Fitch Upgrades Miami, FL's GOs to 'AA-' on Criteria Revision; Outlook Stable

Fitch Ratings-New York-17 March 2017: Fitch Ratings has taken the following rating actions on the city of Miami, Florida:

--General obligation (GO) refunding bonds, series 2002A upgraded to 'AA-' from 'A+';
--Issuer Default Rating (IDR) upgraded to 'AA-' from 'A+';
--Streets and sidewalk improvement program special obligation bonds, series 2007 and series 2009 upgraded to 'AA-' from 'A+';
--Various non-ad valorem bonds upgraded to 'A+' from 'A';
--Limited ad valorem tax bonds, series 2007A and series 2009 affirmed at 'A-'.

The Rating Outlook is Stable.

SECURITY
The GO bonds are a general obligation of the city backed by its full faith and credit and unlimited taxing power.

The streets and sidewalk improvement program special obligation bonds are backed by a first lien on a portion (80%) of the city's allocation of the countywide transportation surtax (a one-half cent sales and use tax), the city's share of the county's sixth-cent and third-cent local option gas tax (LOGT), and a portion of certain city parking surcharges.

Special obligation parking revenue bonds (Marlins Stadium Project) are payable in the first instance from a lien on the city's portion of the county's 3% transient rental accommodations tax (the convention development tax) and certain parking fees and charges associated with Marlins Park, home of Major League Baseball's Miami Marlins.

All other special obligation bonds are backed by the city's covenant to budget and appropriate legally available non-ad valorem (NAV) revenues. The availability of NAV revenues to pay debt service is subject to the funding of essential government services and obligations with a specific lien on such revenue.

The limited ad valorem bonds are backed by a pledge of an ad valorem tax whose rate, when debt service on all GO bonds issued prior to November 2001 or issued to refund such bonds is considered, cannot exceed 1.218 mills. The bonds are additionally backed by a limited non-ad valorem covenant, in an amount not to exceed 10% of maximum annual debt service (MADS).

KEY RATING DRIVERS

The upgrade of the city's IDR and GO rating to 'AA-' from 'A+' reflects the application of Fitch's U.S. Tax-Supported Rating Criteria which was published on April 18, 2016. In particular, the new criteria highlight the strength of various budgetary tools available to the city to manage risks associated with a moderate economic downturn. The rating also reflects the strong growth characteristics of the city's revenue base, a moderate burden on resident income from debt and retiree liabilities, and adequate expenditure flexibility with some pressure related to employee wage and pension costs. .

Economic Resource Base
Miami serves as the focal point of the Miami-Ft. Lauderdale-West Palm Beach metropolitan statistical area (MSA) which is one of the largest regional economies in the U.S. Construction, trade and transportation, financial activities, and tourism are the largest drivers of economic activity, each leveraging the city's desirable geographic location and proximity to Latin American markets. Miami's employment and income metrics are not particularly robust in part due to large number of workers in the lower-wage hospitality sector.

Revenue Framework: 'aaa' factor assessment
The city's vibrant economy and tax base are expected to continue to support a strong level of general fund revenue growth absent the influence of policy action. The 'aaa' assessment is further supported by the city's high legal revenue raising power relative to potential revenue declines in a moderate economic downturn.

Expenditure Framework: 'a' factor assessment
Fitch expects employee wage and benefits to remain a pressure on the budget, tempered to some extent by the city's broad legal control over employee headcount. Moderately high costs for debt service and retiree benefits further constrain the city's expenditure profile in Fitch's view.

Long-Term Liability Burden: 'aa' factor assessment
Fitch estimates the city's long-term liability burden at 17%. Capital needs are viewed by Fitch as manageable and the Fitch-adjusted net pension liability (NPL) has remained a fairly stable component of the metric in recent years.

Operating Performance: 'aa' factor assessment
Miami's strong operating performance is evidenced in a relatively low expectation for cyclical revenue volatility, high reserves and inherent budget flexibility. The city's budget management practices and financial results are improved but the operating environment in Miami remains dynamic and prone to management turnover and various outside risks over time.

