FITCH AFFIRMS HILLSBOROUGH CSD, CA'S GOS AT 'AAA'; OUTLOOK STABLE

Fitch Ratings-San Francisco-23 September 2011: In the process of routine surveillance Fitch Ratings has affirmed Hillsborough City School District, California's (the district) bonds as follows:

--$39.8 million general obligation bonds, election of 2002, series 2003A and B at 'AAA'.

The Rating Outlook is Stable.

KEY RATING DRIVERS:
--Strong financial position. The 'AAA' rating reflects the district's strong financial position, exhibited by its basic aid status, a parcel tax to be levied in perpetuity, sound reserve levels, prudent expenditure reductions in recent years, and a high degree of further expenditure flexibility.
--Wealthy and resilient economy. The rating is further supported by an extremely strong economy with a resilient and diverse tax base, exceptionally high wealth levels, and ready access to the San Francisco Bay Area's large and diverse employment market.
--Satisfactory debt profile. The district's debt levels are low, capital needs are limited, and both pension and other post employment benefit (OPEB) costs appear currently manageable, though principal amortization is slow.

SECURITY:
The bonds are secured by an unlimited property tax levied on all taxable properties within the district.

CREDIT PROFILE:
Located in the extremely affluent bedroom community of Hillsborough in San Mateo County, the district serves a population of approximately 10,800 residents, including portions of the cities of Burlingame and San Mateo. Economic characteristics are very strong, including per capita income levels roughly four times the state and national averages and a very high assessed valuation (AV) per capita level of $616,000. The tax base is predominantly residential with minimal concentration levels. After four years of moderate AV growth, fiscal 2011 AV held roughly flat, indicative of the maturity and resilience of the tax base and property market.

The district's financial operations are strong. General fund operations in fiscal 2010 (the last year for which an audit is available) produced an $898,900 surplus, raising the total and unreserved general fund balances to sound levels of $3.43 million (16.7% of expenditures and transfers out) and $3.36 million (16.3%), respectively. Operations were enhanced by years of prudent expenditure reductions that were implemented to offset state of California (state) categorical funding losses.

Estimated actual results for fiscal 2011 indicate a manageable $388,800 deficit that would lower the total and unreserved general fund balances to still sound levels of $3 million (14.6%). However, the district's total financial cushion rises to a strong $5.1 million (24.3%) when including non-general fund resources that could be transferred to the general fund for any operational purpose. These include $331,000 in an OPEB reserve, $1.2 million in a special reserve for capital, and $499,000 in a special reserve not to be used for capital. Management has not indicated intent to draw from these non-general fund sources, though Fitch views the flexibility to do so as a credit positive. Budgeted operations in fiscal 2012 show a general fund deficit of $684,000, however the district has tended to outperform its budget due to a degree of budgeting conservatism.

As a wealthy district, the district's revenue limit revenues are generated solely from the strong local tax base (basic aid), so reductions to the state's Proposition 98 funding guarantee have not materially impacted unrestricted revenues as has occurred with most of the state's districts. However, the state has implemented 'fair share' reductions to basic aid districts' categorical revenues for three consecutive years, which are expected to lower district revenues by a moderate $794,000 (3.8% of fiscal 2012 budgeted expenditures).

The risk of even larger reductions in the future is mitigated by a very high degree of remaining expenditure flexibility, and management's demonstrated willingness to make needed expenditure reductions in prior years. Also, management stated that the state is obligated by law to provide minimum funding of $120 per student. Given funding losses to date, management estimates that the state could only reduce funding to the district by a further $308,000 before reaching the legal funding floor, at which point the vast majority of the district's revenues would derive from the strong local tax base.

Financial operations are further aided by a parcel tax levied in perpetuity and donations from a school foundation. The levy is expected to generate $1.8 million in fiscal 2012, and includes an escalator that is subject to the Gann limit.

The district's debt profile is satisfactory overall. Direct and overlapping debt is low at 2.5% of AV, and capital needs are limited. However, principal amortization is slow, with just 6% and 20% of debt retired in five and 10 years, respectively. OPEB and pension costs seem manageable currently, but pension costs may rise moving forward given recent investment returns. Likewise, without a change to the district's OPEB benefits or historical pay-as-you-go funding method, OPEB costs likely will rise, as well. Fitch views as positive a recent board action to transfer $331,000 to a fund intended to pay for future OPEB costs.

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In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 16, 2010);
--'U.S. Local Government Tax-Supported Rating Criteria' (Oct. 08, 2010).

For information on Build America Bonds, visit www.fitchratings.com/BABs.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648898
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648842