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CREDIT OPINION

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Contacts

Austin Harris +1.415.274.1707
Associate Lead Analyst
austin.harris@moodys.com

Alexandra J. Cimmiyotti +1.415.274.1754
VP-Sr Credit Officer
alexandra.cimmiyotti@moodys.com

Sunny Zhu +1.415.274.1721
Analyst
sunny.zhu@moodys.com

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Pasadena Area Community College District, CA

Update after upgrade to Aa1

Summary

Pasadena Area Community College District, CA's (Aa1) credit profile is supported by the district's large LA metro based taxbase which will continue to see solid growth over the medium term driven by housing turnover as well as the efforts of the district's proactive management team to position the district for success under the state's new Student Centered Funding Formula (SCFF). While the district's fiscal reserves and liquidity are somewhat below average for the rating, the district's demonstrated ability to consistently keep reserves at these levels, coupled with a robust minimum fund balance policy give us confidence that the district will continue to maintain an acceptable financial profile for the rating level. The district's credit profile also reflects its above average socioeconomic measures, a stable enrollment trend supported by significant out of district enrollment and a moderate debt and pension burden.

On February 13, 2020 Moody's upgraded the district's GO rating to Aa1 from Aa2.

Credit strengths

- » Large and diverse tax base demonstrating sustained annual growth rates coupled with above average wealth levels
- » Low debt burden with rapid payout
- » Proactive management of pension and OPEB liabilities
- » Significant winner under new CCD funding formula

Credit challenges

- » Somewhat thin reserves for the sector and rating level
- » State not fully funding the new funding model creates uncertainty for all CCDs
- » Rising pension costs common across all California CCDs

Rating outlook

Outlooks are not typically assigned to credits with this level of debt outstanding.

Factors that could lead to an upgrade

- » Attainment of community funded status

- » Significant and sustained growth in financial reserves and liquidity consistent with the higher rating category

Factors that could lead to a downgrade

- » Material weakening in the district's financial position, including a narrowing of reserves
- » Loss of market share as evidenced by a material reduction in out of district students

Key indicators

Exhibit 1

Pasadena CCD	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$69,664,518	\$74,969,448	\$78,920,378	\$84,165,761	\$89,050,285
Population	431,073	431,270	433,558	433,558	433,558
Full Value Per Capita	\$162,071	\$173,834	\$182,030	\$194,128	\$205,394
Median Family Income (% of US Median)	157.5%	153.5%	163.5%	163.5%	164.0%
Finances					
Operating Revenue (\$000)	\$155,524	\$188,065	\$194,617	\$206,934	\$210,011
Fund Balance (\$000)	\$21,202	\$28,243	\$32,860	\$32,943	\$36,091
Cash Balance (\$000)	\$37,916	\$49,473	\$55,123	\$50,219	\$50,068
Fund Balance as a % of Revenues	13.6%	15.0%	16.9%	15.9%	17.2%
Cash Balance as a % of Revenues	24.4%	26.3%	28.3%	24.3%	23.8%
Debt/Pensions					
Net Direct Debt (\$000)	\$70,823	\$87,465	\$81,766	\$77,214	\$73,430
3-Year Average of Moody's ANPL (\$000)	\$295,166	\$322,243	\$358,223	\$400,617	\$424,999
Net Direct Debt / Full Value (%)	0.1%	0.1%	0.1%	0.1%	0.1%
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.4x	0.4x	0.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.4%	0.4%	0.5%	0.5%	0.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.9x	1.7x	1.8x	1.9x	2.0x

Source: Moody's Investors Service

Profile

The district is located in the West San Gabriel Valley of the County of Los Angeles (Aa1 Stable). The district operates Pasadena City College located on a 53-acre site in the City of Pasadena, as well as three satellite campuses. Pasadena CCD is governed by a seven-member Board of Trustees, with each member elected by trustee area to four year terms. The district's FTES enrollment in 2020 is 22,829.

Detailed credit considerations

Economy and Taxbase: Large, affluent taxbase well positioned for continued growth

The district's credit profile is underpinned by its strong, stable and diverse LA Metro tax base. Growth in the district's assessed value (AV) has remained robust over the past five years, with an average annual growth in AV of 6.1% resulting in a \$93.9 billion tax base in fiscal 2020. The area is largely built out so the majority of this growth is derived from housing turnover. With a third of the district's single family homes having an AV of below \$300,000 compared to the average of \$720,000, we expect that housing turnover will continue to drive further taxbase growth over the medium term.

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The district's tax base is diverse, with the top ten taxpayers making up only 2.4% of the total AV. These taxpayers are concentrated in office buildings, shopping centers and hotels. The Rose Bowl stadium and NASA's Jet Propulsion Lab are also located within the district's boundaries. Unemployment in the city of Pasadena, the largest component of the district is low at 3.4% as of December 2019.

The district has above average wealth measures, with an AV per capita of around \$200,000 and an MFI of 164% comparing favorably to similarly rated peers. Wealth measures in the district are strong, with the district's MFI of 164% of the US comparing favorably to comparably rated CCD's in California.

