FITCH AFFIRMS PENSACOLA'S (FL) NON AD VALOREM REV BONDS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-26 September 2013: Fitch Ratings has taken the following actions on Pensacola, Florida's (the city) non ad valorem revenue bonds:

--$45.6 million in outstanding redevelopment revenue bonds, series 2009A and 2009B affirmed at 'AA'.

In addition, Fitch affirms the city's implied general obligation (GO) rating at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The bonds are secured primarily by the city's covenant to budget and appropriate (CB&A), by amendment if necessary, legally available non-ad valorem (NAV) revenues sufficient to pay debt service on the bonds. The bonds are also secured by tax increment finance (TIF) revenues derived from the city's Community Redevelopment Area, although these revenues are currently pledged on a senior basis to a new markets tax credit transaction until 2017.

The series 2009B bonds were issued as Build America Bonds (BABs). The federal BABs interest subsidy received by the city is pledged to debt service on the series 2009B bonds.

KEY RATING DRIVERS

SOUND FINANCES: The implied GO rating of 'AA+' reflects the city's sound financial management as demonstrated by maintenance of solid reserves and augmented by revenues from the city's gas utility.

MODERATE DEBT: City debt levels are moderate, with average amortization and no planned near-term debt issuance. Combined debt service, pension, and other post-employment (OPEB) costs are manageable.

ECONOMIC IMPROVEMENT; MILITARY PRESENCE STABILIZES ECONOMY: City employment has seen growth in recent years after prior year declines and unemployment is below state and national levels. Following multiple prior year decreases, taxable assessed value (TAV) has shown recent modest growth. The area's large military presence provides some stability to balance the city's reliance on a potentially volatile tourism sector. Significant reductions in military operations in and around the city are not expected.

ONE NOTCH RATING DIFFERENTIAL: The city's CB&A rating of 'AA' is one notch below the implied GO rating due to the requirement that essential services and any debt secured by specific NAV revenue must be paid before CB&A debt service. The distinction reflects the absence of a pledge of specific revenue for these bond issues and inability to compel an increase of revenues to pay bondholders.

STRONG CB&A DEBT SERVICE COVERAGE: Total fiscal year 2013 NAV revenues cover maximum annual debt service (MADS) by about 4.4 times (x). Coverage is expected to grow strongly in fiscal year 2014, reflecting the maturity of certain series of NAV backed debt, and no additional planned NAV-backed debt issuance.

LOW DILUTION RISK: An adequate additional bonds test and the use of NAV revenues to support city operations protect against over-issuance of CB&A obligations.

RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics including the city's financial management practices. The city's history of maintaining adequate reserves and debt service coverage levels while addressing operating and capital needs indicates continued rating stability.

CREDIT PROFILE

Pensacola is located within Escambia County (the county) in the Florida Panhandle. The city's area covers 25 square miles. Totaling 52,340 in 2012, the city's population decreased by about 7% since 2000.

CB&A BACKED BONDS; STRONG DEBT SERVICE COVERAGE BY NAV REVENUES

The rating on the bonds is based upon the city's CB&A pledge. Fitch considers the CB&A pledge to be a strong security due to the continuous nature of the pledge and the wide array of NAV revenues available to pay debt service. NAV revenues include sales tax revenue, but are mostly derived from utility related franchise fees and public service taxes. The largest source of NAV revenues consists of transfers from the city's gas utility, which made up about 24% of covenant revenues in fiscal year 2013. Gas utility revenues typically have been sufficient to cover operating and debt service costs while providing a sizable transfer to the city.

NAV revenues have been affected by economic shifts, as well as utility rate changes. Following modest growth in fiscal year 2011 (0.9%), fiscal year 2012 revenue grew by 7.6%, reflecting one-time revenues from a capital asset sale. Excluding these one-time moneys, fiscal year 2012 revenues decline by 2.3% due to utility rate decreases related to lower energy costs, which affected franchise fees. Continued rate decreases result in an estimated fiscal year 2013 NAV revenue decrease of about 1.5%, with revenue growth projected (1.6%) in fiscal year 2014 reflecting growth in public service taxes and franchise fees.

Even with shifts in annual NAV revenues, debt service coverage has been strong. Fiscal year 2012 revenues of $37.8 million provided ample MADS coverage of about 4.9x including the BABs subsidy, and coverage is estimated at 4.4x for fiscal year 2013. With the scheduled retirement of the city's sales and excise tax bonds in fiscal year 2013, coverage levels increase considerably to an estimated 7.9x in fiscal year 2014. While a 2.0x MADS coverage test limits additional parity bonds, the city's dependence on NAV revenues to fund operations provides a practical safeguard against over-issuance.

The series 2009B bonds were issued as BABs and the federal BABs interest subsidy received by the city is pledged to debt service on the bonds. While the federal subsidy for the 2009 BABs was reduced for fiscal year 2014 from about $978 thousand to $893 thousand, an 8.7% decline, the impact on debt service coverage of a loss of even the total subsidy would not be significant given strong coverage by NAV revenues.

