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Summary:

San Ysidro School District, California; Appropriations; General Obligation

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Credit Profile

San Ysidro Sch Dist GO

Unenhanced Rating

BBB-(SPUR)/Negative

Downgraded

Rationale

Standard & Poor's Ratings Services lowered its rating to 'BBB-' from 'A+' on San Ysidro School District, Calif.'s general obligation (GO) bonds based on our view of the district's recent weakened financial position as well as the district's disclosure that it may apply for a loan from the state to meet operational needs through fiscal 2014. In addition, Standard & Poor's lowered its underlying rating (SPUR) to 'BB+' from 'A' on the district's certificates of participation (COPs) outstanding. The outlook is negative.

The ratings reflect our view of the district's:

- Weakened finances and extremely limited financial flexibility with no agreed-upon concessions with the bargaining units at this time;
- Current-year liquidity concerns and the need for approval to obtain a state loan;
- Multiple years of negative operations due to a planned spend down and overly optimistic revenue projections, combined with a projected structural imbalance; and
- Pending lawsuits and ongoing investigations.

In our opinion, the preceding credit weaknesses are partly offset by the district's large property tax base, participation in San Diego County's diverse economy, and stable average daily attendance (ADA), a key determinant of state aid.

Unlimited ad valorem taxes levied on taxable property within the district secure the bonds. The San Diego 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 San Ysidro Schools Public Financing Corporation, as lessor, for the use and possession of the leased asset.

While the district has historically maintained a good financial position during the last several years, in our view, the district has budgeted to end both fiscal 2014 and fiscal 2015 with a negative assigned and unassigned general fund balance. The district closed audited fiscal 2012 with \$2.2 million, or 5.4% of expenditures, which we consider good. According to the estimated actuals for fiscal 2013, the district drew down on the general fund and ended the year with a balance of \$1.6 million, or 4.0% of expenditures, which we view as adequate. Fiscal 2013 is the sixth consecutive year of drawdowns on general fund reserves. Management described the deficit spending as a planned spend down in order to provide the resources necessary to boost the district's test scores; however, the plan was based upon the

expectation that the state funding environment in fiscal 2013 would be restored close to the level of funding received in fiscal 2008. While the state funding environment has improved this past year, funding remains significantly lower than the fiscal 2008 level. In addition, management expressed that there have been no agreed-upon concessions with the bargaining units, and expressed that there are no additional areas in the budget to cut without collective bargaining concessions. Including the additional money the district would receive under the current Local Control Funding Formula, the district anticipates negative general fund operations of roughly \$3.2 million for fiscal 2014. Accordingly, the district anticipates an assigned and unassigned general fund balance of negative \$1.5 million, or negative 3.5% of expenditures, which we consider low.

As a result of the recent drawdowns and limited operational flexibility, the district has sought and received a loan from the county in order to meet its cash flow needs. Even with the loan, the district stated it expects to have no liquidity by May 2014. With the county loan, the district is currently operating with a county financial advisor to assist in overseeing the district's operations. Due to imminent liquidity concerns, we understand that management has decided to seek an unsecured loan from the state, the receipt of which would result in its entering state receivership. We understand that if the district were to go into state receivership, district management would need to turn over the administration of the district's daily operations to an appointee of the state superintendent of public instruction. The appointee would exercise the power and responsibilities of the district's governing board.

In addition to the current fiscal challenges, the district is currently involved in two legal matters. First, the former superintendent, who was put on leave in January 2013 and retired effective June 30, 2013, and one of the current board members are currently a part of an ongoing FBI investigation on corruption charges. Second, on April 5, 2012, Eco Business Alliance LLC, a company retained by the district to install solar energy projects at various district school sites, filed a breach of contract lawsuit against the district for approximately \$17.9 million in damages, which is roughly 42.9% of the district's \$41.7 million budget in fiscal 2013. A judgment against the district in this case could have a significant negative effect on the district's general fund. We expect to be updated with further materials as the legal process develops and will analyze the potential effects on the district's credit once more information is available. We feel that these pending outside factors have contributed to the breakdown in relations between the district and the bargaining units and to a lack of confidence in management. At a minimum, the lawsuit and investigation may continue to serve as a distraction from existing fiscal challenges, in our opinion.

