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New Issue

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Santa Monica-Malibu Unified School District, CA

New Issue – Moody's Upgrades Santa Monica-Malibu USD, CA's GOs to Aaa; Assigns Aaa to 2012C GO Bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aaa rating to Santa Monica-Malibu Unified School District, CA's $60 million Election of 2012 General Obligation (GO) Bonds, Series C. Concurrently, Moody's has upgraded the ratings on outstanding GO bonds to Aaa and outstanding certificates of participation (COPs) to Aa2. Post-issuance, the district will have $383.7 million par value in GO debt and $8.1 million in COPs, all Moody's rated. The outlook is stable.

The upgrade to Aaa reflects material improvement in the district's already strong financial profile. The district will start receiving new revenues from a half-cent sales tax increase approved by the voters of Santa Monica in November 2016, with a companion measure directing the city to provide a portion of the tax to the school district. The sales tax has no sunset and will provide the district with a significant, unrestricted revenue source.

The Aaa GO rating reflects the district's exceptionally large, diverse, and growing tax base; high resident wealth levels; very strong financial position bolstered by increasing local revenues; average debt burden; manageable pension and OPEB liabilities; and strong, conservative management. The rating incorporates the strength of the voter-approved, unlimited property tax pledge securing the bonds. The county rather than the district levies, collects, and disburses the district's property taxes, including the portion constitutionally restricted to pay debt service on GO bonds.

The Aa2 rating on the COPs is two notches below the GO rating, reflecting a standard legal structure for a California abatement lease financing and leased assets that we view as "more essential." While the 2001 COPs have a debt service reserve (DSR), the absence of a DSR for the 2010 COPs is a notable weakness partially mitigated by the district's otherwise strong credit fundamentals and healthy liquidity. The notching also reflects the strong legal features of California GO bonds that are not shared by lease revenue debt.

Credit Strengths

» Very large, diverse tax base, benefiting from its coastal location, with robust growth

» Very high resident wealth levels

» Supplementary revenues bolstering financial position and per-pupil resources

Credit Challenges

» Slow amortization of debt

» Pension contribution rate increases

Rating Outlook

The stable outlook reflects our opinion that the district will maintain its improving financial position consistent with the Aaa rating category and that its large tax base will continue to expand, while exhibiting a very favorable socioeconomic profile.

Factors that Could Lead to an Upgrade

» Not applicable

Factors that Could Lead to a Downgrade

» Material decline in the financial position

» Significant contraction to the tax base or wealth levels

Key Indicators

Exhibit 1

Santa Monica-Malibu USD, CA	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 37,576,797	$ 39,101,560	$ 41,637,141	$ 43,691,490	$ 46,876,732
Full Value Per Capita	$ 343,682	$ 355,239	$ 375,333	$ 390,172	$ 418,617
Median Family Income (% of US Median)	185.1%	186.9%	185.8%	184.0%	184.0%
Finances					
Operating Revenue ($000)	$ 138,053	$ 152,680	$ 158,448	$ 180,979	$ 183,597
Fund Balance as a % of Revenues	24.6%	33.1%	35.0%	42.3%	37.6%
Cash Balance as a % of Revenues	29.2%	36.8%	44.6%	48.5%	50.4%
Debt/Pensions					
Net Direct Debt ($000)	$ 236,362	$ 315,712	$ 303,553	$ 352,262	$ 380,205
Net Direct Debt / Operating Revenues (x)	1.7x	2.1x	1.9x	1.9x	2.1x
Net Direct Debt / Full Value (%)	0.6%	0.8%	0.7%	0.8%	0.8%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.4x	1.6x	1.8x	1.8x	1.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.5%	0.6%	0.7%	0.7%	0.7%

Operating funds include the general fund and debt service funds.
Source: Santa Monica-Malibu Unified School District and Moody's Investors Service

Recent Developments

Malibu residents have initiated an effort to unify a separate school district in Malibu, which would result in a reorganization into two separate districts. The district's board has indicated its commitment to seek a mutually beneficial and fair reorganization, which would be subject to statutory and regulatory requirements, including the approval of the Los Angeles County Office of Education, the California Department of Education, and a majority vote of Malibu voters. The Malibu Unification Negotiations Committee has submitted to the board for its consideration later this month a set of terms of agreement on the financial implications of the potential reorganization. Presuming board approval of the terms, as well as sufficient community support, and statutory and regulatory approvals, the process is expected to take several years. Such a reorganization would impact the then-existing bonded indebtedness of the district between the two resulting school districts.

