Hartnell Community College District, CA

New Issue: Moody’s assigns Aa2 to Hartnell Community College District, CA’s 2016A GO Bonds

Summary Rating Rationale
Moody’s Investors Service has assigned an Aa2 to Hartnell Community College District’s, CA, $70.0 million Election of 2016 General Obligation Bonds, Series A. Post issuance, the district will have approximately $210.6 million in GO bonds outstanding.

The Aa2 rating reflects the district’s very strong financial position, with healthy balances available outside the general fund and growing enrollment. The rating further reflects the sizable, yet comparatively modest, tax base for the rating category, with a below-median socioeconomic profile typical of agricultural economies. The rating incorporates the district’s somewhat elevated but manageable debt and pension liabilities, and a low OPEB liability.

The rating reflects the security of an unlimited property tax pledge of all taxable property within the district boundaries. Monterey and San Benito counties, rather than the district, will levy, collect, and disburse the district’s property taxes, including the portion constitutionally restricted to pay debt service on GO bonds.

Credit Strengths
» Strong financial profile, with sizable reserves outside the general fund
» Growing enrollment
» Disciplined financial management with history of balanced operations

Credit Challenges
» Below average socioeconomic profile for the rating category
» Below average tax base for the rating category

Rating Outlook
Outlooks are not typically assigned to local governments with this amount of debt outstanding.

Factors that Could Lead to an Upgrade
» Significant growth in assessed valuation (AV)
» Significant strengthening and diversification of the local economy
» Material improvement in the district’s socioeconomic profile
Factors that Could Lead to a Downgrade

- Material, sustained deterioration of financial metrics
- Regional economic decline

Key Indicators

Exhibit 1

<table>
<thead>
<tr>
<th>Hartnell Community College District, CA</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
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</thead>
<tbody>
<tr>
<td>Economy/ Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$21,161,813</td>
<td>$21,465,020</td>
<td>$22,130,613</td>
<td>$23,513,621</td>
<td>$24,790,075</td>
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<tr>
<td>Full Value Per Capita</td>
<td>$77,888</td>
<td>$78,637</td>
<td>$80,483</td>
<td>$84,970</td>
<td>$89,582</td>
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<tr>
<td>Median Family Income (% of US Median)</td>
<td>87.4%</td>
<td>86.9%</td>
<td>84.7%</td>
<td>83.8%</td>
<td>83.8%</td>
</tr>
<tr>
<td>Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Revenue ($000)</td>
<td>$49,330</td>
<td>$49,334</td>
<td>$51,991</td>
<td>$56,688</td>
<td>$68,951</td>
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<tr>
<td>Fund Balance as a % of Revenues</td>
<td>25.5%</td>
<td>27.1%</td>
<td>26.6%</td>
<td>23.7%</td>
<td>20.8%</td>
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<tr>
<td>Cash Balance as a % of Revenues</td>
<td>16.2%</td>
<td>21.5%</td>
<td>25.5%</td>
<td>29.3%</td>
<td>26.3%</td>
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<tr>
<td>Debt/Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Direct Debt ($000)</td>
<td>$121,462</td>
<td>$120,075</td>
<td>$123,487</td>
<td>$121,965</td>
<td>$162,893</td>
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<tr>
<td>Net Direct Debt / Operating Revenues (x)</td>
<td>2.5x</td>
<td>2.4x</td>
<td>2.4x</td>
<td>2.2x</td>
<td>2.4x</td>
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<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.5%</td>
<td>0.7%</td>
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<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>N/A</td>
<td>1.5x</td>
<td>1.8x</td>
<td>1.7x</td>
<td>1.5x</td>
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<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>N/A</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.4%</td>
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</tbody>
</table>

Population is estimated based on the combined population of Salinas Union High School District, South Monterey County Joint Union High School District, North Monterey County Unified School District, Soledad Unified School District, and Gonzales Unified School District. Median Family Income (MFI) for the CCD is estimated as the average of the MFI of these five school districts weighted by the number of families in the districts.

