Fitch Affirms Flagler County School District, FL's COPs at 'A+'; Outlook Stable

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NEW YORK--(BUSINESS WIRE)--Fitch Ratings has affirmed the following Flagler County School District, FL (the district) ratings:

--Approximately $41.8 million certificates of participations at 'A+'.

In addition, Fitch has affirmed the district's Issuer Default Rating (IDR) at 'AA-'.

The Rating Outlook is Stable.

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 all 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.

KEY RATING DRIVERS

The 'AA-' rating on the IDR reflects the district's strong expenditure flexibility, solid revenue growth prospects and low long-term liability burden. These strengths are balanced against the district's somewhat constrained financial flexibility, given management's limited ability to independently raise revenues.

The A+ 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, which is coterminous with Flagler County, is located on Florida's Atlantic coast approximately 70 miles south of Jacksonville and 30 miles north of Daytona Beach. The district operates 11 schools and sponsors two charter schools, which represent a small share of enrollment. The county sustained enormous population growth of nearly 80% between 2000 and 2010, and is projected to maintain strong but more moderate growth. Student enrollment similarly experienced a period of robust growth followed by some declines subsequent to the national recession, though modest growth is now apparent.

Revenue Framework: 'a' factor assessment

Fitch expects future revenue performance to fall below historical growth levels but still remain solid given modest but sustained enrollment growth prospects. The district's independent legal ability to raise revenues is statutorily limited.

Expenditure Framework: 'aa' factor assessment

Future spending growth is expected to trend in line with revenue growth. The district derives solid expenditure flexibility from low carrying costs associated with debt service and retiree benefits. Management also maintains reasonable control over staffing, wages and benefits, though it is somewhat restricted by class size requirements.

Long-Term Liability Burden: 'aaa' factor assessment

The long-term liability burden related to debt and retiree benefits is a small share relative to personal income. Management has no plans for future debt issuance and amortization of outstanding debt is above average. The district participates in the adequately-funded Florida Retirement System (FRS).

Operating Performance: 'a' factor assessment

The district's financial operations became challenged in recent years due to somewhat pressured revenue performance, but management has taken measures to control costs and increase reserve levels, providing for improved financial flexibility to manage through the economic cycle.

RATING SENSITIVITIES

Financial Flexibility: The rating is sensitive to the district's ability to address any budget imbalances and maintain adequate gap-closing capacity throughout economic cycles. A reduction in reserves beyond Fitch's expectations could reduce its financial flexibility, and result in downward pressure on the ratings.

CREDIT PROFILE

Flagler County is located within the Deltona-Daytona Beach-Ormond Beach metropolitan statistical area, and is anchored by education, healthcare, leisure and hospitality sectors. Beyond the district, the county's largest employers include Florida Hospital-Flagler (1,057), Palm Coast Data (721), Sea Ray Boats (700) and Publix (690).

Strong population growth between 2000 and 2010 helped develop a real-estate focused economy, which proved vulnerable to the effects of the national recession. The district experienced a large 44% decline in taxable value between fiscals 2008 and 2013, but has experienced healthier growth in recent years. Management projects continued growth given the affordability of housing, increased construction activity and strong population growth projected by the U.S. Census Bureau. The county's unemployment rate has been trending positively, though remains above state and national levels. Income metrics remain slightly below state levels.

Revenue Framework

The Florida Education Finance Program (FEFP) is the primary mechanism for funding the operating costs of Florida school districts. The FEFP process determines a base per-student funding level. The funding is split between the state funds, largely derived from statewide sales tax revenue, and local funds via the required local millage rate established pursuant to state statutory procedure. Discretionary taxes for operations and capital/maintenance are also levied by the district, and currently lie at the statutory maximum rates of 0.748 mills and 1.5 mills, respectively. State aid comprised roughly 49% of the district's fiscal 2016 revenues (prior to transfers in), and 47% generated by property taxes.

