Research Update:

Palomar Community College District, CA GO Bond Rating Affirmed At 'AA'

February 26, 2025

Primary contacts

Joyce Jung
Englewood
1-212-4380629
joyce.jung
@spglobal.com

Robert Tu, CFA
San Francisco
1-415-371-5087
robert.tu
@spglobal.com

Credit Highlights

- S&P Global Ratings affirmed its 'AA' long-term rating on Palomar Community College District (CCD), Calif.'s existing general obligation (GO) bonds.
- The outlook is stable.

Rationale

Security

The district's GO bonds are secured by revenue from unlimited ad valorem taxes levied on taxable property within the district.

In an effort to support the facility upgrade at the San Marcos campus, the district has preliminary plans to approach voters for additional bond authorization. The estimated bond proceed is sizable, approximately $638 million, which the district will issue multiple series over the long term. Considering that the incoming leadership members will partake in the district's capital improvement plan, the timing of this bond election is uncertain at this time.

Credit overview

The rating reflects our view of Palomar CCD's strong enterprise risk profile and adequate financial risk profile. The enterprise risk profile reflects the district's rebounding enrollment from the pandemic loss, sizable service area population, and experienced leadership team, though there have been some recent transitions and a vacant Vice President of Fiscal and Administrative Services position. The financial risk profile reflects the CCD's projected deficits for fiscal years 2025 through 2028, primarily driven by expenditures growth outpacing revenue and limited flexibility on budget cuts due to labor union negotiations. While we anticipate the financial performance and resources will moderate in the near term, we believe that the district has ample liquidity to withstand these deficits, if managed appropriately. The adequate financial risk profile also reflects the elevated debt burden given the magnitude of prior debt issuances. The rating also reflects the significant depth and breadth of the CCD's robust property tax base, with material assessed value (AV) growth, solid wealth and income metrics, and very low taxpayer concentration, all of which provide material support for both the district's operations and debt obligations.

The rating reflects our view of the district's:

- Large and expanding property tax base, with access to the broad and diverse economy in the San Diego metropolitan statistical area (MSA);
- Rising enrollment trends, supported by a focus on career training programs and growth in the number of dual enrollment students; and
- Healthy liquidity to support the projected drawdowns for the near term.

Somewhat tempering these strengths, in our opinion, are the CCD's:

- Moderating financial performance and resources in the near term;
- Somewhat limited revenue flexibility because of the CCD's high dependence on state revenues, which places a large portion of the operating budget under control of the state, and
- High leverage based on our debt metrics, which we expect will remain high as additional bonds are issued incrementally over the next decade.

Environmental, social, and governance

We view the district's physical risks as elevated due to significant seismic activity in the region, though we believe its compliance with state building codes partly mitigates risk to facilities; the large and diverse tax base is also a mitigating factor. Although the region is exposed to elevated wildfire occurrences, we understand recent wildfires have not expanded within the district's boundaries, and management further indicates this risk, as well as other weather-related events, is mitigated by insurance. We view governance and social factors as neutral in our credit analysis.

Outlook

The stable outlook reflects our view that the CCD has sufficient liquidity to absorb the projected deficits in the near term and our understanding that district leadership plans to adjust the future budget to achieve and maintain structural balance and healthy financial resources. In addition, we do not expect the district to issue additional debt within the outlook period.

Downside scenario

We could lower the rating if the district is unable to correct the budget imbalance, weakening its financial performance and resources to levels we no longer consider commensurate with those of peers.

Upside scenario

We consider a positive rating action for the near term unlikely, given projected operating deficits over the next few fiscal years. We could consider a higher rating beyond the outlook period if the CDD achieves budgetary balance and maintains healthy financial resources while successfully managing its union contracts, all else remaining equal.

Credit Opinion

Enterprise Risk Profile

Economy

The district is in San Diego County, serving approximately 802,349 residents, covering about 2,555 square miles spanning the cities of San Marcos, Escondido, San Diego, Vista, Poway, and Oceanside, among others. Altogether, it covers about 55% of San Diego County, as it shares a border with Mira Costa CCD, Grossmont-Cuyamaca CCD, and San Diego CCD. The district's primary operations are at the main campus in San Marcos, along with an education center in Escondido and four additional outreach sites serving the northern part of San Diego and communities in unincorporated portions of the county, including Mt. Carmel, Fallbrook, Camp Pendleton, and Pauma Valley. Reflective of the large service area and solid local economy, the CCD's tax base is sizable at $161.8 billion, with steady annual growth of 2%. The tax base is diverse, with the 10 leading taxpayers accounting for only about 2% of AV. We expect ongoing tax base stability, based on our view of the regional economy, relatively good access to the San Diego County MSA, and anticipated residential development in the local housing market.