Operating funds include the general fund and debt service funds. Available balances include unassigned, assigned, and committed balances and balances restricted for payment of debt service.

Source: Hartnell Community College District and Moody’s investors Service

Detailed Rating Considerations

Economy and Tax Base: Sizable, Growing Tax Base with Below-average Socioeconomic Metrics, Typical of an Agricultural Economy

The district’s fiscal 2017 AV reached $25.5 billion, up 2.9% from the prior year and growing at an average annual rate of 3.6% since fiscal 2005. The estimated growth in AV for fiscal 2018 is 5.7%. We anticipate that the tax base will continue to grow, given new development underway.

The district’s AV declined 12.8% during the recession, including a considerable single year loss of 8.0% in fiscal 2010. After hitting its recession trough in fiscal 2012, the district returned to growth and surpassed its pre-recession peak in fiscal 2016. While the district’s AV is large in absolute terms, it is among the smallest for Aa2-rated community college districts in California and falls below the national Aa2 median of $31.9 billion. Full value per capita is $92,197, falling near or below national and state medians for the rating category, which are $89,009 and $103,927, respectively, but reflecting the district’s underlying agricultural economy.

The district’s tax base is sufficiently diverse, with residential uses comprising approximately 64% of secured AV and the top ten taxpayers accounting for 5.6% of total AV. They include gas and oil production, agriculture, apartment complexes, and miscellaneous commercial uses. The district’s AV should continue to grow, given new residential development underway in Salinas and Soledad, and the significant amount of developable land within the district. The regional housing market has returned to healthy growth, and the
median home sales price for the district's principal cities is about $450,000, as compared to the median AV of a home in the district of $245,000. The spread in these values provide a healthy level of untapped value for future tax base growth.

Consistent with many agricultural economies, the district's socioeconomic profile is below average. While the median family income (MFI) in Monterey County is 98.3% of the US MFI, the district does not include the county's wealthy coastal enclaves. Based on the MFI of the five K-12 school districts that, when combined, are nearly contiguous with the CCD, the MFI of district residents is estimated at 83.8% of the US MFI. The unemployment rate in Monterey County equaled 5.5% in June 2017, exceeding the rates in the state and nation for the same time period, which were 4.9% and 4.5%, respectively.

Financial Operations and Reserves: Strong Financial Position Supported by Growing Enrollment and Balances Outside General Fund
The district's strong financial position and operating flexibility are key credit strengths. The district ended fiscal 2016 with a $1.1 million general fund surplus. The available fund balance equaled $10.9 million, or 17.1% of general fund revenues. The district is expecting a $409,000 draw on general fund reserves in fiscal 2017, the result of spending prior-year, one-time revenues on one-time expenses. The district is budgeting an $807,000 general fund surplus for fiscal 2018. Because the district regularly outperforms its budgets, we anticipate that general fund balances will remain strong, equaling at least 17% of revenues.

The district has a regular practice of transferring general fund operating savings to other funds for other uses, including capital outlay and to fund its OPEB and pension trust funds. As of fiscal 2016, the district had $8.9 million in balances outside the general fund that were available for general fund purposes without repayment. These balances reflect an additional 14% of general fund revenues. Notably, the district has irrevocable trust funds for its OPEB and pension liabilities, equaling $4.3 million and $1.0 million, respectively.

General fund revenues should continue to grow, given the recovery of the state's CCD funding environment and the district's growing enrollment, which is expected to increase by 1% to 3% annually in the near term. The district can readily absorb enrollment growth through modest staffing increases without compromising its strong financial position, and has added 100 positions since fiscal 2013. Additionally, the district does not face built-up pressure for salary increases given significant, recent compensation awards of 5% in fiscal 2014 and 4% in fiscal 2015 to its employee organizations. Salary increases for fiscal 2018 are manageable at 1.5%. Community colleges typically feature a countercyclical enrollment trend that declines during periods of economic expansion. The district's expanding enrollment positions it favorably amongst its peers, as it is poised to benefit from an improving state education funding environment.

