Fitch Rates $149MM Palm Beach County School Board, FL COPs 'AA-'; Outlook Stable

Fitch Ratings-New York-07 September 2017: Fitch Ratings has assigned a 'AA-' rating to the following obligations issued by the Palm Beach County School Board (the district), Florida:

-- $149 million certificates of participation (COPs), series 2017A.

In addition, Fitch has affirmed the following ratings:

-- Issuer Default Rating (IDR) at 'AA';
-- $965 million in outstanding COPs at 'AA-'.

The Rating Outlook is Stable.

The COPs will be sold on a competitive basis on or about September 19. The proceeds will be used to prepay the outstanding series 2007C COPs.

SECURITY

The district's COPs are secured by lease payments made to the trustee and pursuant to a master lease purchase agreement. Lease payments are payable from legally available funds of the district, subject to annual appropriation by the district. The district is required to appropriate funds for all outstanding leases on an all-or-none basis. In the event of non-appropriation, all leases will terminate, and the district would, at the trustee's option, have to surrender all lease-purchased facilities under the master lease for the benefit of owners of the COPs which financed or refinanced such projects.

ANALYTICAL CONCLUSION

The 'AA' IDR reflects the district's solid revenue growth prospects, low long-term liability burden, adequate reserves, and a moderate amount of budgetary flexibility. The 'AA-' rating on the COPs is one notch below the IDR, reflecting the slightly higher degree of optionality associated with lease payments subject to appropriation.

Economic Resource Base

The school district is coterminal with Palm Beach County, encompassing 2,385 square miles in south Florida on the Atlantic coast. The district is the fifth largest in the state and operates 183 schools with K to 12 student enrollment of 167,631 for the 2016-17 school year. Traditional school enrollment picked up modestly in recent years and continued growth is projected at a similar rate. Charter student enrollment growth has eased in recent years and comprises 11% of the total student population. The county's population has experienced over 9% growth since 2010 to an estimated 1.4 million for 2016.

KEY RATING DRIVERS

Revenue Framework: 'a'
District operations are funded through a combination of state aid and local property taxes. The district's 10-year general fund revenue growth rate (through fiscal 2016) exceeded national inflation but was lower than GDP growth. Fitch expects this trend to continue, given moderate enrollment growth projections. The district has very limited independent ability to raise revenues.

Expenditure Framework: 'aa'
The district's natural pace of spending growth is expected to be close to or marginally above that of revenue. Enrollment growth and staffing costs are the main expenditure drivers. Carrying costs associated with debt service and retiree costs are moderately low.

Long-Term Liability Burden: 'aaa'
The district's long-term liability is very low and is expected to remain stable even with moderate plans of future debt issuance. The district participates in the adequately-funded Florida Retirement System.

Operating Performance: 'aa'
The district has historically maintained sound financial operations, despite a history of mixed operating results. Fitch believes that the district, supported by its solid expenditure flexibility, would maintain reserves at sound levels throughout economic cycles.
RATING SENSITIVITIES
Maintenance of Financial Flexibility: The rating is sensitive to material changes in the district’s solid expenditure flexibility, low long-term liability burden, and expectations for maintenance of adequate reserve levels.

CREDIT PROFILE

The local economy is broad and well diversified, and county income levels exceed state and national averages. Unemployment levels are currently below the state and national norms and have shown considerable improvement from their recessionary peak.

Assessed values have increased in the past six years, benefitting from improved home values and economic development. Prospects for additional tax base expansion are good, given the continued increase in permit activity and numerous projects planned and underway.

Revenue Framework
Common to Florida school districts, revenues are almost entirely derived from a combination of state aid and property taxes. The state determines the overall level of funding for each school district and then allocates total funding between property taxes within the district and state aid. Typically, the larger a district’s tax base, the higher proportion of revenues sourced from property taxes. In fiscal 2016, state funding comprised about 31% of the district’s general fund revenues and the property tax component was about 63%.

Discretionary taxes for operations and capital/maintenance are also levied by the district up to the statutory maximum rates of 0.748 mills and 1.5 mills, respectively. In addition, the district has a voter approved 0.25 mills with revenue generated designated for art, music, and physical education instruction, choice programs, and career academies. The levy was last approved by voters in 2014, from fiscal 2015 through fiscal 2019, and must be renewed every four years. Voters first approved the millage in 2010.

Historical general fund revenue growth has outpaced national GDP over the past decade. Fitch expects revenues to grow at a similar pace due to expectations for positive enrollment trends attributable to continued population growth.

The district has historically experienced some enrollment loss due to charter school expansion; however, recent charter school growth has eased and management expects this trend to continue. Projected charter school growth over the next five years averages about 1% per year, consistent with the level of growth experienced since fiscal 2015. Management attributes the recent slower growth in their charter schools to both the school choice options available in Florida and a reduction in the approval of new charter schools. Charter school enrollment currently represents 11% of total district enrollment.