Enrollment

Although enrollment fell substantially during the pandemic years, the district's full-time equivalent (FTE) enrollment rebounded in the past three school years. For fall 2024, the district's FTE enrollment increased to 15,521. While enrollment has not reached prepandemic levels, management anticipates modest growth in the near term and anticipates reaching the prepandemic enrollment level in the long term. The district's student population reflects high school dual enrollment students, as well as students who transfer to the University of California and California State University school systems. In addition, the district offers workforce development training programs, which support the local economy and workforce demand. Although there are several CCDs in the area, management indicates that they are not significant competition, as the CCDs are restricted to their designated service area and the students typically attend the school where they reside.

Management

The district is governed by six board members: five board members along with one nonvoting student trustee. The board term limit is four years for board members, and one year for student trustees. Board members and management meet monthly for strategic and operational oversight, reviewing monthly budget to actual reports, quarterly investment reports, and the five-year long term financial plan. The district also has a formal investment and reserve policy of holding at least 16.67% of operating expenditures, which it adheres to. The district is in the process of developing a long-term capital improvement plan for potential bond authorization in upcoming years.

There has been material turnover in key management positions: two new board members, a new senior director of fiscal services, and a new vice president of fiscal and administrative services. The district is supported by the interim vice president of fiscal and administrative services and is in the process of filling the position permanently.

The new leadership team developed the fiscal 2025 budget along with the five-year long-term financial plan, which reflects consecutive deficits through fiscal 2028. Although leadership acknowledges expenditures are outpacing revenues due to the expiration of the hold harmless agreement under the state funding formula and rising personnel-related expenditures associated with union contract negotiations, the board approved and is supportive of use of excess cash to support the operating budget. Management indicates that the district will adjust future budgets (fiscal years 2027 and 2028) as needed to maintain a healthy budget and liquidity; however, the board is not considering active budget cuts for fiscal years 2025 and 2026, at this time. We will continue to monitor management's ability to balance future budgets and navigate tenuous union negotiations.

Financial Risk Profile

Finance performance

The district's financial performance reflects mixed operating results. While the CCD reported positive operating margins in fiscal years 2021 through 2023, it reported negative operating margins from fiscal years 2015 through 2020. In addition, the fiscal 2025 budget, along with the long-term financial plan, indicates further deficits from fiscal years 2025 through 2028, largely due to expenditures outpacing revenues. Management attributes these deficits to state revenue loss associated with the expiration of the hold harmless agreement from the state funding formula, along with current enrollment being below the prepandemic level and rising expenditures associated with labor contracts negotiated in fiscal 2023, which extend through fiscal 2025 for faculty and fiscal 2026 for the classified staff. Management anticipates a modest deficit of 2% for fiscal 2025 and 4% for fiscal 2026; however, management projects larger deficits in fiscal years 2027 and 2028 if expenditures continue to rise without corresponding revenue growth. To manage the deficit budgets, leadership plans to be strategic about hiring and replacing retirees, and to adjust staffing based on the current enrollment.

Liquidity and financial flexibility

In our view, despite projected use of reserves, the district's financial resources are healthy for the rating and the CCD has sufficient cushion to support these multiyear deficits. After adjusting out about $130 million of bond proceeds that will be spent down in the next few years, the district's adjusted cash and investments are approximately $155 million or about 55% of total adjusted operating expenditures for fiscal 2024. Based on the projected deficits through fiscal 2028, we anticipate financial resources to be approximately 41% of total adjusted operating expenditures. However, management indicates the magnitude of future deficits will be lower than budgeted, due to anticipated increase in property tax revenues, along with reallocation capital expenditures funds to support operations. We will continue to monitor the CCD's liquidity, as persistent budgetary imbalance could materially reduce the overall financial profile.

Debt, pension, and OPEB liabilities

We view the district's debt burden to be elevated, with approximately $721.7 million in debt outstanding, along with a maximum annual debt service burden of 29.5%. Principal paydown is below average, in our view, with 27% of debt scheduled to retire in the next 10 years. Considering that the district will ask voters for additional bond authorization in the coming years, we expect its debt profile will remain elevated. Because the board has no definite timeline for additional issuance or the voter election, we have not considered potential debt in our pro forma analysis.