Detailed Rating Considerations

Economy and Tax Base: Very Large Tax Base Benefits from Long-Term, Robust Growth Along Pacific Coast; Very Strong Wealth Measures

The Santa Monica-Malibu Unified School District serves residents of the cities of Santa Monica (Aaa Stable) and Malibu, as well as a portion of unincorporated Los Angeles County (Aa2 Positive). The district's FY 2017 assessed valuation (AV) is very large at $49.9 billion, reflecting a strong 6.47% increase over the prior year. The district's tax base has demonstrated stable, consistent growth over many years, with 5.8% average annual growth rates over the last twenty five years. The size of the tax base compares favorably with other Aaa-rated school districts in California and nationally, with medians of $26.6 billion and $12.0 billion, respectively. The tax base is diverse, with the top ten taxpayers accounting for a low 5.9% of FY 2017 secured AV, and residential uses reflecting 74.4% of FY 2017 secured AV.

The local housing market has seen significant appreciation, as home prices in the district continue to rise, driving tax base growth. The median price of a single family home in Malibu is $3.1 million and in Santa Monica is $1.5 million, both far exceeding the median AV of a home in the district, which is nearly $700,000 in FY 2017. There is also notable non-residential development underway in Santa Monica, which further supports continued tax base growth.

The district has very high resident wealth levels that compare favorably to state and national medians and represent a key credit strength. The median family income for district residents is 184.0% of the US median, compared to 196% and 188% medians for Aaa-rated districts in California and nationally. AV per capita is an extremely strong $445,706 in FY 2017, ranking amongst the highest of Moody's-rated school districts. The unemployment rate in Santa Monica (4.3%), as of March 2017, is lower than both the state (5.1%) and nation (4.6%) for the same time period.

Financial Operations and Reserves: Very Strong Financial Position Exhibits Flexibility and is Bolstered by Significant Supplemental Revenues; Very Strong Liquidity

The district’s financial position is very strong, with a large $150 million general fund operation that provides notable financial flexibility. The district’s general fund available balances totaled $32.5 million at the end of FY 2016, equaling a 22.0% of revenues, slightly below the medians for the rating category, which are 24.6% nationally and 28.6% in California. The district ended FY 2016 with a small general fund surplus, primarily the result of $7 million in one-time revenues, which are being spent on one-time expenses.

The district's overall financial profile is strengthened by large supplemental revenue streams that significantly increase per-pupil resources. In FY 2017, the district’s revenues include $11.7 million from a parcel tax, which has no sunset date and is annually adjusted for inflation; $8.8 million from a facilities use agreement with the city of Santa Monica; $16 million from a one cent sales tax add-on, which does not expire and which the voters directed in a companion ballot measure to be used by the city of Santa Monica to support the district; $2.3 million from property leases; and $2 million generated annually by a school foundation. Collectively, these supplemental revenues account for 27% of FY 2017 general fund revenues. Half of the sales tax revenue is new in FY 2017, having received recent voter approval. Enrollment has also remained stable in recent years and out-of-district transfers have provided a lever to moderate potential enrollment declines, and currently account for approximately 9.2% of enrolled students. Notably, the district is approaching basic aid funding status, which would insulate it from volatility in state funding.

The district had been anticipating a very small structural deficit beginning in FY 2017, due to increases in compensation and fixed costs, which we expect will be fully addressed through the combination of new supplemental revenues and expenditure cuts to be identified in the FY 2018 budgeting process. Notably, the district has a track record of conservative budgeting, consistently outperforming its budgets in recent years. The district budgeted a $14.1 million draw on reserves in FY 2017, but is now projecting the draw will be only $3.1 million, due entirely to expenditure of prior-year, one-time funding. We anticipate that the district’s financial position will strengthen in the near term, given new an substantial local revenues, which are the primary driver for upgrade to Aaa.

The district’s operating fund available balances, which for the purposes of our analysis includes the general fund and debt service funds, was a very strong 37.6% of operating revenues.

