Palm Beach Co. (FL) School District

New Issue: Moody’s Assigns Aa3 to Palm Beach Co. SD’s (FL) $149M COPs; Outlook Stable

Summary Rating Rationale
Moody’s Investors Service has assigned a Aa3 rating to the Palm Beach County School District’s (FL) $149.1 million Certificates of Participation (COPs), Series 2017A. We currently maintain a Aa2 issuer rating and a Aa3 rating on approximately $1 billion in outstanding COPs. The outlook is stable.

The Aa2 issuer rating reflects the district’s limited, but still satisfactory financial position, manageable level of debt, and a recovering broad-based, tax base and economy. Finally, the rating also incorporates the district’s more aggressive risk profile within its debt structure than usually seen with school districts in Florida.

The School Board’s Aa3 COP rating reflects the district’s strong motivation to appropriate due to the essential nature and high degree of asset-backed projects in the master lease (in whole or part about 86%) which require appropriation for all or none of the district’s COPs, as well as the ability to utilize a portion of a separate capital outlay levy to repay lease obligations.

Credit Strengths
» Recent tax base growth
» Ability to garner voter support for special voted operating millage
» Stable, albeit still limited, financial reserves
» Manageable debt burden given separate funding source for COPs

Credit Challenges
» Moderate variable rate and swap exposure

Rating Outlook
The stable outlook reflects the expectation that the district’s tax base will continue to expand given its position as a tourism economy and recent increases in taxable values. The outlook also reflects the district’s limited reserve position, which is expected to increase at a moderate pace given management’s conservative budgeting practices.

Factors that Could Lead to an Upgrade
» Material increase in state aid and property tax revenues
» Substantial strengthening of district reserves and cash
» Significant improvement in available capital funds to pay for lease obligations and capital needs

Factors that Could Lead to a Downgrade
» Additional demands on limited available capital funds
» Future financial deterioration, inability to maintain structural balance or grow reserves in step with revenues
» Overleveraging of capital outlay millage

Key Indicators

| Exhibit 1 |
|---------------------------------|-------|-------|-------|-------|
| Palm Beach County School District, FL | 2012 | 2013 | 2014 | 2015 | 2016 |
| Economy/Tax Base |
| Total Full Value ($000) | $163,284,612 | $163,011,694 | $171,664,590 | $192,619,660 | $217,421,528 |
| Full Value Per Capita | $123,319 | $121,721 | $126,310 | $139,700 | $156,223 |
| Median Family Income (% of US Median) | 99.7% | 99.3% | 99.8% | 99.8% | 99.8% |
| Finances |
| Operating Revenue ($000) | $1,686,516 | $1,724,890 | $1,851,744 | $1,894,372 | $1,955,848 |
| Fund Balance as a % of Revenues | 8.2% | 5.5% | 4.0% | 9.2% | 11.6% |
| Cash Balance as a % of Revenues | 15.7% | 13.4% | 12.4% | 17.7% | 19.4% |
| Debt/Pensions |
| Net Direct Debt ($000) | $1,832,003 | $1,771,333 | $1,725,225 | $1,610,178 | $1,573,809 |
| Net Direct Debt / Operating Revenues (x) | 1.1x | 1.0x | 0.9x | 0.8x | 0.8x |
| Net Direct Debt / Full Value (%) | 1.1% | 1.1% | 1.0% | 0.8% | 0.7% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 1.2x | 1.3x | 1.3x | 1.3x | 1.2x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 1.2% | 1.3% | 1.4% | 1.3% | 1.1% |

Source: Moody's Investors Service, Audited Financial Statements

Detailed Rating Considerations

Economy and Tax Base: Local Economy Continues to Expand

The school district benefits from a large economic base that has become more resilient over recent years and is expected to grow in value in the near term. The district is coterminous with Palm Beach County (Aaa) in the southeast part of the state, which experienced high unemployment and a severe housing market correction during the recession. The school district’s tax base has begun to experience growth, following several years of declines, increasing by 6.1% to $251.9 billion in fiscal 2017. Going forward, annual tax base increases of between 4%-6% are projected given ongoing residential and commercial construction. Full value per capita, at $181,004, is favorable.

The district’s tax base benefits from an established tourism sector, which has traditionally been a primary driver in the economy, and has recorded a fairly constant number of visitors (over four million a year). Recent indicators, such as tourist tax collections and the number of seasonal residents, indicate continued strength in this sector. Palm Beach County is the second location of The Scripps Research Institute, one of the world’s largest biomedical research institutes (non-profit). In addition, Max Planck, a German biomedical firm, has also located in the county and should complement the Scripps development, adding more depth and higher-paying jobs to the economy. The county’s socioeconomic profile is strong, with per capita income equal to 125.4% of the statewide level. Full value

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per capita is strong at $181,004 due to a large number of second homes. The county’s unemployment rate is low at 4.5% as of July 2017 and is in line with the statewide rate.

**Financial Operations and Reserves: Reserve Position Remains Sound, But Limited**

Financial operations have remained adequate, despite challenges by limited state aid increases, ongoing state-mandated class size reductions and property tax reform measures. Due to continued growth in revenues and conservative expenditure spending, General Fund reserves increased by $10.1 million in fiscal 2016 and officials project a $11.4 million increase in fiscal 2017 to $138.7 million (8.3% of estimated revenues).

The district remains in compliance with its 3% contingency reserve, held in unassigned fund balance, which totaled $50 million, or 3.1% of revenues, in fiscal 2016. However, renewed tax base growth, voter-support for additional operating millage, and increased state funding, will allow the district to maintain and increase reserve levels. The fiscal 2018 budget includes a 1.4% increase in per pupil state aid and a modest increase in fund balance, in line with budget growth.