On an operating basis, which for the purposes of our analysis includes the district's debt service funds, the available balance in fiscal 2016 equaled a strong 20.8% of operating revenues, reflecting balances held by the county that are restricted for use in payment of debt service.

LIQUIDITY
The district's general fund cash position is strong, with fiscal 2016 ending cash balance of $14.6 million or 23.0% of revenues. Additionally, balances outside the general fund noted above provide the district with additional liquidity.

Debt and Pensions: Somewhat Elevated, but Manageable Debt and Pension Liabilities; Minimal OPEB Liability
The current offering includes $70 million from the district's Measure T bond authorization approved by voters in November 2016. Post-issuance, the district will have $97 million in remaining bond authorization, which will be issued over the next six years, as AV growth permits. The district's outstanding debt includes $140.6 million par value GO bonds.

Post-issuance, the district will have $210.6 million in net direct debt, equal to a somewhat-elevated 0.8% of AV. Given anticipated AV growth, we expect that this will remain manageable, despite planned additional issuances.

The ten-year payout rate is a slow 26.1%, reflecting the district's capital appreciation bonds that are structured such that the majority of principal is repaid in out years.

DEBT STRUCTURE
The current offering includes $70 million in fixed-rate, current interest GO bonds maturing through 2047. The district's post-issuance debt portfolio will consist of about $210.6 million par value in current interest and capital appreciation GO bonds, carrying fixed rates of interest, with final maturity in 2050.
DEBT-RELATED DERIVATIVES
The district has no debt-related derivatives.

PENSIONS AND OPEB
District employees participate in the California Public Employee Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS). The Moody's adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, was $109.7 million in fiscal 2016. The three-year average of ANPL to operating revenues is moderate at 1.5 times operating revenues and the three-year average of ANPL to full value is moderate at 0.4%. 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 district is pre-funding its other post-employment benefits (OPEB) in an irrevocable trust. The district's OPEB unfunded actuarial accrued liability was $5.1 million in fiscal 2016, a low 25% of covered payroll.

Management and Governance
California community college districts have an institutional framework score of A or moderate. California community college districts have a low level of revenue raising ability. For most districts, revenues are primarily set by the state with revenue raising ability limited to fundraising or approval of a parcel tax requiring a two-thirds majority vote. State law sets a minimum annual funding level for community college districts that is designed to provide districts with a guaranteed funding source that grows each year with the economy and the number of students enrolled. However, revenue predictability has proven somewhat unstable, given that the state can easily make unexpected revenue reductions based on the volatility of the state's general fund revenues per capita. Expenditures for community college districts are highly predictable, and CCDs have significant expenditure flexibility with respect to staffing and course offerings.

Positively, the district adopted a formal reserve policy in 2014 to maintain unrestricted general fund reserves equal to at least 20% of unrestricted general fund expenditures.

The district's five-year operating ratio is moderate at 1.01 times, which is understated given the district's practice of transferring operating surpluses out of the general fund for capital outlay and other uses.

Legal Security
The general obligation offering is secured by an unlimited property tax pledge of all taxable property within the district boundaries. Debt service on the rated debt is secured by the district's voter-approved unlimited property tax pledge. The 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 GO bonds.

Use of Proceeds
Proceeds of the current issuance will be used to finance the acquisition, construction, modernization and equipping of district sites and facilities. In particular, the district will construct a new health sciences facility, which will enable it to expand it offerings and accommodate additional students.

Obligor Profile
Hartnell Community College District spans 3,000 square miles in Monterey County (Aa2) and a very small portion of San Benito County, and is anchored by the City of Salinas, which is about 20 miles northeast of Monterey (Aa2) and 60 miles south of San Jose (Aa1 stable). Based on the combined population of five nearly contiguous K-12 school districts, the CCD has an estimated population of 276,729.

The college serves 17,000 students across three campuses, with a full-time equivalent enrollment of 7,345. The district draws students throughout the Salinas Valley, a prominent agricultural region, including the cities of Salinas, Soledad, Greenfield and King City.

