

RatingsDirect®

Summary:

Alum Rock Union Elementary School District, California; Appropriations; General Obligation

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Credit Profile

Alum Rock Un Elem Sch Dist taxable COPs (QSCBs) ser 2010A (MAC) (SEC MKT) <i>Unenhanced Rating</i>	BBB(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative
Alum Rock Un Elem Sch Dist GO <i>Long Term Rating</i>	BBB+/Watch Neg	Downgraded, On CreditWatch Negative

Rationale

S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'BBB+' from 'AA-' on Alum Rock Union Elementary School District (ESD), Calif.'s outstanding general obligation bonds. S&P Global Ratings also lowered its long-term rating and SPUR to 'BBB' from 'A+' on the district's certificates of participation (COPs). All of the ratings remain on CreditWatch with negative implications.

The rating actions reflect a change in our assessment of the district's management, brought about by confirmation from the district that the Santa Clara District Attorney's (DA) Office has opened an active investigation into the district, our concerns about the district's ability to reconcile its cash position in a timely manner, and the difficulties we have encountered in obtaining information from district management.

Revenue from unlimited ad valorem taxes levied on taxable property within the district secures the bonds. The Santa Clara County Board of Supervisors has 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 COPs represent an interest in lease payments made by the district, as lessee, to the Public Property Financing Corp. of California, as lessor, for the use and possession of the leased asset.

FCMAT report and DA investigation

On June 9, 2017, the California Fiscal Crisis & Management Assistance Team (FCMAT) released an "extraordinary audit" of Alum Rock Elementary School District that concluded: "there is sufficient evidence to demonstrate that fraud, misappropriation of funds and/or assets, or other illegal activities may have occurred in the specific areas reviewed." The report also noted that FCMAT had "serious reservations about the district's ability to repay the COPs without affecting the unrestricted general fund. As a result, the debt service payments pose a serious threat to the district's ongoing fiscal solvency." Based on the 2010 official statement, the next debt service payment for the series 2010A COPs will be on Dec. 1, 2017. Based on subsequent conversations with us, management has indicated that the district has a plan to address the debt service payments for the COPs.

On Sept. 14, the district confirmed to S&P Global Ratings that the Santa Clara County DA's Office had initiated an

active investigation of the district. District intermediaries were unable to provide additional information to us about the investigation, and could not confirm if the investigation's scope went beyond the issues identified in the FCMAT report. The district also declined to provide responses to our questions about how the district is planning for any fiscal contingencies that could arise as a result of the investigation.

Conditional budget approval due to cash reconciliation, governance concerns

On Sept. 15, the Santa Clara County Office of Education (COE)--one of the bodies charged with fiscal oversight of school districts--completed its review of Alum Rock ESD's 2018 budget, as required by education code (EC) sections 42127 and 52070, and "conditionally approved" the district's budget. Per EC sec. 42127.4, until a school district receives approval of its budget, the district generally has to operate at prior-year levels. The Santa Clara COE explained that cause for the conditional approval was based on the district's "on-going and unresolved cash accounting issues" coupled with weaknesses in the district's control environment and governance issues, including "micro-management of staff and decision making" and "an erosion of public confidence in the Board's ability to make sound, ethical decisions, especially in management of the Bond program." The letter went on to state, "Requests that the district prepare timely reconciliations of its book's cash to those of the county treasury were made multiple times...during the past fiscal year" but that "delays in providing monthly reports are recurring."

As a condition of budget approval, the COE has requested that the district complete several deliverables by Oct. 8, 2017, including "preparation of the monthly cash reconciliation by each monthly due date" and "preparation of a cash flow report for the current fiscal year that utilizes ending cash balance from the June 30 cash reconciliation as verified by a third party auditor." We note that while the district has received clean opinions on its recent financial statement audits, the Santa Clara COE has additionally required that the district seek approval from the Santa Clara COE for the third-party auditor retained by the district for this audit.

We also note that the district's financial and economic fundamentals could be consistent with a higher rating and that the presence of an active investigation into the district would not necessarily change our assessment of management on its own; however, the existence of the investigation coupled with significant audit findings, concerns by district oversight bodies about governance, and difficulty in our ability to obtain information from the district about these issues caused a change in our assessment of management and potential sources of risk.

The CreditWatch with negative implications placement reflects our concern that the district may be unable to provide sufficient information to assuage the Santa Clara COE's concerns about the district's cash reconciliation. We note that if the district is unable to address these reconciliation concerns, our determination that information provided by the district is reliable could be called into question. After we have further evaluated the deliverables expected in October and other relevant information, we may lower our ratings, or withdraw our ratings, or both. This would occur during the 30 days of the CreditWatch horizon, although it is possible that the CreditWatch status could be resolved sooner.

Ratings Detail (As Of September 29, 2017)

Alum Rock Un Elem Sch Dist

Long Term Rating

BBB/Watch Neg

Downgraded, On
CreditWatch Negative

Ratings Detail (As Of September 29, 2017) (cont.)

Alum Rock Un Elem Sch Dist GO		
<i>Long Term Rating</i>	BBB+/Watch Neg	Downgraded, On CreditWatch Negative
Alum Rock Un Elem Sch Dist GO (AGM)		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative
Alum Rock Un Elem Sch Dist GO (ASSURED GTY)		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Watch Neg	Downgraded, On CreditWatch Negative

Many issues are enhanced by bond insurance.

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