The change in FEFP funding levels in recent years has lagged the rate of growth in the state’s general revenues. The enacted state budget for fiscal 2018 includes a roughly 1% increase in the level of per-pupil funding.

Due to the state funding mechanism, Florida school districts have very limited ability to independently increase general fund revenues. However, this limitation as a factor in the revenue framework assessment is somewhat offset by the recognition of K-12 education as fundamentally a state responsibility and the strong foundation of state support for education funding.

Expenditure Framework
Instructional related expenditures, including salaries and benefits, make up the bulk of the district’s general fund spending.

The pace of spending growth is expected to match or marginally exceed revenue growth, reflecting enrollment-driven spending needs largely funded by related increases in state-controlled per-student funding.

Carrying costs related to debt service, pensions and OPEB are moderately low at about 11% of governmental spending for fiscal 2016 - affording the district spending flexibility. Wages and benefits are collectively bargained between the district and unions representing teachers and support staff. Under Florida law a bargaining impasse is ultimately resolved by action of the governing body of the local government following the conclusion of a non-binding mediation process. State class size requirements also can impact personnel decisions. The district is currently meeting its minimum class size mandates.

Long-Term Liability Burden
The district’s long-term liability burden, consisting of debt and the district’s share of the net pension liability of the Florida Retirement System (FRS), was low at about 4% of personal income in fiscal 2016. The total liability is comprised predominately of direct debt, with an average rate of principal amortization of approximately 54% in 10 years.

The district has approximately $347 million in variable-rate debt outstanding, equaling about 22% of total debt in fiscal 2016. The debt is structured as floating-rate notes absent a put feature, eliminating the need for liquidity support. Interest rate risk is hedged via three derivative contracts with a negative mark-to-market value of approximately $71 million as of Sept. 1, 2017 (unaudited).
Fitch believes this poses a modest risk to the district's long-term liability profile.

County voters approved a 1-cent sales tax increase in a November 2016 referendum. The tax increase began on Jan. 1, 2017 and will sunset in 10 years or earlier if the expected $2.7 billion in revenue is generated before then. The district will receive half of the revenue generated through the tax increase (the county receives 30% and cities the remaining 20%). According to the district's fiscal 2018 - 2028 capital improvement plan (CIP), revenue generated by the tax increase will be used to fund modernization, facility renewal and replacement projects, as well as help fund the construction of five new schools. The CIP also includes an additional $500 million of COP debt issuance. Fitch expects the debt burden to remain relatively low even with the anticipated additional debt.

The district has historically paid COPs debt service with revenue from its capital outlay millage, although all legally available revenues are available for this purpose. Current legislation allows Florida school districts to levy 1.5 mills for capital outlay. Three-fourths (1.125 mills) of the 1.5-mill levy is available for COPs debt service associated with new issuances after 2009. The district has not issued any new COPs since 2010. Based on the 2018 assessed valuation, the district plans use about .80 mills of the capital outlay millage for COP debt service.

Florida recently passed legislation (HB 7069) which requires the district to allocate a portion of its capital outlay millage on a per student basis to support charter school capital projects. The district currently estimates $10 million will be allocated to the charter schools in fiscal 2018, which represents roughly 2% of the district's capital budget. Management anticipates the amount to be transferred to the charter schools will aggregate to more than $230 million over the next 10 years. The district plans to adjust its capital plans accordingly and is pursuing legal options to challenge the legislation.

The district participates in the adequately-funded FRS. As of June 30, 2016, FRS reported an asset to liability ratio of 85%, or an estimated 70% when adjusted by Fitch to assume a 6% rate of return.

Operating Performance

The three-year scenario revenue estimate generated by Fitch's analytical sensitivity tool (FAST) indicates that revenues would decline modestly in a 1% U.S. GDP decline. Fitch expects the district to address a revenue downturn as it has in the past, by implementing expenditure reductions and through the use of reserves to maintain a satisfactory level of financial flexibility. Flexibility is augmented by available balances outside the general fund, specifically capital funds, and Fitch's financial resilience assessment assumes the maintenance of adequate balances in these funds.

The district had been drawing down on its capital reserve fund balances for maintenance needs in lieu of alternative revenue sources or issuing debt over the past several years (through fiscal 2015). The infusion of additional revenue from an increase in the sales tax rate will provide flexibility for the district in addressing its capital needs going forward.

The district has maintained adequate reserve levels despite a history of mixed operating results. The district's planned use of fund balance from fiscal 2012 through fiscal 2014 was primarily due to operational needs associated with declining state aid revenue, salary increases and one-time bonuses paid to employees, and enrollment loss without a commensurate decline in expenditures.

The district's financial operations were positive in fiscal 2016, posting a $10 million general fund surplus which increased unrestricted reserves to approximately $102 million or 6% of spending. Unaudited results for fiscal 2017 depict another general fund surplus of approximately $11 million (less than 1% of spending), increasing unrestricted general fund reserves to approximately $110 million or about 6% of spending. The district anticipates the maintenance of unrestricted reserves at similar levels, above the 3% recommended by the state.

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