Methodology
The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.
### Ratings

#### Exhibit 2

**Hartnell Community College District, CA**

<table>
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<th>Issue</th>
<th>Rating</th>
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<td>Election of 2016 General Obligation Bonds, Series A</td>
<td>Aa2</td>
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- **Rating Type**: Underlying LT
- **Sale Amount**: $70,000,000
- **Expected Sale Date**: 08/25/2017
- **Rating Description**: General Obligation

*Source: Moody’s Investors Service*
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Hartnell Community College District, CA: New Issue: Moody’s assigns Aa2 to Hartnell Community College District, CA’s 2016A GO Bonds
Summary:
Hartnell Community College District, California; General Obligation

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Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@spglobal.com

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Credit Profile

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<th>Rating</th>
<th>Status</th>
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<td>US$64.455 mil GO bnds (Election Of 2016) ser 2017A due 08/01/2047</td>
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Rationale

S&P Global Ratings raised its long-term and underlying (SPUR) rating to 'AA' from 'AA-' on Hartnell Community College District (CCD), Calif.'s outstanding general obligation (GO) bonds. At the same time S&P Global Ratings assigned its 'AA' long-term rating to the district's election of 2016A GO bonds. The outlook is stable.

The rating action is based upon our view of the district's improved full-time equivalent students (FTES) trend, strengthening within the local economy, reduction of the district's other postemployment benefit (OPEB) liability due to funding into an irrevocable trust, and our opinion of the district's strong financial management policies and practices.

Security & key rating factors

Unlimited ad valorem taxes levied on taxable property within the district secure the GO bonds. The Monterey and San Benito counties’ boards of supervisors have the power and obligation to levy these taxes at the district's request for the bonds' repayment. The county is required to deposit such taxes, when collected, into the bonds' debt service fund. The 2016A GO bonds will be issued for capital improvements to the district that includes facility upgrades and the opening of a new satellite campus. The bonds are authorized under the Nov. 8, 2016, election as part of Measure T, which permitted the issuance of up to $167 million of GO bonds for capital improvements.

The GO rating reflects our view of the district's:

- Large and diverse property tax base with access to the economies of San Jose and Silicon Valley, coupled with good household income and very strong property wealth indicators;
- Effective management of the state funding cycle that has helped the district to maintain very strong available reserves and that is reinforced by a reserve policy well above the state minimum for community college districts;
- Recent donation of a $28 million property that could be converted to cash;
- Operational flexibility as a community college, provided by the ability to reduce class sections and offerings if necessary, an operational feature not shared by other kindergarten through 12th-grade (K-12) districts; and
- Low-to-moderate overall debt burden.

Partly offsetting the above strengths, in our view, are the district's adequate per capita effective buying income (EBI) and high historical unemployment rate.
District overview
The 2,633-square-mile Hartnell Community College District generally straddles the U.S. Route 101 corridor and stretches from Castroville near the Pacific Coast in the northwest corner of Monterey County to Bradley in the southeast corner. Its main campus is in Salinas, which is the county's largest city. In addition to the Salinas campus, the district offers an education center in King City and a Center for Advanced Technology in East Salinas. The district was founded in 1920 and is one of the oldest community college districts in the state of California.

The district offers an array of general, career/technical and specialized programs that include an array of specialized agricultural technology programs under the district’s Agricultural Business and Technology Institute. Other popular programs include offerings in arts, career technical, nursing, physical education, STEM, social and behavioral sciences, and humanities. We note that the district has demonstrated a track record of timely program offerings that address key needs within the region. Supporting our view is the district’s recent introduction of an innovative three-year computer science program that is entirely cohort-based. We believe that this is the only program of its kind within the United States within a community college. At the time of this writing, the current enrollment within the program is about 90 FTES, although we expect the program will grow considerably within the coming years.

