Fitch Rates Pittsburg Unified School District, CA's $34MM GOs 'AAA'; Outlook Stable

Fitch Ratings-San Francisco-16 June 2017: Fitch Ratings has assigned a 'AAA' rating to the following bonds to be issued by the Pittsburg Unified School District, California (the district):

--$15 million general obligation (GO) bonds, election of 2014, series B (2017);
--Approximately $18.6 million 2017 GO refunding bonds.

The bonds will be sold via negotiation during the week of June 26. Proceeds of the election of 2014, series B (2017) bonds will fund various capital needs of the district. Proceeds of the 2017 GO refunding bonds will refund outstanding debt for interest savings.

In addition, Fitch has affirmed the 'AAA' rating on the following district bonds:

--$69.7 million 2016 GO refunding bonds.

Fitch has also upgraded the district's Issuer Default Rating (IDR) to 'AA-' from 'A+'. The upgrade reflects the correction of an error in certain historical general fund revenue data that inform the rating process as well as continued operating performance improvements. The IDR was placed on Rating Watch Positive on June 9 following the identification of the error. The Rating Watch Positive has been removed in conjunction with this upgrade.

The distinction between the 'AAA' rating on the bonds and the 'AA-' IDR reflects Fitch's assessment that bondholders are legally insulated from any operating risk of the district.

The Rating Outlook on all of the district's ratings is Stable.

SECURITY
The bonds are payable from unlimited ad valorem property taxes levied on all taxable property in the district.

KEY RATING DRIVERS

SPECIAL REVENUE ANALYSIS: The 'AAA' rating on the bonds is based on a dedicated tax analysis without regard to the district's financial operations. Fitch has been provided with legal opinions by district counsel that provide a reasonable basis for concluding that the tax revenue levied to repay the bonds would be considered 'pledged special revenues' under Section 902(2)(e) of the U.S. Bankruptcy Code in the event of a district bankruptcy.

STRONG TAX BASE; MODERATE DEBT: The tax base supporting the GOs is diverse, growing at a healthy pace and unlikely to erode significantly in downturns. Tax rates are low, and debt is moderate relative to personal income and assessed value (AV).

IDR LIMITED BY FINANCIAL OPERATIONS: The 'AA-' IDR reflects the district's solid expenditure flexibility and elevated but still moderate long-term liability burden, in combination with the district's extensive gap-closing capacity and a constrained revenue framework.

RATING SENSITIVITIES
Tax Base Drives GO Rating: The 'AAA' GO rating would be sensitive to a significant and prolonged decline in the district's tax base, which Fitch does not currently anticipate.

Financial Performance: The 'AA-' IDR could come under downward pressure if the district fails to maintain satisfactory financial flexibility, including reserves sufficient to withstand expected revenue volatility throughout the economic cycle, at a level consistent with the current rating level.

CREDIT PROFILE

Debt Service Viewed as Special Revenue
The specific features of the district's GO bonds meet Fitch's criteria for rating special revenue obligation debt without consideration of the district's general credit quality. Fitch believes bondholders are effectively insulated from the operating risk of the district as expressed in its IDR.

Fitch sets a high bar for considering local government tax-supported debt to be secured by special revenues, which provide security that survives the filing of a municipal bankruptcy (in preservation of the lien) and benefit from relief from the automatic stay provision of the bankruptcy code. Fitch gives credit to special revenue status only if, in its view, the overall legal framework renders remote a successful challenge to the status of the debt as secured by special revenues under Section 902 (2) (e) of the U.S. Bankruptcy Code.

Fitch has identified a number of elements it considers sufficient to reduce the incentive to challenge the special revenue status given the definitions outlined in the bankruptcy code. These include clear restrictions on the use of pledged revenues for identified projects and clear separation from the entity's operations. Fitch has undertaken an extensive review of the statutory provisions that govern the use of the pledged property tax revenues. Those provisions, along with the legal documents governing the bond issuance, provide sufficient strength for Fitch to rate the district's GO bonds higher than its IDR.

As a result, Fitch analyzes these bonds as dedicated tax bonds. This analysis focuses on the district's economy, tax base and debt burden without regard to the IDR. Fitch typically calculates the ratio of available revenues to debt service for dedicated tax bonds, but the unlimited nature of the tax rate pledge on the district's GO bonds eliminates the need for such calculations.

Growth prospects for pledged revenues are strong and track changes in taxable values in the district. Taxable values experienced a decline of nearly 20% during the last recession and remain about 9% below peak levels as of 2017. Over the long-term, however, the district's tax base expanded at a compound annual growth rate of more than 4% between 1999 and 2017.