SOLID FINANCES FEATURE SOLID RESERVE LEVELS

Management has been effective at aligning spending to shifts in revenue performance. Recent years have seen departmental cuts, wage freezes, and reduced staffing. The city's financial position remains strong despite revenue pressures over the past few years. Finances have featured generally balanced operations with strong ending balances. The fiscal year 2012 budget was balanced with the help of one-time revenues from the sale of city land. The use of one-time revenue was planned with the understanding that reduced debt service costs would ultimately act as an offset. The fiscal year 2012 unrestricted general fund ending balance was $11.7 million or a solid 21.9% of spending.

Fiscal year 2013 operating revenues including the standard utility transfer ($8 million in recent years), but controlling for the impact of the asset sale, are estimated to decline by about 1.5% reflecting lower property tax and lower franchise fee revenue due to utility rate decreases. Utility-related fees, including transfers, represent a significant percentage of general fund revenues, totaling 47% in 2013.

Fiscal 2013 operating expenditures are estimated to grow by about 1%. While a modest fiscal year 2013 operating deficit after transfers is projected (1.8% of spending), the estimated general fund ending balance is expected to remain strong at about $11.3 million or 23.9% of spending. Management has indicated that as fiscal year 2013 expenditures are coming in under the latest budgeted estimates and revenues are on target, the size of the fiscal year 2013 deficit may shrink.

The fiscal year 2014 budget is balanced and reserves are expected to remain at similar levels to the prior year. Revenues are budgeted to grow by 1.2%, reflecting good growth in franchise fees and public service taxes, and operating expenditures are budgeted to increase by 2.8%, reflecting increased pension costs related to recent plan revisions.

ECONOMIC GROWTH; STEADY MILITARY PRESENCE STABILIZES ECONOMY

The city's economy is dependent upon the military, with six bases located within and around the city. Naval Air Station Pensacola provides employment for 28,000 uniformed and civilian jobs. Area military personnel and civilians employed by the military have been affected by furloughs related to sequestration. However, management reports that it has not seen a significant impact on the city's finances or economy as a result. Health care and tourism are two other major sector employers. The city reports strong performance for the tourism sector in the last two years that has contributed to recent annual growth in sales tax collections after prior year declines.

Due to economic slowing, city employment dropped by almost 9% from 2007 to 2009, with a smaller decline experienced in 2010(0.7%). Employment returned to growth in 2011 (1.7%) and 2012 (1.5%), and year over year figures for June 2013 show continued growth of 2%. City unemployment has been declining and the unemployment rate as of June 2013 (6.4%) is below state (7.4%) and national (7.8%) levels.

The city's tax base weakened in recent years with TAV decreasing by about 2% to 5% annually since fiscal year 2009. Fiscal year 2014, however, shows some stabilization. TAV increased by 0.9% over the prior year. Tax base concentration is moderate, with the top 10 taxpayers accounting for about 10.5% of the base and the top taxpayer (Gulf Power) at 3.2%. Top 10 taxpayers are in the utilities, retail, real estate, healthcare and manufacturing sectors.

DEBT LEVELS ARE MODERATE

City debt levels (1,662 per capita and 1.8% of market value) are modest and debt service as a percent of operational spending is average at about 9%. Principal amortization, about 46% repaid within 10 years, is also average. Capital plans are manageable, with funding derived largely from the local option gasoline tax and the local infrastructure sales tax. There are no plans to issue tax-supported debt in the foreseeable future.

The city operates three defined benefit pension plans, a general plan for non-public safety employees and separate plans for police and fire. In order to achieve long-term cost savings, the general plan was closed to new employees hired after fiscal 2007 who were then required to participate in the state-run Florida Retirement System. City pension costs relative to governmental operations run high at about 16% of governmental operational spending, although it should be noted that about 30% of pension costs are attributable to the city's enterprise funds. Excluding these, pension contributions for general government employees are manageable at about 11% of spending.

City officials have continued to explore ways to control pension costs, and recently implemented adjustments via union negotiations. Recent actions included closing the Police Pension Plan to new hires (effective January 2013) and shifting new employees to the Florida Retirement System (FRS0, reducing benefits for the Police and General Plans, and reducing over time the interest rate assumptions for the Police (from 7.75% to 7.25%) and General (from 8% to 7%)plans. While near-term pension expense increases are expected as all changes phase in, negotiated benefit reductions act as a buffer to lessen longer-term expenditure growth. The city is continuing to review retirement system costs and may seek to negotiate additional benefit reductions.

The city does not contribute to retiree health insurance but allows retirees to participate in its employee health care plans at their own cost. As such, the city's other post-employment benefit (OPEB) liability consists solely of the implicit subsidy arising from the co-mingling of retirees with active employees to determine OPEB costs.

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In addition to the sources of information identified in Fitch's
Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial
Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, and National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria'
(Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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