S&P Global
Ratings

RatingsDirect®

Summary:

Santa Monica-Malibu Unified School District School Facilities Improvement District No. 1 (Santa Monica Schools), California
Santa Monica-Malibu Unified School District School Facilities Improvement District No. 2 (Malibu Schools); Appropriations; General Obligation

Primary Credit Analyst:
Michael Parker, Centennial + 1 (303) 721 4701; michael.parker@spglobal.com

Secondary Contact:
Treasure D Walker, Centennial + 303-721-4531; treasure.walker@spglobal.com

Table Of Contents

Summary:

Santa Monica-Malibu Unified School District School Facilities Improvement District No. 1 (Santa Monica Schools), California
Santa Monica-Malibu Unified School District School Facilities Improvement District No. 2 (Malibu Schools); Appropriations; General Obligation

Credit Profile		
US$200.0 mil GO bnds, election of 2018 (Santa Monica-Malibu USD SFID #2) ser 2021B due 08/01/2050		
Long Term Rating	AA+/Stable	New
US$80.0 mil GO bnds, election of 2018 (Santa Monica-Malibu USD SFID #1) ser 2021B due 08/01/2050		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Santa Monica-Malibu Unified School District (USD) School Facilities Improvement District (SFID) No. 2 (Malibu Schools), Calif.'s estimated $80 million series B (election of 2018) general obligation (GO) bonds. At the same time, S&P Global Ratings assigned its 'AA+' long-term rating to Santa Monica-Malibu USD SFID No. 1's (Santa Monica Schools) estimated $200 million series B (election of 2018) GO bonds.

In addition, S&P Global Ratings affirmed its 'AA+' long-term rating on Santa Monica-Malibu USD's previously issued GO debt. Finally, S&P Global Ratings affirmed its 'AA' long-term rating on the district's certificates of participation (COPs) outstanding. The outlook is stable.

The district's unlimited ad valorem property tax pledge--which obligates the district to levy taxes on taxable property within the district annually, without limitation as to rate or amount such that legally available funds are sufficient to make principal and interest payments--secures its GO bonds. Revenue from unlimited ad valorem taxes levied on taxable property within the SFID Nos. 1 and 2 secures the separate series B bonds (election of 2018). Proceeds from the two 2021 series B GO bonds will be used to finance capital projects within SFID Nos. 1 and 2, and pay the costs of issuance.

The district's COPs represent an interest in lease payments it makes, as lessee, for the use of district facilities. We rate the COPs one notch below our view of the district's general creditworthiness to reflect annual appropriation risk.

We believe the two SFIDs and school district are very similar in credit quality, as the tax base for the two SFIDs combined are coterminous with the school district, differing slightly only in certain economy and debt ratios. In addition, the management team and associated operations for SFID Nos. 1 and 2 and the school district are identical. Hence, our rationale mostly focuses on the credit quality of Santa Monica-Malibu USD.

Credit overview

The ratings reflect our view of the school district's high income levels and extremely strong tax base, in addition to its "basic aid" status, which makes it less reliant on potentially volatile state revenue. Basic aid or local funding districts keep all local property tax revenue and receive little to no general funding from the state, resulting in state budget cuts or average daily attendance (ADA) decreases having less of an effect on revenue. The district maintains several supplemental revenue streams that diversify its overall revenue structure. Moreover, the district has maintained very strong reserves despite the recent recession stemming from the COVID-19 pandemic and subsequent state deferrals of its share of funding formula payments to school districts. The strength of the economy bolsters the credit rating, and recent assessed value (AV) growth has been strong.

We understand the district has had longstanding discussions regarding institutional separation. In 2017, Malibu petitioned Los Angeles County Office of Education to create Malibu USD, which the Santa Monica-Malibu School Board objected to formally. In June 2018, however, the board adopted a resolution that created two separate SFIDs. While the two SFIDs appear to create a middle ground between the district's formal division and remaining unified, we understand formal division is still a possibility as discussions resume. Based on our understanding of the institutional hurdles and management discussions, we do not expect a formal division to occur within the next few years.

Although some economic and financial externalities may arise from the COVID-19 pandemic, we believe that the U.S. recovery is looking more optimistic than projected with the help of federal stimulus, and we believe the district's extremely strong tax base and very strong available reserves adequately position it to manage any effects of the pandemic.

For more information on the coronavirus' effect on U.S. public finance, see S&P Global Economics' report "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect.

The ratings further reflect our opinion of the district's:

- Extremely strong and resilient local property tax bases, with very strong incomes, centered on one of Southern California's main economic centers;
- Substantial, diverse array of supplemental revenue streams not common to most school districts in the state, such as the ability to realize property tax revenue above what is constitutionally allowed under California's funding formula; and
- Good financial management practices under our financial management assessment methodology.

Partly offsetting the above strengths, in our view, are the district's high overall per capita debt and longstanding political discussion regarding the school district's division.

