Fitch Ratings

Fitch Affirms Pensacola, FL's Non-Ad Valorem Revenue Bonds at 'AA'; Outlook Stable

Fitch Ratings-New York-22 March 2017: Fitch Ratings has affirmed Pensacola, FL's (the city's) ratings as follows:

--$43.9 million non-ad valorem redevelopment revenue bonds series 2009A and 2009B at 'AA';
--Issuer Default Rating (IDR) at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The bonds are backed 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; this serves as the basis for the rating. The bonds are also payable from 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

The 'AA+' IDR reflects the city's strong revenue framework and financial resilience that Fitch expects to be maintained throughout the economic cycle. The rating also reflects the city's moderate long-term liability burden.

The 'AA' rating on the non-ad valorem revenue bonds is one notch below the IDR; Fitch rates this debt comparable to appropriation-backed obligations given the absence of a pledge of specific revenue and inability to compel the city to generate non-ad valorem revenue sufficient to pay bondholders.

Economic Resource Base
Pensacola is located in Escambia County in the Florida panhandle. The city's population of 53,193 has remained relatively stable since the 2010 Census. Governmental employment is significant to the city's economy, including from the military which maintains six bases located within and around the city including the Naval Air Station Pensacola.

Revenue Framework: 'aaa' factor assessment
The city's revenue growth is expected to approximate U.S. GDP based on historical trends and ongoing economic development activity. The independent legal ability to increase revenues is significant.

Expenditure Framework: 'aa' factor assessment
Fitch believes that the natural expenditure growth rate will remain generally in line with projected revenue growth based on moderate increases in personnel costs. Carrying costs for debt service and post-employment benefits are somewhat elevated but still moderate as a percentage of expenditures and management maintains capacity for additional expenditure reductions.

Long-Term Liability Burden: 'aa' factor assessment
Fitch expects that the long-term liability burden will remain moderate in relation to the city's economic resource.

Operating Performance: 'aaa' factor assessment
The city has exceptionally strong gap closing capacity including its significant ability to increase revenues and high unrestricted general fund reserve balances.

RATING SENSITIVITIES

Expenditure Growth Expectations: The ratings are sensitive to the city's ability to manage expenditure growth including carrying costs for debt service and post-employment benefits.

CREDIT PROFILE

The city's healthy tourism sector and growing healthcare industry plays a vital role in growth and diversification of the local economy beyond government employment. Sacred Heart Hospital and Baptist Hospital are two of the three largest city property tax payers and combined employee over 10,000 people. Tourism activity has continued to expand in recent years with robust growth in tourist development taxes. Tourism has been a primary driver in the city's strong sales tax revenue growth in recent years. New economic development activity has remained strong in recent years. Some of the larger developments include new construction of mixed use residential, retail and hotel facilities in the downtown area as well as continued development around the Cordova Mall and Pensacola International Airport.

Revenue Framework

The largest source of general fund revenue is local taxes including property taxes (31% of total revenue) followed by sales taxes (10%). Other major sources of revenue include franchise fees (approximately 20%) and intergovernmental revenues (16%).

Fitch expects the city's revenue growth prospects to remain strong, supported by recent trends including significant economic development activity and increasing tourism. The historical revenue trend remained healthy over the past decade through 2016 evidenced by the compound average annual growth that exceeded the rate of U.S. GDP. More recently, taxable assessed values (TAV) have increased by 10% from 2014 through 2016 and reportedly grew over 4% in 2017 after a comparatively modest 14% decline from 2009 through 2013 driven by recessionary pressures. Sales tax collections have grown by approximately 13% since 2014, primarily driven by increased tourism.

Fitch believes that the city's independent legal revenue-raising ability is significant. The largest source of general fund revenue is the ad valorem tax levy. Ad valorem property tax rates are subject to a non-voted statutory limit of 10 mills. The city's adopted fiscal 2017 budget includes a 4.29 millage rate which is well below the limit. The city also has the ability to increase various license and permit revenues and service charges that make up a smaller but still notable portion of its revenue base.

Expenditure Framework
Public safety is the largest expenditure item within the general fund followed by culture and recreation and general government services.

Fitch expects the natural pace of spending growth to remain in line with to marginally above revenue growth. One of the largest cost drivers, employee salary and benefit costs, will increase at the rate of inflation based on current labor agreements.

The city has adequate expenditure flexibility including the ability to manage the size of its labor force. Management generally manages personnel costs through attrition. The city has the ability to contract out various governmental services for budgetary savings including maintenance and various other city functions.

Carrying costs for debt service and annual pension and OPEB contributions are somewhat elevated but still moderate at 25% of governmental expenditures in fiscal 2016. Growth in annual pension costs will likely moderate based on enacted pension reforms including reducing the cost of living increases, increasing employees vesting periods and closing the general employees and police pension plans to new employees. The fiscal 2018 budget assumes a $500,000 reduction in annual pension costs (from a fiscal 2016 base of $14.3 million) driven by the changes to the pension plans.

Long-Term Liability Burden
The long-term liability burden is moderate accounting for approximately 13% of personal income. The largest portion of the total liability is comprised of the adjusted net pension liability (50%) and direct debt of $125 million (40%). The city issued $14 million local option gas tax revenue bonds in fiscal 2016 and future borrowing plans for various capital projects are modest. Borrowing plans are not expected to exceed $10 million in fiscal 2018. Principal amortization is slow with 40% of principal paid within 10 years.

The city operates three single-employer defined benefit pension plans, a general plan for non-public safety employees (general plan) and separate plans for police and fire. The city also participates in the Florida Retirement System (FRS) which provides two cost-sharing multiple-employer defined benefit plans administered by the state. The city's general pension plan was closed to new employees on June 18, 2007 and the police plan was closed on Jan. 1, 2013. The combined ratio of assets to liabilities is estimate at 70% at an adjusted 7% rate of return.

Operating Performance
Fitch's Analytical Sensitivity Tool (FAST) produces a general fund revenue decline of 1.1% in a moderate economic downturn scenario, based on historical results. Fitch believes the city's high inherent budget flexibility, reflecting its strong revenue raising ability and adequate expenditure flexibility, supplemented by high reserves, provide it with the ability to address a decline of that magnitude while maintaining a high level of financial resilience. The unrestricted reserves have remained at or above 20% of general fund expenditures since fiscal 2009 reflecting the city's strong financial operations; reserves totaled $14 million, 28% of spending and transfers out, at fiscal 2016 year-end.

The city maintained ample financial resilience throughout the Great Recession due to management's conservative budgeting and ability to manage expenditure growth. The city adopted strict reserve policies in fiscal 2011 including limiting the use of fund balance to cover shortfalls of more than 5% of budgeted revenue. Additionally, the city council approved an increase to the minimum reserve balance policy raising the required available general fund balance to 20% of budgeted expenditures from 15%. Fitch believes that the projected general fund balances will continue to support strong financial resilience.

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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
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