Streets and Sidewalks Upgrade: The upgrade of the rating on the streets and sidewalks bonds to 'AA-' reflects the strong resilience of the pledged revenue stream to Fitch-modeled and worst cumulative historical losses. Fitch estimates current coverage of MADS at 2.5x and that pledged revenues can withstand a roughly 60% decline before MADS coverage is less than 1.0x. The key revenue component is a general sales and use tax levied throughout Miami-Dade County.

Non-Ad Valorem Ratings: Fitch's ratings on NAV-backed debt is based on the general credit quality of the city as the covenant is an ongoing and enforceable obligation payable from a broad base of resources. Fitch rates this debt comparable to appropriation-backed obligations at one-notch below the IDR given the absence of a lien on revenue. The rating on the parking revenue bonds is based on the NAV covenant given its strength and creditworthiness relative to the pledge of and lien on the CDT and certain parking revenues derived from Marlins Park.

Limited Ad Valorem Affirmation: The 'A-' rating on the limited ad valorem bonds reflects Fitch's dedicated tax analysis and the combination of strong tax base growth prospects and resilience to Fitch-modeled and worst cumulative historical tax base declines. Fitch estimates the tax base could decline by about 45% before MADS coverage would be less than 1.0x.

Issuing Entity Exposure: Fitch does not assume that the revenue pledged to the limited ad valorem tax bonds or the sidewalk improvement program special obligation bonds (the principal source of pledged revenue) would be considered 'special revenue' under Chapter 9 of the U.S. Bankruptcy Code. As such, the rating on the bonds is capped at the IDR of the city.

RATING SENSITIVITIES

IDR Sensitivities: An unexpected increase in the city's long-term liability burden could pressure the general credit quality of the city and result in a lowering of its IDR, GO, and NAV-backed ratings. The rating is also sensitive to a weakening of the city's financial profile and budgetary flexibility.

Limited Ad-Valorem: The rating on the limited ad valorem bonds is sensitive to tax base declines in excess of the cumulative historical loss experience in the last economic downturn.

Streets and Sidewalks: The 'AA-' rating on the special obligation streets and sidewalks revenue bonds is stable based on the very low level of risk to revenue declines and additional leverage and changes in the city's IDR.

CREDIT PROFILE

Miami's economy is performing well, buoyed by a resurgent housing market, strong retail sales activity, and continued job growth among other indicators. The city's tax base is up nearly 50% since fiscal 2011 to $44.6 billion in fiscal 2017. The tax base registers more than $100,000 on a per capita basis and median home values reported by Zillow Group are up 5% on the year to about $300,000 or roughly 50% above the statewide norm.

The city's high property wealth is driven to some degree by demand from investors and second-home owners which can also expose the tax base to quick shifts in market conditions relative to one dominated by homesteaded properties. Job growth has slowed to a pace of about 1.5% in both 2014 and 2015 which is fairly consistent with many other large U.S. metro areas according to data from Global Insight. The city's demographic profile has some weaknesses including a high rate of poverty and low educational attainment that offset some of the inherent economic strengths while placing a higher level of demand on local government services

New hotel construction and renovations are underway within the city which drew a record number of 15.5 million visitors in 2015 according to the Greater Miami Convention & Visitors Bureau. Travel advisories related to Zika virus have dampened hotel tax collections in Miami-Dade County with consecutive year-over-year declines reported for September-December 2016. Miami was declared free of the virus on Dec. 9, 2016 by the State of Florida. Despite garnering much of the attention, the tourism component of the economy is only the third largest sector by employment in the Miami-Fort Lauderdale-Miami Beach MSA, trailing professional and business services and education and health services.

Miami's multi-modal transportation assets and its proximity to Latin America have fostered a considerable trade and transportation sector. The city's international connection is also evident in the number and diversity of firms that locate their Latin American headquarters in Miami, including Exxon-Mobil, Sony, IBM, Cisco Systems, Caterpillar, and Johnson & Johnson among others. Fitch's assessment of the economic resource base does not assume any federal changes with a significant impact on the city's demographics or in the performance of its trade and tourism industries.

Revenue Framework
Miami's general fund budget is funded from a diverse stream of revenues led by property taxes at about 45% of the $670 million general fund budget for fiscal 2017. Service charges and franchise fees and taxes each account for about 16%-17% of general fund revenues. Service charges are collected against a broad range of governmental services from solid waste/garbage disposal, emergency medical services, cultural and recreational amenities, parking, and building inspections. Franchise fees and taxes are related to the provision and consumption of various utility services. The general fund budget is dependent on intergovernmental sources for about 10% of its revenue, the

largest component of which is the city's share of the local government half-cent sales tax which is allocated by the state pursuant to a population-based formula.

