Palm Beach County School District, FL

Update to credit analysis

Summary
Palm Beach County School District, FL is projected to remain healthy given its limited but still satisfactory financial position, manageable debt burden 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.

On December 12, we assigned a Aa3 rating to the district’s Series 2017B.

Exhibit 1
Financial Position is Adequate and Stable

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 2

<table>
<thead>
<tr>
<th>Palm Beach County School District, FL</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy/ Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$163,011,694</td>
<td>$171,664,590</td>
<td>$192,619,660</td>
<td>$217,421,528</td>
<td>$237,544,505</td>
</tr>
<tr>
<td>Population</td>
<td>1,339,221</td>
<td>1,359,074</td>
<td>1,378,806</td>
<td>1,391,741</td>
<td>1,414,144</td>
</tr>
<tr>
<td>Full Value Per Capita</td>
<td>$121,721</td>
<td>$126,310</td>
<td>$139,700</td>
<td>$156,223</td>
<td>$167,978</td>
</tr>
<tr>
<td>Median Family Income (% of US Median)</td>
<td>99.3%</td>
<td>99.8%</td>
<td>99.8%</td>
<td>99.8%</td>
<td>99.8%</td>
</tr>
<tr>
<td>Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Revenue ($000)</td>
<td>$1,724,890</td>
<td>$1,851,744</td>
<td>$1,894,372</td>
<td>$1,955,848</td>
<td>$2,032,746</td>
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<tr>
<td>Fund Balance ($000)</td>
<td>$95,261</td>
<td>$74,210</td>
<td>$174,867</td>
<td>$227,286</td>
<td>$232,309</td>
</tr>
<tr>
<td>Cash Balance ($000)</td>
<td>$230,453</td>
<td>$229,817</td>
<td>$334,716</td>
<td>$378,992</td>
<td>$355,796</td>
</tr>
<tr>
<td>Fund Balance as a % of Revenues</td>
<td>5.5%</td>
<td>4.0%</td>
<td>9.2%</td>
<td>11.6%</td>
<td>11.4%</td>
</tr>
<tr>
<td>Cash Balance as a % of Revenues</td>
<td>13.4%</td>
<td>12.4%</td>
<td>17.7%</td>
<td>19.4%</td>
<td>17.5%</td>
</tr>
<tr>
<td>Debt/ Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Direct Debt ($000)</td>
<td>$1,771,333</td>
<td>$1,725,225</td>
<td>$1,610,178</td>
<td>$1,573,809</td>
<td>$1,490,243</td>
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<tr>
<td>3-Year Average of Moody’s ANPL ($000)</td>
<td>$2,177,318</td>
<td>$2,455,252</td>
<td>$2,415,652</td>
<td>$2,437,430</td>
<td>$2,733,343</td>
</tr>
<tr>
<td>Net Direct Debt / Operating Revenues (x)</td>
<td>1.0x</td>
<td>0.9x</td>
<td>0.8x</td>
<td>0.8x</td>
<td>0.7x</td>
</tr>
<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>1.1%</td>
<td>1.0%</td>
<td>0.8%</td>
<td>0.7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>1.3x</td>
<td>1.3x</td>
<td>1.3x</td>
<td>1.2x</td>
<td>1.3x</td>
</tr>
<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>1.3%</td>
<td>1.4%</td>
<td>1.3%</td>
<td>1.1%</td>
<td>1.2%</td>
</tr>
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</table>

Source: Moody’s Investors Service, Audited Financial Statements

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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.

Detailed credit considerations

Economy and Tax Base
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 is growing, following several years of declines, increasing by 6.0% to $251.9 billion in fiscal 2018. Going forward, annual tax base increases of between 4%-6% are projected given ongoing residential and commercial construction.

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 per capita, at $178,136, is favorable. The county’s socioeconomic profile is strong, with per capita income equal to 125.4% of the statewide level. The county’s unemployment rate is low at 3.6% as of October 2017 and is in line with the statewide rate.

Financial Operations and Reserves
Financial operations have remained stable, 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 budgeting, available (unassigned plus assigned plus committed) operating fund (general, debt service and special revenue funds) reserves increased by $5 million in fiscal 2017 or a satisfactory 11.4% 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 2017. 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 $355.8 million (17.5% of revenues) across the operating funds at the end of fiscal 2017, net of $115 million in outstanding tax anticipation notes.

Debt and Pensions
The district’s debt burden will remain manageable because of limited borrowing plans and renewed growth in the tax base. The direct debt burden is modest at 0.7%.

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, representing a $10 million, a fraction of the district’s revenues. 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 $1.35 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 0.791 mills are used to pay debt service on the COPs, with the remaining 0.709 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 three floating rate obligations (total $341.6 million, approximately 25% of total debt outstanding) with no credit facilities, an exposure level that we believe is manageable given the high levels of operating cash. 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.

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 (based on LIBOR), and Series 2003B and 2012B, 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 $66.5 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 $60.4 million in fiscal 2017. The adjusted three-year average net pension liability for the board under Moody’s methodology for adjusting reported pension data, is $2.7 billion, or a moderate 1.34 times operating revenues and 1.15% 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 $10.1 million in fiscal 2017.

Management and Governance
Management is strong as evidenced by recent surpluses. Management has also been proactive about generating 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 is not subject to override. 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.
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