Economy
The district serves a population of roughly 262,300 and a local economy that centers on agriculture, energy production, and food processing and excludes the wealthier coastal cities of Monterey and Carmel-by-the-Sea. As a result, we consider local income indicators to be good to adequate, as demonstrated by the county’s per capita effective buying income (EBI) at 108% of the national level and median household EBI at 84% of the national level. In addition, the Monterey County unemployment rate is trending lower at about 7.2%, despite rather volatile seasonal fluctuations influenced by seasonal agriculture employment. The current level is notable as the county produced a monthly unemployment rate of 17.6% in January 2010 at the peak of the economic recession. We also note that the city of Salinas posted a 21.9% unemployment level in December 2010, or one of the highest monthly unemployment rates in the nation at the time.

The district's assessed value (AV) totaled about $25.5 billion for fiscal 2017, a strong 2.9% increase from the fiscal 2016 level of $24.8 billion. The district's overall AV is in the midst of a strong period of multiyear growth since the fiscal 2017 growth represents the fifth consecutive year of growth. Looking ahead, we are anticipating continued growth within the tax base as the preliminary fiscal 2018 AV figures for Monterey County (relatively coterminous with the district's taxing area) grew by 5.7% for the year. The net result is a pro forma market value per capita of about $103,000 or a level that we view as 'very strong'. Offsetting our view of the positive AV forecast, the district's AV was hit relatively hard during the economic recession as AV shed about $3.1 billion (12.8%) over the course four years. The majority of the loss occurred during fiscal 2010 when the district posted an extremely negative 8% AV decline ($1.9 billion) though this level of decline has not rematerialized since the recession.

As previously mentioned, the district's tax base covers a broad area within Monterey and San Benito counties although the primary jurisdiction is Salinas, which contributes 41% of total AV ($10.4 billion). Soledad is a distant second with a 3% ($833 million) contribution followed by King City and Greenfield at 3.0% and 2.5%; respectively. As is typical in agricultural taxing areas, agricultural AV contributions in the form of unincorporated areas from both counties dominate the tax base as about 48%, or $12.7 billion stems from the category. Finally, we consider the district's tax
base to be very diverse, with the leading 10 taxpayers—a broad mix of agricultural, commercial retail, supply chain management, and service-providers—accounting for 5.6% of total AV.

Looking ahead, we are anticipating at least stable AV trends as we are forecasting stable-to-positive growth for the urban regional centers in California as continued home-price appreciation has helped boost local government tax receipts throughout much of the region, including the AV results in community colleges. As a result, we expect the broader macroeconomic forces to support our view and expectation of a stable-to-positive AV result within the near-term future. For additional information, please refer to our "U.S. State And Local Government Credit Conditions Forecast" (published July 24, 2017, on RatingsDirect)

**Enrollment & financial profile**

Similar to other community college systems in the state, the district's full-time equivalent student (FTES) count is influenced by employment cycles and tuition rates, the latter of which are set by the state. The district can enroll students from within and outside its direct service area although it does have regional competitors. As a result, the district plans to capture about 1% annual FTES growth as it continues to increase its share of enrollment from the service area. In fiscal 2017, the district's funded FTES level was 7,345 or about 1% growth from the prior year FTES level. Looking ahead, we are also expecting steady enrollment growth at or near the 1% level as the district's broad array of program offerings and competitive position within the local education market should ensure stable FTES growth. We note that the district's FTES jumped 5% between fiscals 2014 and 2015 as the district opened an outreach center with a focus on adult students.

The district's financial flexibility is very strong in our view, with an available general fund balance of 19.6% of operating expenditures or $11.0 million in audited fiscal 2016, which was led by a very strong $1.1 million general fund operating surplus. The large surplus was partly driven by one-time mandated cost reimbursement from the state and the district's budgeting practices. Historically, the district's general fund operating results echo the fiscal 2016 year-end, as the district has a strong track record of positive operations. Looking ahead, we expect this trend to continue as the district expects to close fiscal 2017 with a slight deficit of $400,000, followed by a very strong planned surplus of about $2.9 million for fiscal 2018. Altogether, the district's fund balance position is likely to increase and maintain around a 20% of general fund operating expenditures or a level that we view as very strong.