The ability to make debt service payments is unlikely to be reduced by expected cyclical variations in the tax base and economy. The top 10 taxpayers account for a somewhat high 22% of AV, but no taxpayer accounts for more than 6% and industry concentration is limited. Residential properties account for about 64% of total AV.

Tax-supported debt is somewhat elevated relative to the size of the tax base with overall tax-supported debt at about 9% of AV. The countywide tax rate of 1% of AV is established in the state constitution and cannot be increased. Tax override levies for overlapping jurisdictions are similarly low at a combined 0.15% of taxable AV for fiscal 2017

IDR EXTENDS ANALYSIS TO OPERATIONS

Economic Resource Base
The district is largely coterminous with the city of Pittsburg, population 68,000, which includes a substantial industrial base in addition to a growing residential population. The city's location approximately 40 miles from the city of San Francisco affords residents access to the region's strong and diverse employment opportunities and has contributed to steady residential growth in recent years.

Revenue Framework: 'a' factor assessment
District revenues have outpaced overall U.S. economic performance due to both state economic improvement and rising enrollment; however, the district's legal ability to raise revenues is constrained by Proposition 13, which requires voter approval for tax increases.

Expenditure Framework: 'aa' factor assessment
The natural pace of expenditure growth appears likely to be in line with to marginally above revenue growth based on the district's current spending profile. Management demonstrated a solid ability to adjust spending to match revenues during the last recession and carrying costs for debt and retiree benefits are moderate.

Long-Term Liability Burden: 'a' factor assessment
Pension liabilities and overall debt are elevated but still in the moderate range relative to the district's resource base, in part due to substantial overlapping tax increment debt issued for redevelopment purposes.

Operating Performance: 'aaa' factor assessment
District reserves provide very strong gap-closing capacity relative to revenue declines anticipated in a moderate recession. Budget management during the current economic recovery has been solid, with consistent efforts to maintain financial flexibility.

IDR CREDIT SUMMARY

The district operates eight elementary schools, three junior high schools, a comprehensive high school, and an alternative education high school. Total enrollment is approximately 11,500 students and the district has experienced steady enrollment gains for the past 10 years.

Revenue Framework

Approximately three-quarters of the district's revenues are allocated through the state of California's Local Control Funding Formula (LCFF). Such revenues have increased strongly in recent years with the state's economic recovery, but growth appears likely to slow as the LCFF approaches full implementation.

Revenue growth over the past 10 years has exceeded overall U.S. economic performance as a result of enrollment gains, LCFF implementation, and improving state finances. Fitch expects that district enrollment and revenues will continue to expand over time, in line with residential development and population growth, as well as state economic performance.

The district has no meaningful independent revenue raising flexibility due to California constitutional tax limitations. The district may not raise its operating property tax rate under any circumstance, and it may only raise a parcel tax with voter approval.

District voters approved the extension of an existing parcel tax in 2016 that raises approximately $1.2 million per year (about 1% of general fund revenues). Authorization for the tax expires in 2024.

Expenditure Framework

Personnel costs for teachers and staff comprise the vast majority of district expenditures.

Fitch expects expenditure growth to be in line with to moderately above expected revenue growth, in the absence of policy action, based on the district's current spending profile.

The district retains a solid level of spending flexibility. The collective bargaining environment provides moderate support for expenditure flexibility. Management must meet and confer with its unionized workforce, but the elected school board can impose terms if labor and management cannot reach an agreement after a structured bargaining process.

Fixed carrying costs related to debt service, other post-employment benefits (OPEB) and actuarially determined pension contributions are equivalent to a moderate 19% of governmental expenditures. Pension contribution rates are scheduled to rise over the next several years but will remain manageable.

Long-Term Liability Burden

The district's long-term liability burden for overall debt and pensions is elevated but still in the moderate range at about 31% of personal income. Direct debt of $260 million represents about 38% of the overall burden. The district will retain approximately $40 million in voter-approved GO authorization after this transaction and long-term liabilities are expected to remain moderate.

The district participates in two state-funded pension systems, both of which are mandating increasing employer contributions over the next few years to improve their funded ratios. Assuming 6% investment returns, Fitch estimates the ratio of pension assets to liabilities at approximately 62% for the district across its two plans.

Operating Performance

The district's unrestricted reserves of $13 million at the end of fiscal 2016, equal to nearly 11% of general fund spending, provide significant gap closing ability relative to revenue declines anticipated in a moderate recession. Based on the district's performance in the last recession, Fitch expects that revenue declines would likely be offset with expenditure reductions. Over the long term Fitch expects the district to maintain relatively balanced operations and available fund balances above its policy level of 6% of general fund revenues.

District reserves have increased in the years following the great recession, and there has been no material deferral of required spending. The district budgets conservatively and end of year fund balances typically exceed budgeted levels.

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1025257)
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