The district's general fund revenue growth has historically trended well above U.S. GDP and inflation, increasing at a 10-year growth rate of 5.8% through fiscal 2014. The growth largely reflects significant increases in enrollment from 2000 to 2009; however, in subsequent years enrollment slowed and sustained minor declines through 2014.

Fitch's view of school district revenue prospects considers the revenue performance of the state as a starting point given its fundamental responsibility for public education. Fitch believes Florida's revenue prospects will grow at a pace that is above the rate of inflation but below U.S. economic performance based on a resumption of population growth and stronger economic expansion. School district revenue expectations are somewhat tempered by the state's education funding commitments which have been variable in recent history with annual changes in the base student allocation. Enrollment trends and expectations are the second key determinant of a school district's revenue growth prospects and are based on Fitch's view of local economy, demographic patterns, and competition form non-traditional public schools, among other factors. While the district's traditional school enrollment still remains below pre-recession levels, Fitch believes district revenues will perform above inflation but below GDP given recent enrollment gains.

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

The district's expenditures are primarily driven by salaries and employee benefits, which represent roughly 82% of the fiscal 2017 budget.

Fitch expects the pace of spending growth to marginally exceed revenue growth in the absence of policy action given the district's primary spending drivers.

Fixed carrying costs for debt service, pensions and OPEB benefits are low at roughly 9% of total governmental expenditures. Factors limiting district spending flexibility include class size requirements that can dictate staffing levels and the need to maintain adequate salary and benefit levels. All traditional schools are currently meeting class size requirements. Wages and benefits are collectively bargained between the district and unions representing teachers and support staff. The district characterizes its relationship with labor as collaborative, and has had no instances of state arbitration over the past 20 years. 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.

Long-Term Liability Burden

The district's long-term liability, including its share of the net pension liability of the Florida Retirement System and overall debt, is low at roughly 5% of its economic resource base. The burden is largely comprised of the district's outstanding debt, which amortizes at an above average rate (66% in next 10 years). Management has no near-term plans for issuance; district schools currently hold ample capacity for future enrollment needs. Current capital projects and maintenance will largely be funded through the capital outlay levy.

Pensions are provided through the state-run FRS, which is adequately funded. As of the July 1, 2015 valuation the plan reported asset-to-liability ratio of 86.5%, or an estimated 80.7% when adjusted by Fitch to assume a 7% rate of return.

The district also benefits from a voter approved one-half cent sales tax for capital outlay, which generated roughly $5.4 million in fiscal 2016. The sales tax is effective 2013 through 2022.

Operating Performance

The Fitch Analytical Sensitivity Tool indicates that in a moderate economic downturn district revenues would demonstrate limited volatility. Financial operations could become more challenged given the district's limited reserve cushion, but Fitch believes the district would utilize cost controls as it has done in the past while maintaining reserves consistent with an 'a' financial resilience assessment.

The district experienced general fund deficits between fiscals 2012 and 2015. The deficits were largely due to reductions in state aid, though the district also incurred unforeseen retiree benefit costs associated with the FRS Deferred Retirement Option Program (DROP) in fiscals 2014 and 2015. The district has since adopted budgeting practices to better prepare for future DROP costs. Fitch also notes the expiration of a 0.25 critical needs levy in fiscal 2013, which further contributed to the district's weak operating performance. Unaudited fiscal 2016 results indicate a surplus of nearly $2 million, which raises reserves to 4.9% of spending. The fiscal 2017 budget represents an increase of 3.8% from the year prior and is expected to produce another modest surplus. Management has projected they will maintain reserves within their target of 5% to 8% in the out-years.

Certificates of Participation

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 mills levy is available for COPs debt service associated with new issuance after 2009. The district currently levies 1.5 mills and expects to use about 0.54 mills of the capital outlay millage for COPs MADS.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)

https://www.fitchratings.com/site/re/879478

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1014997

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