Environmental, social, and governance (ESG) factors

We analyzed the district's ESG risks relative to its economy, management, financial measures, and debt and liability profile. Our ratings incorporate our view regarding the health and safety risks posed by the COVID-19 pandemic. Although the region has elevated exposure to wildfire, flood, and seismic risks, we believe that state and local government management efforts in the wake of recent wildfires and floods as well as strong state building codes have substantially mitigated the risks.

Stable Outlook

Upside scenario

If revenue growth were to accelerate, leading to a substantial ongoing available reserve increase, particularly if accompanied by strengthening financial management policies and practices such as the formalization of a reserve policy, or if we come to believe the district is not at risk of a credit determination associated with a potential division, we could raise the rating.

Downside scenario

We could lower the ratings if fund balance were to deteriorate to levels we no longer considered commensurate with those of similar rated peers, with management sustaining it but with no plans to replenish it; if management were to reduce local revenue flexibility; or if management were to pursue division, which we think would hamper its ability to repay debt.

Credit Opinion

Very affluent economy along the Pacific Coast, with ongoing property value growth and participation in the Los Angeles-Long Beach-Anaheim metropolitan statistical area

The district is a discontinuous district within Los Angeles County that serves an estimated population of 114,000 within its namesake cities, as well as unincorporated portions of Los Angeles County. This affluent district resides along the Pacific Coast with Santa Monica 16 miles west and Malibu 33 miles west of downtown Los Angeles. Both Santa Monica and Malibu maintain tourism activity while serving as entertainment, restaurant, and retail centers for local residents. A host of health care and technology companies and Santa Monica Community College, one of the state's largest community colleges, stimulate Santa Monica's economy further.

Santa Monica-Malibu USD SFID Nos. 1 and 2 are coterminous with the cities of Santa Monica and Malibu, respectively. AV for the district as a whole has grown continuously for 10 consecutive fiscal years by an annual average of 5.7% to roughly $63 billion, or, in our view, an extremely strong $529,192 per capita. In the previous decade, SFID Nos. 1 and 2 have followed a trend similar to that the district overall, growing 5.9% and 5.2%, respectively. In our opinion, the tax base will likely remain stable as commercial and residential development persist alongside organic growth, despite the recent national economic recession stemming from the pandemic. According to management, tourism has continued to pick back up again in recent months, and we note that the state recently announced capacity limitations would be lifted on June 15.

Stable operations and strong financial flexibility through reserves and additional supplemental revenue

A formula based primarily on ADA, grade levels served, and the share of English language learners, low- to moderate-income families, or foster youth served determine general purpose funding for California school districts. California funds most school districts through a combination of state general fund and local property tax revenue, up to the amount determined by the formula. For these districts, ADA increases or decreases can lead to corresponding movements in general purpose funding under the formula. In some districts, however, the property tax base generates local revenue in excess of the formula-determined amount.

These districts, known as basic aid or local funding districts, keep all local property tax revenue and receive little to no general funding from the state, resulting in state budget cuts or ADA decreases having less of an effect on revenue. The district transitioned to basic aid status from state aid status in fiscal 2018. While the benefit of this transition is small, roughly $5.1 million, we expect this to grow as a result of continued AV growth and the loss of students in 2021. According to the district's second interim projections, ADA in 2021 totaled approximately 8,780 students, down 10.8% from the prior year (9,841), which management largely attributes to a smaller kindergarten class size following the pandemic. We note the district's ADA has decreased overall since 2015, by a cumulative 19%. In our view, we believe the average ADA is also on a downward trend as a result of shifting age demographics in the region and declining birth rates in California.

Despite some drawdowns of available reserves in recent years, the district's financial profile remains very strong. The district has reported essentially balanced or surplus operations in four of the previous six audited years and has maintained strong-to-very-strong available fund balances. The district ended fiscal 2020 with an available general fund balance of roughly $24.3 million, or about 14.4% of expenditures, a level we consider very strong. Based on the second interim report for 2021, the district projects a $7.3 million deficit to end the year. However, management anticipates ending the year balanced operationally largely as a result of one-time state and federal aid not originally budgeted for, and additional pass-through tax increment revenue from the City of Santa Monica Redevelopment Agency. In addition, we note the district has historically been conservative with budget estimates, such as underestimating sales tax revenue.

Multiyear projections indicate balanced operations for fiscal years 2022 and 2023. We note two bargaining-unit contracts are set to expire before July 1 2021 and therefore that the fiscal 2022 budget does not reflect salary adjustments; the district is in negotiations. Management expects forthcoming contract resolutions, and interim reports would reflect salary adjustments. Moreover, officials have no intentions of reducing available reserves further, and are discussing creating a larger formalized reserve policy in fiscal 2022.