Beginning in fiscal 2010, the state allowed districts to impose an additional 0.25 mills (Critical Millage) for a two-year period with Board approval for either operating or capital needs (not both) with the understanding that voter approval would be required after that period to maintain the millage. In November 2014 voters approved another four year extension of this additional operating millage through the end of fiscal 2019.

**LIQUIDITY**

The district’s cash position is sound with $379 million (19.4% of revenues) across the operating funds at the end of fiscal 2016, which includes the General Fund, special revenue funds and the Debt Service Fund.

**Debt and Pensions: Manageable Debt Burden**

The debt burden will remain manageable in light of limited borrowing plans and considering renewed growth in the tax base. The direct debt burden is modest at 0.6%, and overall debt burden remains reasonable at 0.9%, inclusive of overlapping debt. During the last legislative session, HB 7069 was approved which requires districts to share a portion of their capital millage with charter schools on a per student basis. The district estimates that the impact in 2018 will be a manageable $10 million. Positively, in November 2016, voters approved a ten-year one penny sales tax. The district will share the revenues with the county and cities, with the district receiving half of the projected $2.7 billion over the ten year period.

The district has $1.3 billion in total COPs outstanding, including privately-placed issues, and anticipates issuing $500 million COPs over the next ten years, beginning with $188 million in 2018. While COPs are secured by annually appropriated lease payments, funding for COP debt service requirements has historically been provided from a separate capital outlay millage. Currently, approximately 0.84 mills are used to pay debt service on the COPs, with the remaining 0.66 mills used for annual pay-go capital needs. There is no debt service reserve on any of the district’s COPs.

**DEBT STRUCTURE**

The district has strong appropriation incentive resulting from the essential nature of the projects, the sizable amount of certificates outstanding, the requirement to appropriate for all or none of the projects under the master lease, and the utilization of COPs as the primary financing vehicle for school districts statewide. Unless prior to fiscal year end the School Board gives notice of its intent not to appropriate for lease payments coming due in the following year, the superintendent shall include the funds necessary to make lease payments in the proposed budget. About 87.5% of all projects under the master lease are asset-backed and approximately 38% of all gross square feet of the district’s facilities are under the master lease.

COP principal repayment is average with all COPs scheduled to be retired within 18 years, and annual debt service remains mostly level. Lease payments are made one month prior to debt service payment dates on the certificates (and on a slightly shorter period for two variable rate issues). There is no limit as to the number of projects in the master lease, and substitution of facilities with equal or greater value and same useful life is allowed. The Corporation has assigned its rights, title and interest in the lease to the Trustee, including the right to receive basic lease payments.
The district has three floating rate obligations (total $341.6 million, approximately 25% of total debt outstanding) with no credit facilities. All three series are privately placed and have similar terms to parity COPs. None of the district’s variable rate debt is rated by Moody's. We believe that the district’s variable rate exposure is manageable.

**DEBT-RELATED DERIVATIVES**
The district is party to three outstanding swaps for a notional amount of $341.6 million. Swaps include: variable-to-fixed rate swaps on the Series 2002B, Series 2003B, and 2012B, all based on SIFMA. The district is never required to post collateral on any of the swaps and termination rating triggers are dual for both the board and the insurer at A3 minimum rating levels for the two insured swaps, and below an A3 rating for the issuer on the remaining swap. The 2003B swap contains a “knockout” provision whereby, if the average of SIFMA rates over a period of 180 days are above 7%, the counterparty can cancel the agreement without a termination payment. As the provision expires on August 1, 2018, before the swap expires, and rates are expected to remain low through that period, we believe that the district is subjected to minimal risk. As of September 1, 2017, combined total swaps had a negative termination value of about $71.4 million.

**PENSIONS AND OPEB**
The district belongs to the state-administered Florida Retirement System (FRS), a multi-employer, cost-sharing retirement plan sponsored by the State of Florida (Aa1 stable). The annual required contribution (ARC) for the plan was $80 million in fiscal 2016. The adjusted net pension liability for the board under Moody’s methodology for adjusting reported pension data, is $2.5 billion, or a moderate 1.25 times operating revenues and 1.12% of full value. Moody’s uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district reported liability information, but to improve comparability with other rated entities. We determined the district’s share of liability for the state-run plans in proportion to its contributions to the plans.

The district funds OPEB on a pay-as-you-go basis, contributing $6.8 million in fiscal 2016.

**Management and Governance: Strong Management**
Management is strong as evidenced by recent surpluses. Management has also been proactive about generating additional revenues through additional millage and sales tax revenues.

Florida School Districts have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. School districts’ major revenue source, property taxes, are subject to a cap of 10 mills which cannot be overriden. However, the cap still allows for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Florida has public sector unions, which can limit the ability to cut expenditures, although municipalities have legal ability to make changes to union contracts. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

**Legal Security**
The COPs are issued under a Master Lease and are secured by the Board’s annually appropriated lease payments.

**Use of Proceeds**
Proceeds from the 2017A COPs will refund all outstanding Series 2007C COPs for net present value savings of $25 million or 14.4% of refunded bonds.

**Obligor Profile**
The school district is reportedly the fifth largest school district in the state and 12th in the nation, based on enrollment. There are 183 schools, about 184,578 students, and over 21,000 full-time and part-time employees.
Methodology
The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. The additional methodology used in this rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Ratings

Exhibit 2

Palm Beach County School District, FL

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Source: Moody’s Investors Service
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