The district is located in southwest San Diego County, 12 miles south of downtown San Diego. It serves a portion of the city and unincorporated areas of the county. ADA, which is the primary basis for state funding levels, is approximately 93% of the district's enrollment and has been relatively flat for the last several years. For fiscal 2014, the district has budgeted for continued flat ADA at 4,911 students. However, due to the planned future growth in the district, management expects ADA will increase significantly during the next 10 years. Assessed value (AV) for fiscal 2013 is \$4.4 billion, which is a decline of 5.6% from the previous year. AV was relatively stable during the previous three years, decreasing by less than approximately 2%. Market value per capita is extremely strong, in our opinion, at roughly \$102,000. In our opinion, the district's median household income is good, at 121% of the national level, while its per capita income is low, at 58%, representing the larger and extended families that live together in the district.

The district participates in the State of California Teachers' Retirement System and the State of California Public

Employees' Retirement System, and fully funded the annual required contributions of \$1.7 million and \$736,000, respectively, for fiscal 2012. Combined district contributions represented 5.9% of governmental expenditures. In addition, the district funds its other postemployment benefits on a pay-as-you-go basis; in fiscal 2012, it funded \$384,000 or less than 1.0% of total governmental expenditures.

We have revised the district's financial management assessment (FMA) score to "standard" from "good" under our FMA methodology due to the district's projection that it will fall below the state-mandated 3% reserve policy in fiscal 2014, overly optimistic revenue and expenditure assumptions, and inability to make budget amendments in light of gridlocked negotiations with labor. An FMA of "standard" indicates our view that the finance department maintains adequate policies in some, but not all, key areas.

In our view, the district's overall net debt burden is high on a per capita basis, at \$6,900, and moderately high as a percent of market value, at 6.4%. The district's carrying charge is 10.1%, which we consider moderate. The district has approximately \$175 million of GO bonds and COPs outstanding. We understand that the district has no plans to issue additional debt within the next 12 to 18 months.

Outlook

The negative outlook reflects our opinion that the rating will come under pressure during the next nine months because the district might not receive state loans or management may fail to address the near-term budget gap, leaving the district in a financial imbalance. We could lower the rating if the district's finances were to continue to weaken because of insufficient liquidity for operations resulting from a poor match between receipt of state loans, issues with its contingent liabilities, or a continuing structural imbalance. However, we could revise the outlook to stable if the district were able to adjust its finances and place itself on a path toward long-term structural balance and sufficient liquidity.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Ratings Detail (As Of July 25, 2013)

San Ysidro Sch Dist certs of part (Sch Fac Proj) ser 2012 (AGM)		
<i>Unenhanced Rating</i>	BB+(SPUR)/Negative	Downgraded
San Ysidro Sch Dist GO (wrap of insured) (FGIC) (MBIA) (National)		
<i>Unenhanced Rating</i>	BBB-(SPUR)/Negative	Downgraded
San Ysidro Sch Dist GO (AGM)		
<i>Unenhanced Rating</i>	BBB-(SPUR)/Negative	Downgraded
San Ysidro Sch Dist certs of part (School Facilities Project) ser 2007		
<i>Unenhanced Rating</i>	BB+(SPUR)/Negative	Downgraded
San Ysidro Sch Dist certs of part (School Facs Proj)		

Summary: San Ysidro School District, California; Appropriations; General Obligation

Ratings Detail (As Of July 25, 2013) (cont.)

<i>Unenhanced Rating</i>	BB+(SPUR)/Negative	Downgraded
San Ysidro Sch Dist go bnds (1997 Election)		
<i>Unenhanced Rating</i>	BBB-(SPUR)/Negative	Downgraded
San Ysidro Sch Dist (Sch Fac Proj) certs of part ser 1998		
<i>Unenhanced Rating</i>	BB+(SPUR)/Negative	Downgraded
San Ysidro Sch Dist 2001 certs of part (Sch Fac Proj) dtd 06/01/2001 due 09/01/2001-2016 2020 2025 2030		
<i>Unenhanced Rating</i>	BB+(SPUR)/Negative	Downgraded
San Diego Cnty, California		
San Ysidro Sch Dist, California		
San Ysidro Sch Dist (San Diego Cnty) GO		
<i>Unenhanced Rating</i>	BBB-(SPUR)/Negative	Downgraded
Many issues are enhanced by bond insurance.		

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