An important element to the credit is the recent donation of a 215-acre property from a local family. As this is a new development, we do not have a cash value for the donation at this time, although we do have the property's fiscal 2016 AV ($28 million). While we do expect the cash value of the donation to be greater than $28 million, we believe this transaction to be one of the largest philanthropic transfers of wealth to a community college in the state. Looking ahead, we are uncertain about the use of the property and if all or a portion of the property will be converted to a cash or cash-equivalent asset. We estimate that a full cash conversion at the recent AV would increase our view of the district's available fund balances to about 70% of operating expenditures from the current level of about 20%. This perspective could lead to our placement of the credit on positive outlook or an upward rating change as we believe the credit quality could be improved further if the district were to increase its unrestricted cash balances as a result of the donation.
Financial Management Assessment

We view the district's financial management policies and practices as strong under our financial management assessment (FMA) methodology. An FMA of strong indicates financial practices are strong, well embedded, and likely sustainable. We revised our assessment to strong from good due to a change in our view of the district's debt management policies. Key management practices and policies include frequent review of the budget with board participation, as well as realistic and well-grounded revenue and expenditure assumptions. The district maintains an independent long-term financial plan that forecast multiple years beyond the current fiscal year and is updated at least annually. The district maintains an updated master facilities plan that identifies capital needs, lists funding sources, and is updated at least annually. The district invests exclusively through the county's local government investment pool and defers to the county investment policy. Moreover, the district maintains a formal board-level reserve policy of 20% and audited reports show compliance with the policy. Finally, the district recently adopted a debt management policy per SB-1029.

Debt, pension, and other postemployment benefits (OPEB)

In our view, the overall net debt burden is moderate on a per capita basis at about $3,300, and as a percentage of market value at 3.1%. Carrying charges are typically low, in our view, with debt service accounting for less than 6% of total governmental fund expenditures. The district does not have direct purchase debt on its balance sheet.

The district participates in the California Teachers' Retirement System and the California Public Employees' Retirement System, and fully funded the annual required contributions of representing 3.5% of total operating expenditures in fiscal 2016. The total net pension liability of $48 million represents about 86% of general fund operating expenditures in fiscal 2016; or an above average level for a California CCD. We note that the district is budgeting for planned pension rate increases and we do not anticipate the increases to negatively impact the district's financial performance.

The district offers other post-employment benefits (OPEBs) to eligible district employees and, in response to the long-term liability, the district established an irrevocable OPEB trust that currently carries about $4.8 million of assets. At the current rate of funding within the trust, the district's OPEB liability is about half-funded or a level above the majority of peer district's in the state.

On an annual basis, the district's OPEB funding level was significantly above-average as the fiscal 2016 contribution represented 678% of the annual required contribution (ARC). As a result of the OPEB trust, the district's unfunded actuarial accrued liability (UAAL) is retreating though the current liability is about $5 million liability. As such, we believe that the district's OPEB liability is below that of peer California community colleges as a result of the irrevocable trust.

Outlook

The stable outlook reflects our expectation that the district's available fund balance levels will remain at a very strong level. The stable outlook also reflects our expectation that the district's FTES will remain at least stable along with a very strong general fund operating balance as a result of the district's strong policies and practices. As a result, we do not expect to change the rating within our two-year outlook horizon.
Upside scenario
We could raise the rating within our two-year outlook horizon if the district's economy were to dramatically improve in line with those of higher rated peers. We could also raise the rating if the district were to substantially improve its fund balance position should the district convert the donated property to cash.

Downside scenario
We could lower the rating if the district's available fund balances were to reduce to a level in line with lower rated peers. We could also lower the rating if the district's economic indicators were to materially weaken, as indicated by the district's EBI figure or AV trend.

Related Research
U.S. State And Local Government Credit Conditions Forecast, April 18, 2017

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