In addition to basic aid status, we view supplemental revenue, which is unusual in the state, as a credit strength. The district has the following revenue streams available:

- A parcel tax with no sunset date that annually generates about $12.6 million, or 7.3% of general fund revenue;
- Sales tax measures with no sunset dates that generate annually roughly $12.5 million, or 7.3%;
- A facility lease through 2022 that annually generates $9.8 million, or 5.7%;
- Lease rental revenue from several district-owned properties that annually generates $2.5 million, or 1.5%;

- Pass-through tax increment revenue that annually generates about $20.3 million, or about 11.8%; and
- A foundation that, since fiscal 2015, has averaged annual contributions of about $2.2 million, or 1.3%.

These sources generated a combined 34.9% of general fund revenue in fiscal 2021.

Good financial management policies and practices

S&P Global Ratings considers the district's management practices good under our financial management assessment methodology, indicating our view that financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Highlights of key policies and practices include:

- Compliance with a well-established state framework that requires the district to report revenue and expenditure assumptions, including ADA changes (the district uses a demographer and other outside sources to make revenue and expenditure assumptions);
- Presentations on budget-to-actual performance to the school board at least six times per year, coupled with budget updates in state-mandated intrayear reports;
- Maintenance of a long-term financial plan that extends a year beyond the state-required current-year-plus-two-year forecasting;
- Adherence to state investment-management requirements, including mandatory participation in the county's investment pool, coupled with annual holdings-and-performance reports in audited financial reports;
- Adoption of a debt-management policy that provides a conceptual framework for debt issuance that complies with Senate Bill 1029 (for more information, see our report "California's Passage Of SB-1029's Formal Debt Management Policy Requirement Could Improve Our View Of Credit Quality," published Nov. 22, 2016), although we view its guidelines as lacking significant quantitative constraints; and
- Compliance with a state-required reserve minimum at 3% of expenditures, bolstered by an informal minimum of two months, or 17%, of expenditures as a cushion against cash-flow risks of economic uncertainties.

Debt per capita and carrying charges are comparatively high, but low-to-moderate against the tax base

We consider the school district's overall net debt high at $17,728 per capita but moderate at 3.2% of market value. We consider the district's debt service carrying charge elevated at 17.3% of 2020 expenditures excluding capital outlays. Reduction in debt service carrying charges is limited, given the district's relatively slow amortization and utilization of capital appreciation bonds, with 34% of principal to be retired in the next 10 years. Following the 2021 series B issuance, SFID Nos. 1 and 2 will have approximately $175 million and $80 million remaining from the 2018 authorization, respectively, which officials intend to utilize within the next four years.

Costs are manageable, but increased pension and OPEB costs will continue to be a challenge

- We view pension and OPEB liabilities as a moderate near-term source of credit pressure for the district given lower funding levels and our expectation that costs will increase.
- While the district's pension contributions 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, given that the state is required to

absorb a portion of future cost increases.

- The district maintains an irrevocable OPEB trust for prefunding retiree health care benefits, and at June 30, 2020, the district had set aside roughly $8.3 million.

Santa Monica-Malibu USD participates in the following plans:

- CalSTRS: 71.8% funded with a net pension liability of $119.6 million
- CalPERS: 70.0% funded with a net pension liability of $67.5 million
- Medicare Premium Payment Program administered by CalSTRS: 100% funded

The district paid its full required contribution of $17.6 million, or 4.1% of total governmental expenditures, toward its pension obligations for its participation in CalSTRS and CalPERS in fiscal 2020. Pension and OPEB carrying charges totaled 4.9% of governmental fund expenditures. The CalSTRS contributions exceeded static funding in 2020, making some progress in reducing liabilities, but fell short of our assessment of minimum funding progress. The statutory funding plan requires the state, which is responsible for about one-third of all districts' pension liabilities, and the 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 new unfunded liability caps district contributions only slightly above the 2021 level, we believe the state will absorb most rate increases, limiting cost increases to districts. However, if actuarial assumptions are not realized, authority to increase state contributions may not be sufficient to eliminate new unfunded liabilities generated before 2046 without increasing district contribution rates beyond the legal limit.

Related Research

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

Ratings Detail (As Of June 11, 2021)		
Santa Monica-Malibu Unif Sch Dist GO		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica-Malibu Unif Sch Dist GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica-Malibu Unif Sch Dist GO (MBIA) (MBIA of Illinois)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Santa Monica-Malibu Unif Sch Dist Sch Facs Dist No. 1 GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica-Malibu Unif Sch Dist Sch Facs Dist No. 2 GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Santa Monica-Malibu Unif Sch Dist APPROP		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Ratings Detail (As Of June 11, 2021) (cont.)		
Santa Monica-Malibu Unif Sch Dist 2016 GO rfdg bnds (2020 Crossover Rfdg) ser C due 07/01/2035		
Long Term Rating	AA+/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.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.