Fitch believes Miami's general fund revenue outlook remains strong with growth expected to align with the pace of expansion of the national economy, at a minimum, over time. General fund revenues increased at a 4.2% compound annual growth rate (CAGR) from fiscal 2005-2015. Impressively, the 10-year revenue CAGR captures the adverse impact of statewide property tax reforms that included a mandated millage rate reduction effective for fiscal 2008 of almost 13%.

A combination of property tax revenue, which lags the current economic environment, and service-based charges and taxes have contributed to a fairly resilient revenue profile for the city through economic cycles. For example, the city's tax base declined about 20% from fiscal 2009-2012 due to the impact of the housing market collapse and Great Recession; however, during this period general fund revenues increased by about 6% with the benefit of a fairly modest 5% increase in the operating tax rate. General fund revenues are currently hitting on all cylinders with growth of almost $150 million or 33% from fiscal 2010-2015 absent meaningful policy action. The general fund budget for fiscal 2017 represents a two-year increase of about $70 million or 12%.

The city has ample legal revenue raising authority relative to potential revenue losses associated with a cyclical economic downturn. Florida local governments are subject to a statutory ad valorem tax cap of 10 mills (non-voted). The city's operating millage rate for fiscal 2017 was set at 7.6465 mills. At the maximum legal rate Fitch estimates the city would generate close to $100 million in additional revenue based on a fiscal 2017 tax base of $44.6 billion and a 95% collection rate. This additional property tax revenue capacity, which is equivalent to roughly 15% of the total general fund budget, positions the city to easily manage risks associated with cyclical revenue declines. In Florida annual changes in the property tax rate are determined using a roll-back or revenue neutral rate which is then adjusted for changes in the Florida per capita personal income; however, the roll-back rate may be overridden by vote of the city.

Expenditure Framework

The general fund supports a wide range of governmental activities led by public safety at roughly 53% of fiscal 2017 spending, public works 12%, general government 9%, and parks and recreation 6%. Spending is largely driven by personnel-related costs including wages, pension benefits, and healthcare costs.

General fund spending has, on average, remained comfortably below the pace of revenue growth over the prior decade. New service demands associated with population and business expansion are expected to generally be offset by revenue related to new construction, property value appreciation and increases in consumption-based fees and charges. Fitch expects this trend to continue over time absent a material shift in the city's debt profile and retiree liabilities or new service mandates from higher levels of government.

Expenditure flexibility is largely evident in the city's legal control over personnel levels and the ability to enact layoffs and furloughs, if necessary. Employee salaries and wages consume close to 50% of the general fund budget. The city utilized its broad discretion over workforce size with an almost 14% single-year cut effective fiscal 2010. The city has prudently taken measures to restore positions during the current economic and revenue recovery. The fiscal 2017 budget funds more than 4,300 full-time employees which exceeds staffing levels at the height of the economic run-up that preceded the Great Recession. The city has modest flexibility in the area of pay-go capital and a contingency reserve set at $5 million.

Annual charges related to debt service and retiree pension and health benefits consumed 20% of all governmental spending in fiscal 2015. These fixed carrying charges will likely range as high as 25% of spending going forward due to a combination of rising pension payments and modest debt additions. Pension payments were budgeted at $93 million for fiscal 2017 and are expected to be more than $103 million in fiscal 2018 due to a combination of investment losses, state law changes to the mortality tables used in actuarial calculations, and higher staffing and salaries. The city's pension contribution for fiscal 2018 would represent an almost $30 million or 39% increase from the amount paid in fiscal 2012.

Employment terms for the bulk of the city's labor force are subject to collective bargaining. Labor contracts with general employees and police terminate at the end of fiscal 2017 and 2018, respectively. The city is currently in negotiation with its fire union which covers 739 positions. Under Florida law impasse resolution would occur through action of the governing body of the local government following the conclusion of a non-binding mediation process.

