in 2015 and will likely continue to grow in value over the life of the bonds. The rating on the improvement district bonds also reflects the below-average socioeconomic profile of the residents within the improvement district boundaries. The rating also reflects the district-wide financial position characterized by satisfactory reserve levels and healthy general fund liquidity, which position we expect will continue under strong district management, though we are watching the planned draw down of reserves in the next few fiscal years. We anticipate a below-average debt profile for the improvement district even when the entire 2012 bond authorization has been issued.

The Aa2 underlying, district-wide rating has been affirmed and reflects the large and growing tax base of the larger overall district and stronger socioeconomic profile of overall district residents. The Aa2 rating also incorporates the district's adequate financial position and below-average debt profile, which we expect will remain manageable.

The general obligation bonds of both the improvement district and the community college district are secured by the district's voter-approved unlimited property tax pledge. Orange County rather than the district will levy, collect, and disburse the district's property taxes, including the portion constitutionally restricted to pay debt service on general obligation bonds. Orange County has approved implementation of the Teeter Plan and thus

apportions full ad valorem property taxes levied to pay the bonds irrespective of delinquencies.

The negative outlook reflects new information that the district, in a worst-case scenario, could likely deficit spend an additional $6.0 million in fiscal 2015 for an estimated ending general fund balance of $19.3 million (10.7% of revenues). The $6.0 million increase in expenditures is new information to district management, who learned that local colleges under-estimated the cost of contracted part-time faculty. District management will likely implement administrative budget reductions on the colleges to offset the faculty salary expenditures, but management would need to backfill any difference between budget cuts and total expenditures with general fund reserves. With part-time faculty hiring contracts already in place, district management won't be able to reduce the number of part-time faculty until Spring of 2015, which, if carried out, would result in some easing of budgetary pressure in fiscal 2016. At this point, it is unclear where the district reserve levels will remain long-term. If the district were to maintain total reserves at levels below the medians for an Aa2-rated community college district, there would be downward pressure on the district's rating.

STRENGTHS

- Large, growing tax base that has recovered from the economic recession

- Controlled financial operations featuring satisfactory reserves

- Strong management team

CHALLENGES

- Planned draw down of reserves

- Potentially larger draw down of reserves in fiscal 2015 than originally anticipated

- Continuing negotiations with bargaining units that could increase budgetary pressure

DETAILED CREDIT DISCUSSION

LARGE TAX BASE SUPPORTED BY DIVERSIFIED ECONOMY

The Santa Ana College Improvement District No. 1 has a large and diverse tax base that has remained stable in recent years and will likely increase in value over the next several years. The improvement district boundaries incorporate small portions of Garden Grove, Irvine, Costa Mesa, and Newport Beach, but the majority of the economic metrics and tax base value is derived from the City of Santa Ana, which will serve as a reference for the improvement district. Santa Ana is the 11th largest city in California and the largest city in Orange County. The city benefits from its position in the Greater Los Angeles economy, though, despite its favorable location, the city's unemployment level remains high and income levels are significantly below state and national levels. The relative weakness of the income levels underscores the affordable nature of the residential base.

The tax base of the improvement district is still large at $32.9 billion assessed value (AV) as of 2015 and is comparable to similarly-rated community college districts. Favorably, the improvement district's AV has remained stable since fiscal 2011 and grew slightly in fiscal 2015. We expect incremental improvement of the district's AV to continue for the next several years given the recovery of the local economy. For comparison, the City of Santa Ana's AV only suffered two years of value decline in 2010 and 2011 before value increases resumed in 2012. The city's AV is largely residential, but has also has a healthy percentage of commercial and industrial activities.

The district-wide AV is even larger at $63.4 billion as of 2015 and we expect continued growth given that the district's overall AV incorporates stronger economic areas than the improvement district. District-wide AV grew by 5.0% in fiscal 2015 and similar growth percentages are projected for the next several fiscal years.

For purposes of this rating, the City of Santa Ana's economic and socioeconomic metrics will be used as proxy for the improvement district. Santa Ana has a diverse set of taxpayers with the ten largest taxpayers comprising only 3.6% of the city's total 2013 AV. As mentioned above, the city has a below-average socioeconomic profile and weak economic metrics that have been incorporated into the rating of the improvement district. The city's 2012 per capita income of $16,613 (60.8% of US) and median family income of $53,495 (82.0%) are below US averages. The city's unemployment rate remains stubbornly high at 9.2% as of July 2014 compared with the national (6.5%) and the state (7.8%) unemployment rates for the same period.

FINANCIAL RESERVES SHOULD REMAIN ADEQUATE; UNCLEAR FUTURE RESERVE LEVELS

We expect management will maintain satisfactory district-wide financial operations, though reserves could fall below Aa2-medians in fiscal 2015, which would put downward pressure on the district's current rating. While it is unclear to what level reserves will fall in fiscal 2015 and, if they were to fall, how long they would remain at that level, we anticipate the district will manage its finances to ensure a healthier fund balance than current projections. District officials have used high ending fund balances to help manage district operations and fund capital projects for the past few fiscal years, which has put some downward pressure on the district's rating. District officials indicate they are comfortable gradually drawing down reserves to $20.0 million, which would be 11% of fiscal 2015 revenues and below the medians for an Aa2-rated community college district.

The unaudited results for fiscal 2014 reflect a total fund balance of $29.6 million (17.3% of revenues), which is likely what the audited results will report. The district transferred out $9.3 million from the general fund, which resulted in a large operating deficit for the fiscal year. The majority, or $7.4 million, of the transfer out was for capital spending related to the Orange Education Center and Child Development Center. In the fiscal year, the district also added additional classes and revamped its academic offerings after several years of cut backs. We feel the fiscal 2014 reserve level is appropriate for the rating category.