Financial Operations and Reserves: Stable, somewhat narrow reserves supported by positive enrollment trends

The district benefits from a strong management team that has maintained a stable financial position in recent years. We expect the district's finances will remain appropriate for the rating level going forward given the improved state funding environment and management's conservative budgetary practices.

Available general fund reserves at the end of fiscal 2019 were adequate at 14.6% of revenues. While reserve levels fall below the national Aa1 23% medians for CCDs, they are slightly above the CA Aa1 median of 12% and have remained stable, fluctuating within a narrow band over the past three years. The district's 2020 budget shows a small deficit, however the district anticipates outperforming its budget and returning a small surplus at years end, which has been its pattern for the past few years.

The district's recently adopted board policy is to maintain a minimum of 18% in unrestricted general fund reserves, up from 5%, which is not directly comparable to available general funds which includes assigned and committed funds, but equates roughly to the district's current reserve level. This new policy coupled with the district's stable financial performance give us confidence that the district will continue to keep reserves at or around this level.

The district has experienced a period of stable steady enrollment growth, with an FTES in 2020 of 22,829 up from its recent low of 19,740 in 2013. In general the district has grown enrollment by about 1% annually, a positive outcome given generally flat to declining CCD enrollment in California. The district also has significant success in drawing in students from outside its boundaries with around 74% of its students living outside of the district, a remarkably high number which the district has maintained for a number of years. This helps boost the district's number of need based Pell Grant students, a component of supplemental funding under the new SCFF, despite having an MFI of 164%. While ordinarily such an outsized reliance on out of district transfers would represent a risk to the district's finances, given that its students have other, more conveniently located options, however the district's stable enrollment through the economic cycle, supported by these out of district transfers, coupled with their strong performance discussed below, give us confidence that Pasadena will continue to benefit from these transfers.

The district has invested considerable effort in supporting its students, with a number of pathway and student mentoring programs which both aid students transitioning to college and helps ensure they successfully graduate or transfer. The college boosts a very high transfer to four year college rate of 49% against the national 39% average and is the number 1 in the California for transfers to the UC and CSU systems. These successes will hold the district in good stead as the SCFF moves to more heavily weight success metrics such as transfers in coming years.

LIQUIDITY

The district's general fund liquidity position is solid at \$43.4 million or 21.5% of revenues, slightly down from the \$47.6 million the district had at the end of fiscal 2017. In addition the district has over \$34 million available in funds outside the general fund that are usable for temporary liquidity purposes if required.

Debt, Pensions and OPEB: Modest and manageable debt and pension burdens

The district benefits from a minimal debt burden of around 0.1% of assessed value, and without any remaining debt authorization, we expect it will remain so going forward. Like most California CCDs the district's pensions are somewhat elevated, and will represent a growing burden on the general fund, however the district is taking proactive measures to mitigate this impact.

DEBT STRUCTURE

The district's debt is all fixed interest General Obligation Bonds with a final maturity of 2034.

DEBT-RELATED DERIVATIVES

The district does not have any debt-related derivatives.

PENSIONS AND OPEB

Pension and OPEB costs will continue to pose an increasing expenditure pressure on the district, typical of other California CCDs as current pension contributions are not sufficient to keep the liability from increasing. District employees participate in the California Public Employee Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS). In fiscal 2019, the district reported a net pension liability using a 7.12% discount rate is \$170.1 million, significantly lower than the Moody's adjusted NPL using a 3.87% discount rate of \$421.3 million, which equates to 2.0 times operating revenues.

The district's pension contributions represented 7.9% of its operating revenue in fiscal 2018, up from 4.4% of operating revenue in fiscal 2014. To help offset the impact of rising pension contributions the district has established an irrevocable pension stability trust with Public Agency Retirement Services (PARS), which currently holds \$5.3 million. This trust can be used to augment the district's pay go pension expense in any given year.

In fiscal 2019, the district's pension contribution was \$192,000 below Moody's calculated tread water level, or the level of contribution that would prevent reported unfunded liabilities from growing under reported assumptions. This contribution gap a de minimis amount level of operating revenue, signaling that the district's reported pension burden will remain at or around current levels assuming investment targets are achieved.

Unusually, the district continues to offer lifetime OPEB benefits to eligible employees, however the annual amount is modest at \$1,440 with fairly long vesting periods. Positively, the district has created an irrevocable trust for OPEB which at the end of fiscal 2019 had accumulated assets of \$12.8 million against a net OPEB liability of \$19.0 million or around 40% funded.

Environmental, Social and Governance Considerations

The district benefits from a strong and experienced management team and board which have been proactively positioning the district to maximize its funding under the new SCFF.

California CCDs have an Institutional Framework score of "A", or moderate compared to the nation. California CCDs' 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 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

Despite CCD enrollment typically exhibiting counter cyclical patterns, the district has been able to stable enrollment despite a sustained period of low unemployment and economic growth.

Environmental considerations are not a material credit rating driver for the district at this time

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