FitchRatings

Fitch Upgrades Lee County, FL Tourist Tax Revs to 'AA'; Outlook Stable

Fitch Ratings-New York-20 March 2017: Fitch Ratings has upgraded the following Lee County, FL outstanding obligations to 'AA' from 'AA-':

--$41.5 million tourist development tax (TDT) revenue bonds series 2013;
--$42.5 million TDT revenue bonds series 2010A taxable Build America Bonds (BABs);
--$37.4 million TDT revenue bonds series 2010B taxable BABs, Recovery Zone Economic Development Bonds.

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

The Rating Outlook is Stable.

SECURITY
The TDT revenue bonds are backed by a pledge of, and lien upon, the pledged revenues including: the five cent tourist development tax revenues, an annual state sales tax rebate, federal interest subsidy payments related to the outstanding 2010 series A and B BABs, investment income, and gross revenues. Gross revenues consist of lease payments from the Minnesota Twins and Boston Red Sox (collectively the teams) for use of the county's spring training facilities, capital contributions from the teams, and a contribution from JetBlue for naming rights to one of the facilities.

The bonds are also backed by a debt service reserve fund that is funded with a combination of cash and a surety bond.

KEY RATING DRIVERS

The affirmation of the county's 'AA' IDR reflects Lee County's strong financial resilience evidenced in high reserves and revenue raising authority relative to potential revenue declines in a moderate economic downturn as well as a low level of liabilities and solid spending control.

The one-notch upgrade of the TDT revenue bonds to 'AA' from 'AA-' is based on prospects for continued TDT revenue growth solid coverage of debt service and the application of Fitch's revised criteria for state and local governments released April 18, 2016 which highlights the analysis of the resiliency of pledged revenues through economic cycles. Fitch views the pledged TDT revenues as special revenues under section 902(2)(B) of the bankruptcy code, so their rating is not capped by the county's IDR.

Economic Resource Base
Located along Florida's Gulf Coast, the county encompasses approximately 811 square miles in southwest Florida. Major cities include Fort Myers ('AA-' IDR/Stable Outlook) and Cape Coral ('AA' IDR/Stable Outlook). County population increased rapidly during the early and mid-2000s, but growth has tapered off since then. The 2015 estimated census population was 701,982 and is up 13.5% since 2010. Prime economic sectors include health care, higher education and tourism.

Revenue Framework: 'aa' factor assessment
Fitch expects natural revenue growth to be in line with inflation. General fund revenue growth for the 10-year period through 2015 was below both inflation and GDP for the same period reflective of significantly lower property tax revenues following the Great Recession and resulting property value declines. Economic growth the past five years has been strong, and Fitch expects slower growth, on average, for the future. The county has strong revenue raising flexibility.

Expenditure Framework: 'aa' factor assessment
Fitch expects natural expenditure growth to be in line with to slightly above revenue growth as growth-driven demands on spending are countered by commensurate growth in the tax base and other economically sensitive revenues. Management has control over staffing and salary levels with a small number of employees represented by unions. Fixed costs are moderate.

Long-Term Liability Burden: 'aaa' factor assessment
The county's long-term liabilities are low as a portion of personal income and

not expected to change materially.

Operating Performance: 'aaa' factor assessment
Management effectively responded to revenue declines during the Great Recession by reducing expenditures and staffing levels, and drawing down reserves moderately. A rebound in the economy has provided for new revenues and, combined with management's careful spending, reserves are being rebuilt above policy levels providing for a superior level of financial resilience. Fitch expects similar actions by management would occur during a future downturn.

RATING SENSITIVITIES
IDR: The county's IDR is sensitive to changes in its financial and operating flexibility and its revenue growth prospects. Sustained growth in revenues, outside of Fitch's expectations, could lead to an upward change in the rating.

TDT Bonds: Sustained reduction in Fitch's expectations for the TDT revenues, although not expected, would be viewed as a negative credit development.

CREDIT PROFILE

The county is experiencing a strong economic rebound following the recession as evidenced by growth in the tax base and tourism. Tourism related activity including spending and visitor rates saw brisk growth for the past five years with some tapering off of visitor levels in 2016. This has led to strong annual growth in TDT revenues as discussed below. Commercial and residential expansion has been occurring since the recession supporting a notable rebound in the economy and tax base growth.

Revenue Framework
The county derives its revenues primarily from property taxes, which represent roughly two-thirds of general fund revenues.

Fitch expects natural revenue growth to continue at a moderate pace reflective of improving housing values and various new development projects underway or planned throughout the county. After a period of sluggish revenue growth, revenues have grown due to a strong rebound in property tax values. During the Great Recession the county experienced significant declines in it tax base but management held property taxes flat limiting growth in overall revenues over that time. Property taxes were kept flat though fiscal 2016 and then lowered 2.4% in fiscal 2017 due to growth in the tax base of 28% from fiscal 2013 to fiscal 2017.