Outcome of Fiscal Urgency Dispute Remains Unclear

The city's relationship with labor has not always been cooperative. Effective for fiscal 2011, the city exercised a provision under Florida's "financial urgency" laws to unilaterally impose significant general fund contract reductions (wages and benefits) estimated at $100 million. The police and fire unions subsequently sought reinstatement of the contract modifications with the city prevailing in various cases heard by the Public Employees Relations Commission (PERC) and the first district court of appeals (DCA). The Florida Supreme Court recently overturned the DCA ruling against the police union (a separate active case filed by the firefighters was put on hold pending the outcome of the police challenge) on the grounds the city altered the terms and conditions of the collective bargaining agreement before completing the impasse procedures required by state law. The Supreme Court also held that the DCA failed to uphold the proper standard for determining whether the only way of addressing a dire financial condition is through modification of a collective bargaining agreement.

The financial implications of the Supreme Court ruling remain unclear. The Supreme Court did not find the city liable for back pay and benefits nor did it opine on the question as to whether a "financial urgency" existed at the time of the 2010 contract modifications. The case was remanded for proceedings consistent with state law; as such, the timetable for resolution could be lengthy. At worst case the city estimates the cost of reinstating the prior contract terms at roughly $150 million. The city believes it has the ability to bond for judgment - the $150 million amount represents less than 1% of personal income which would not result in pressure on the current rating in and of itself. Another potential scenario would include the financial terms of any legal settlement in future collective bargaining agreements. Fitch will continue to monitor the situation and maintain communication with the city and its fiscal agents until a resolution is defined.

Long-Term Liability Burden

Fitch estimates the city's long-term liability burden at 17% of personal income. Fitch's calculation of the long-term liability burden incorporates the city's direct debt and the proportional share (relative to its economic base) of debt outstanding of overlapping local units of government, which equal 4% and 8% of personal income, respectively. The last component of the metric, equivalent to 5% of personal income, is the net pension liability (NPL) associated with various single-employer defined benefit pension plans, primarily the firefighters and police officer's retirement trust (FIPO) and the general employees and sanitation employees retirement trust (GESE).

Fitch believes the city's long-term liability burden will remain within the 20% guideline for a 'aa' assessment; however, there are potential pressures. City debt is expected to remain fairly stable. The six-year capital program adopted for fiscal 2017 totals $680 million, the bulk of which ($511 million) is funded by a combination of prior year sources. The city plans to come to market with upwards of $75 million in new money debt in 2017 although the issuance of $45 million for marina redevelopment could be delayed. The city is scheduled to pay off approximately $200 million in outstanding debt over the next five years providing it some capacity for new money issuance without increasing the existing resource burden. Miami-Dade County and the Miami-Dade County School Board are in the process of advancing sizable capital plans with additional borrowing anticipated that will keep some pressure on the metric going forward.

On the pension side, to date the city has kept pace with the sharp increase in actuarially-based contributions to its pension plans, and the combined NPL has remained fairly stable at about $920 million over the last five years. Deviation from the city's pension funding practices or other actuarially-based factors that contribute to a higher total pension liability could also pressure the metric.

The city's other post-employment benefit (OPEB) liability was reported at almost $960 million or 5% of personal income in fiscal 2015. Fitch does not include OPEB liabilities in its long-term liability burden metric given distinctions in actuarial assumptions and legal protections relative to pension liabilities.

However, an inability to control the escalation of the OPEB liability could adversely impact Fitch's assessment of the city's long-term liability burden over time.

Operating Performance
Fitch views the city's financial resilience and capacity to address revenue declines associated with economic cycles as very strong. The city's property tax revenue raising powers are considerable relative to the low level of general fund revenue loss in the standard -1% U.S. GDP depicted by the Fitch Analytical Sensitivity Tool (FAST). Fitch also believes the city could tap into its reserves without comprising its overall financial flexibility if necessary. Unrestricted general fund reserves totaled almost $114 million in fiscal 2015 or 20% of spending. Fitch expects the city to maintain a comparable level of reserves going forward on the basis of its internal financial policies which establish a minimum unassigned fund balance equal to 10% of the prior three years average of general revenues (excluding transfers) and a 10% assigned fund balance for funding long-term liabilities and commitments of the city.