The adopted budget for fiscal 2015 reflects a total fund balance of $25.3 million (14.0% of revenues), which, given new information, could actually fall to $19.3 million (10.7% of revenues). The adopted budget reflects an accurate picture of the district's financial projections and is not an overly conservative picture of financial operations. Management is increasing its level of Full-Time Equivalent Students (FTES) to 29,415 in fiscal 2015 from 28,628 the previous year, while also planning some salary increases for employees. The district is also using available funding for capital projects and for match dollars for federal and state capital grants. We do not expect the salary increase for employees will be beyond the district's ability to pay and will likely reflect prudent management analysis. District management newly discovered, however, an additional $6.0 million in expenditures for part-time faculty that will affect the fiscal 2015 adopted budget. The $6.0 million increase in expenditures is from local colleges under-estimating the cost of contracted part-time faculty. District management will likely implement administrative budget reductions on the colleges to offset the faculty salary expenditures, but management would need to backfill any difference between budget cuts and total expenditures with general fund reserves. With part-time faculty hiring contracts already in place, district management won't be able to reduce the number of part-time faculty until Spring of 2015, which, if carried out, would result in some easing of budgetary pressure in fiscal 2016. At this point, it is unclear where the district reserve levels will remain long-term. If the district were to maintain total reserves at levels below the medians for an Aa2-rated community college district, there would be downward pressure on the district's rating.

The district's cash position is stable and should remain healthy for the foreseeable future. The general fund ending balance for fiscal 2013 was $35.4 million (21.7% of revenues). The district has ample internal resources to manage cash flow issues arising from the continued deferrals of state apportionment revenues. The district has not needed to rely on tax and revenue anticipation notes.

MANAGEABLE DEBT BURDEN

We expect the debt position of the improvement district and the overall community college district to remain below-average and manageable. The current offering will be the first series of debt issued by the improvement district and we expect with the current issuance the net direct burden to be a very low 0.2% of the improvement district's 2015 AV. We expect the net direct burden of the improvement district to remain low even with the issuance of additional debt given the projected increases in AV that will offset the issuance of additional debt.

Measure Q, approved by voters in November 2012, authorized the improvement district to issue up to $198.0 million of general obligation bonds. The improvement district will likely issue additional bonds in 2017 and 2020 with the continued growth of the district's AV. The projected tax rate for the improvement district will likely remain below $22.0 per $100,000 of AV. Assumptions are for AV to grow by 4.0% in fiscal 2016 and 2017, by 3.5% for fiscals 2018 and 2019, and 3.0% thereafter.

The district-wide debt position remains below-average and manageable. Net direct debt was a low 0.5% of AV in fiscal 2013 and we do not anticipate any debt increases in the next few fiscal years. Per capita net direct debt was also low at $454 in fiscal 2013. Payout of principal is average at 47.1% in ten years. Favorably, all of the district's voted debt consists of fixed-rate obligations.

Pension-driven budgetary pressures for the overall district are stable, though pension rate increases expected through fiscal 2021 could prove to be a budgetary burden. The district's contribution to the state's retirement

system is reasonable relative to the district's overall expenditures.

Moody's adjusted net pension liability (ANPL) for the overall district, under our methodology for adjusting reported pension data, is $237.1 million, or an above-average 1.51 times operating revenues. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities.

The overall district has a relatively large estimated actuarial accrued liability of $82.1 million as of February 1, 2014, down from $92.4 million on February 1, 2012, but the district is managing this liability. The annual required contribution (ARC) was $8.3 million as of February 2014, and the district had pay-go of $5.6 million in fiscal 2014 and will likely have pay-go of $6.1 million in fiscal 2015. The district has committed to pay the either 1% of total salaries plus a minimum of $500,000 in addition to its pay-go to the fund the ARC or the full difference between the annual pay-go and the ARC. The district has contributed 100% of its ARC from fiscals 2012 through 2014. The district has a large $38.1 million separate account in which it holds benefit reserves to help address its $82.1 million estimated liability.

WHAT COULD MOVE THE RATINGS UP

- Trend of significant growth in assessed valuation

- Significant improvement in socioeconomic measures

- Trend of significant improvement in the district's financial position

WHAT COULD MOVE THE RATINGS DOWN

- Significant deterioration in the district's financial position

- Maintenance of general fund reserves below medians

- Protracted decline in the district's assessed valuation

KEY STATISTICS

Improvement District Assessed Value, Fiscal 2015: $32.9 billion

District-wide Assessed Value, Fiscal 2015: $63.4 billion

District-wide Assessed Value Per Capita, Fiscal 2015: $90,595

City of Santa Ana, CA Median Family Income as % of US Median: 82.0%

Fund Balance as % of Revenues, Fiscal 2013: 24.0%

5-Year Dollar Change in Fund Balance as % of Revenues: -14.4%

Cash Balance as % of Revenues, Fiscal 2013: 21.7%

5-Year dollar Change in Cash Balance as % of Revenues: -9.9%

Institutional Framework: A

5-Year Average Operating Revenues/Operating Expenditures: 1.02x

Net Direct Debt as % of Assessed Value: 0.5%

Net Direct Debt / Operating Revenues: 2.3x

3-Year Average ANPL as % of Assessed Value: 0.42%

3-Year Average ANPL / Operating Revenues: 1.51x

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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