We do not view pension and other postemployment benefits (OPEB) liabilities as a near-term source of credit pressure, despite lower funding levels and our expectation that costs will increase. While the CDD's pension contributions are set to increase for the next few years (similar to those of peers), the statutory funding policy for the larger pension plan mitigates the risk of dramatic cost escalation contributions, because the state is required to absorb most of any needed future cost increases. The cost of pensions under the state's plan is expected to increase in the next several years, and management has incorporated these increases in its long-term financial plan. Combining both pension and OPEB costs, the district paid 10% of total expenditures in fiscal 2024.

The CDD participated in the following plans as of June 30, 2024:

- Academic employees are members of the California State Teachers' Retirement System: 80.6% funded;
- Classified employees are members of the California Public Employees' Retirement System: 83.5% funded; and
- Single-employer defined-benefit OPEB plan. As of an actuarial report dated June 30, 2024, the district's net OPEB liability was $68.1 million. The district has an irrevocable OPEB trust funded at $16.2 million as of fiscal 2024.

Palomar Community College District, California--Enterprise and financial statistics

	--Fiscal year ended June 30--				
	2025	2024	2023	2022	2021
Enrollment and demand					
Full-time-equivalent enrollment	15,521	15,069	14,429	13,470	14,993
Annual full-time-equivalent change (%)	3.00	4.44	7.12	(10.16)	(8.64)
Tax base					
Service area population	802,349	802,349	802,349	819,269	800,633
Total AV ($000s)	N.A.	161,827,060	150,793,592	139,899,314	134,997,891
Top 10 taxpayers as % of total AV	N.A.	2.0	1.8	1.8	1.9
Market value per capita ($)	N.A.	201,692	187,940	170,761	168,614
Per capita EBI as % of U.S.	N.A.	N.A.	111	113	112
Median household EBI as % of U.S.	N.A.	N.A.	123	124	124
Annual unemployment rate (%)	N.A.	4.7	3.9	3.5	6.5
Income statement	N.A.				
Total adjusted operating revenue ($000s)	N.A.	283,550	274,306	264,915	244,676

Palomar Community College District, California--Enterprise and financial statistics

	--Fiscal year ended June 30--				
Total adjusted operating expense ($000s)	N.A.	283,665	265,452	258,600	239,848
Net adjusted operating income ($000s)	N.A.	(115)	8,854	6,315	4,828
Net adjusted operating margin (%)	N.A.	(0.04)	3.34	2.44	2.01
State appropriations dependence (%)	N.A.	12.2	9.3	11.7	10.7
Student dependence (%)	N.A.	7.0	7.1	7.2	8.8
Taxes and other local support dependence (%)	N.A.	52.8	51.9	49.0	49.5
Financial resources	N.A.				
Cash and investments, including foundation ($000s)	N.A.	298,660	315,115	286,954	255,412
Cash and investments to operations (%)	N.A.	105.3	118.7	111.0	106.5
Total cash and investments to total debt (%)	N.A.	41.3	43.2	39.0	35.3
Debt	N.A.				
Total debt ($000s)	N.A.	722,841	729,757	736,012	723,638
MADS ($000s)	N.A.	83,528	83,528	83,528	83,528
MADS Burden (%)	N.A.	29.4	31.5	32.3	34.8
	N.A.				
Pro forma metrics	N.A.				
Total pro forma debt ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.
Total cash and investments to total pro forma debt (%)	N.A.	N.A.	N.A.	N.A.	N.A.
Pro forma MADS ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.
Pro forma MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.

Total adjusted operating revenue = total operating revenues + institutionally funded financial aid + government appropriations + government grants + endowment spending + tax revenues - realized and unrealized gains/losses. Total adjusted operating expense = operating expenses + institutionally funded financial aid + interest expense – noncash pension and other postemployment benefits expenses. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Student dependence = 100*(gross tuition revenue + auxiliary revenue) / adjusted operating revenue. MADS burden = 100*(MADS/adjusted operating expenses). Cash and investments = cash + unrestricted and restricted financial investments + foundation cash and investments. Total outstanding debt = tax supported debt + revenue/ enterprise-secured debt + foundation debt + other debt. All debt metrics include revenue/enterprise-secured and foundation

Palomar Community College District, California--Enterprise and financial statistics

	--Fiscal year ended June 30--
debt if applicable. FTE--Full-time-equivalent. AV--Assessed value. EBI--Effective buying income. MADS--Maximum annual debt service. N.A. N.A.--Not available. N.M.--Not Meaningful.	

Ratings List	
Ratings Affirmed	
Education	
Palomar Community College District, CA Unlimited Tax General Obligation	AA/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.