Management of the city's budget has greatly improved after consecutive years of operating deficits from fiscal 2006-2010 lowered the general fund balance to less than $4 million or 1% of spending. Operating surpluses have been recorded from fiscal 2011-2015 and reserves increased to 20% of spending. Improved economic conditions have contributed to revenue growth absent meaningful change in the city's property tax rate and the city has done a good job of controlling spending in the wake of its financial urgency declaration and unilaterally imposed wage and benefit cuts in fiscal 2011. As noted previously, the Florida Supreme Court has yet to rule on the lawsuit against the city seeking to reinstate the prior contract terms, which the city estimates could cost $150 million. Fitch will evaluate the long-term credit implications, if any, associated with the court's ruling when delivered.

Unaudited financial statements for fiscal 2016 show a general fund operating deficit of $15.9 million or 2.4% of spending. The adopted budget for fiscal 2017 is structurally balanced. The city adopts a multi-year financial plan each year which currently shows annual operating deficits ranging from 2% to 3% from fiscal 2018-2021 largely driven by employee wage and benefit pressures. The forecasted deficits do not appear outside of the city's capacity to absorb through careful budget management. Revenue growth is shown to slow to a pace of about 3% per year which may be conservative.

The general fund balance would decline to approximately $63 million or 8% of spending by fiscal 2021 based on the city's forecast. At 8% of spending the city's unrestricted fund balance would remain sufficient for a 'aaa' financial resilience assessment, all other factors remaining neutral.

Pledged Revenue Growth Prospects

Revenue growth prospects for the streets and sidewalk improvement program special obligation bonds are principally driven by the countywide sales and use tax which accounts for about 55% to 60% of total pledged revenues. Fitch expects this revenue stream to perform well over time on the basis of anticipated economic and population growth within the county. However, LOGT revenues remain sluggish largely reflecting improvements in fuel efficiency standards. The 10-year CAGR for total pledged revenues was 1.8% for fiscal 2016 and 2.8% for fiscal 2015. Fitch expects similar growth going forward, roughly equivalent to changes in national inflation.

Fitch considers long-term growth prospects for the limited ad valorem bonds to be strong as Miami remains an attractive market for residential and commercial investment. The city's tax base has increased at an impressive 7% CAGR from fiscal 1999-2016 despite a decline of 20% in aggregate over a three-year period following the onset of the Great Recession. The tax base continues a strong rebound with growth in excess of 10% recorded in both fiscal 2016 and 2017. The city expects tax base increases to moderate to roughly 5% per annum from fiscal 2019 and going forward.

Pledged Revenue Sensitivity Analysis

Pledged revenue for the streets and sidewalk improvement program special obligation bonds totaled almost $24 million in fiscal 2016 or 2.5x MADS of $9.5 million. Fitch estimates pledged revenues can decline by 60% before MADS coverage would be less than 1.0x. Revenue losses depicted by FAST in the standard -1% U.S. GDP scenario are only 1% and the worst actual historical loss in the time series of data reviewed by Fitch was 8% from fiscal 2007-2009.

The city does not plan to issue new money parity debt, although additional leverage is permissible based on compliance with a 1.35x MADS additional bonds test (ABT). Assuming issuance up to the minimum coverage required by the ABT Fitch estimates the structure would tolerate 28x the FAST revenue scenario and 3x the worst actual loss - each consistent with a 'aaa' level of financial resilience. The upgrade to 'AA-' reflects these results; the rating on the bonds would be capped at the IDR of the city as Fitch does not assume the pledged revenues would be considered special revenues under the U.S. Bankruptcy Code.

The limited ad valorem bonds are backed by an ad valorem tax not to exceed 1.218 mills on all taxable property within the city. Fitch estimates the city would generate close to $52 million in revenue or 1.85x MADS based on the maximum ad valorem tax pledge levied on the fiscal 2017 tax base of $44.6 billion and a collection rate of 95%. Fitch estimates the tax base could decline by about 45% before MADS coverage would be less than 1.0x. The tax base cushion is equivalent to roughly 2.3x the 20% aggregate decline experienced from fiscal 2008-2011 which Fitch views as consistent with an 'a' level of financial resilience. The city has essentially exhausted its $255 million principal amount of voter authorized limited ad valorem bonds.

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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=1020774&cft=0)
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