LIQUIDITY

The district continues to maintain a healthy liquidity position which remained stable and resilient during the recession, despite the state's practice of deferring revenues to later fiscal periods. As of FY 2016, general fund net cash totaled $56.0 million, or 38.1% of revenues. Net cash on an operating basis, inclusive of both the General and Debt Service Funds, was a stronger $92.5 million (50.4% operating fund revenues). The district also has $17 million outside the general fund which is available for temporary borrowing. Given the district's more diverse revenue base, which is less dependent on a single source of revenue, we expect liquidity to remain strong.

Debt and Pensions: Typical Debt Levels, Manageable Through Continued Tax Base Growth, Despite Slow Amortization; Manageable Pension and OPEB Liabilities

The district has direct debt levels typical of Aaa-rated school districts in the state and nation. The district's post-issuance net direct debt burden is 0.8% of AV, while overall debt, including overlapping tax and assessment-backed obligations to the tax base is 2.3% of AV. The ten-year payout rate is a slow 32% and well below average relative to state and national benchmarks for the rating category. Current debt levels are expected to increase moderately over the next six years. The district has $235 million of remaining authorized, but unissued bonding capacity under its 2012 Election, and plans to issue every other year through 2023 to fulfill projects identified in its facility master plan.

The district’s 2010 COPs are supported with RDA pass-through payments received in a special revenue fund that are more than sufficient to pay debt service on these COPs and thus alleviate the General Fund lease burden, which equaled 1.3% of FY 2016 general fund expenses.

DEBT STRUCTURE

The district's post-issuance debt portfolio consists of about $383.7 million par value, fixed-rate, current interest and capital appreciation GO bonds, maturing through 2042, and $8.0 million of COPs.

DEBT-RELATED DERIVATIVES

The district is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

District employees participate in the California Public Employee Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS). Moody's adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is a relatively low at $362.1 million in FY 2016. 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 three-year average ANPL to full value is 0.8% and the three-year average ANPL to operating revenues is 1.9 times.

The district funds its other postemployment benefits (OPEB) on a pay-as-you-go basis and unfunded actuarial accrued liability (UAAL) was $36.4 million in 2015, equal to a moderately low 38% of covered payroll. The district is currently funding OPEB on a pay as you go basis and is in the process of funding an OPEB irrevocable trust that will offset the OPEB UAAL.

Management and Governance

California school districts have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. California school districts' major revenue sources are determined by the state government or, for the most part, can only be raised with voter approval. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5% and 10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, California has strong public sector unions and additional expenditure constraints, which limit the ability to make cuts. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

The district's five-year average operating ratio of revenues to expenditures is a healthy 1.04 times, reflecting its history of maintaining healthy operating surpluses in four of the last six years. The district hired a new superintendent in January 2017.

Legal Security

The district's GO bonds are secured by the levy of ad valorem taxes, unlimited as to rate or amount, on all taxable property within the district. The portion of district's ad valorem property tax levy restricted for debt service is collected, held and transferred directly to the paying agent by the county on behalf of the district. Under California law, the county must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the school district's financial position.

The 2016 General Obligation Refunding Bonds, Series C (2020 Crossover) are secured by an escrow that is sufficient to pay debt service on the bonds up until the crossover date, July 1, 2020. Following the crossover date, the bonds will be secured by the typical GO levy described above.

The 2001 COPs are secured by a lease payments for the district's use and occupancy of its administrative office facility. The 2010 COPs are secured by lease payments for the district's use and occupancy of Webster Elementary School and Roosevelt Elementary School.

Use of Proceeds

The bond proceeds will be used to finance the acquisition, construction, modernization and equipping of school sites and facilities, and to pay the costs of issuance.

Obligor Profile

Santa Monica-Malibu Unified School District serves residents of the cities of Santa Monica (Aaa/Stable) and Malibu, as well as a portion of unincorporated Los Angeles County (Aa2/Positive). Located on the Pacific Coast, the district encompasses about 29 square miles, with an estimated population of 111,980. The District currently operates 10 elementary schools, two middle schools, one K-8 school, one 6-12 school, one high school, one continuation high school, a regional occupation program, an adult education program, as well as child care and development centers, with a projected enrollment of 11,003 students in FY 2017.

Methodology

The principal methodology used in the general obligation rating was US Local Government General Obligation Debt published in December 2016. An additional methodology used in the lease rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Santa Monica-Malibu USD, CA

Issue	Rating
Election of 2012 General Obligation Bonds, Series C	Aaa
Rating Type	Underlying LT
Sale Amount	$60,000,000
Expected Sale Date	05/24/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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