The county's current tax rate of 4.05 mills is widely below the statewide millage cap of 10 mills providing the county with significant revenue raising authority. The county also retains the ability to raise fees and charges as necessary.

Expenditure Framework
Public safety makes up the bulk of expenditures at 56% of general fund expenditures followed by general government operations at 28%.

Fitch expects natural expenditure growth to be moderate and in line with natural revenue growth due to the nature of county operations.

The county has only two union groups which combined represent less than 10% of total employees. Management retains the flexibility to reduce staff levels as necessary. Fixed costs for debt service, pensions and OPEB are very moderate and represented 11% of fiscal 2015 total governmental spending.

Long-Term Liability Burden
The county's long-term debt and unfunded pension liabilities are low and represent an estimated 4% of personal income. This metric includes overlapping debt. Debt levels are not expected to change materially as capital plans are currently being funded through pay-as-you-go funding.

The county participates in the Florida Retirement System, a cost-sharing, multiple employer retirement system. The plan is adequately funded with an estimated funding ratio of 86%, using Fitch's 7% investment rate of return.

The county maintains two other post-employment benefit (OPEB) plans: a group health plan for most county employees (general employee plan) and a separate health care plan for employees in the sheriff's office (sheriff's office plan). The county has set up a trust for the general employee plan while the sheriff's office plan is funded on a pay-as-you-go basis. The combined UAAL of the county's OPEB plans is reported at $471 million, or a low 1.5% of personal income.

Operating Performance

Fitch expects Lee County to maintain strong financial resilience throughout the economic cycle. The county has built a high reserve cushion through a combination of expenditure reductions and revenue increases and is committed to maintaining reserves at or above its 20% unassigned fund balance policy. While reserves would likely decline during a moderate recession scenario (1% decline in national GDP) absent policy action, Fitch expects management to take similar actions as it did during the last downturn, which included hiring freezes, layoffs where necessary and reduced capital spending. The county's high level of revenue raising capacity along with solid expenditure flexibility provides a superior level of inherent budget flexibility to address a future downturn.

The county experienced significant declines in its tax base during the Great Recession as values declined by approximately 45% for the fiscal period 2008 through fiscal 2013. Management kept tax rates flat and relied on drawdowns of fund balance to help offset revenue declines. A number of cuts in expenditures were made including staffing reductions and elimination of non-mandatory services to help absorb the loss in revenues and reduce the magnitude of fund balance draws. Structural balance was restored in fiscal 2014 with an increase in taxable values and other non-ad valorem revenues due to a rebound in the economy.

The tax rate remained unchanged through fiscal 2016 and fund balance levels have grown in fiscal 2014 and 2015 (to $135 million, 37% of spending, at year end) with expectations for additional fund balance growth in fiscal 2016. Management plans to use future surplus revenues associated with tax base growth to help support capital and maintenance needs.

The fiscal 2017 operating budget is up 2.79% from the prior year's adopted budget and reflects a 8% increase in taxable values and a decrease in the tax rate of 2.4% to 4.05 mills. Management reports that results to date are trending positively.

TDT Revenue Bonds

Pledged revenues have experienced robust growth due to strong levels of tourism related activity. TDT revenues alone have grown by 82% since fiscal 2009 or a CAGR of close to 7%. Annual debt service coverage from total pledged revenues (excluding federal BABs subsidies) was very high at over 7x from fiscal 2016 pledged revenues of $40.9 million, and coverage on MADS, occurring in fiscal 2041, was strong at over 4.6x. Fitch expects pledged revenues to grow at more moderate levels over the next few years, although tourism-related taxes can be vulnerable to weather-related or major economic events. The high coverage levels and history of relatively stable to growing revenues supports the revenue stream's financial resilience.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using the same 1% decline in national GDP scenario that supports assessments in the IDR framework) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on the county's 10-year 5 cents TDT pledged revenue history, Fitch's analytical sensitivity tool (FAST) generates a 3% scenario decline in pledged TDT revenues. The largest actual cumulative decline in revenues was 8% in fiscal 2009.

Based on a leveraging of debt service to the 1.75x ABT, the structure could tolerate a 43% drop in revenues, or about 13x the scenario results and 5x the largest actual consecutive revenue decline in the review period. The 'AA' rating reflects these results and Fitch's expectation for future growth but at slower levels as well as the expectation of additional debt issuances over time.

The county levies the TDT up to five cents on the total rental amount paid from any person or party who rents, leases or lets for consideration living quarters for a period of six months or less. The TDT is levied by the county tax collector and, after deducting a 3% administrative fee, is remitted monthly to the county clerk of courts.

Special excise taxes on particular activities, such as hotel taxes (including the TDT), are considered by Fitch to be special revenues defined under section

902(2) of the bankruptcy code, and so the rating is not capped by the county's IDR.

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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=1020822&cft=0)
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