FitchRatings

Fitch Upgrades FMLC's Deerfield Beach, FL Revenue Bonds; Outlook Stable

Fitch Ratings-New York-29 July 2016: Fitch Ratings has upgraded the following Florida Municipal Loan Council (FMLC) ratings:

--$17.2 million refunding and improvement revenue bonds, series 2012B-1 (Deerfield Beach) to 'AA-' from 'A-';
--$12.6 million refunding revenue bonds, series 2012B-2 (Deerfield Beach) to 'AA' from 'A'
--Issuer Default Rating (IDR) to 'AA' from 'A'.

The Rating Outlook has been revised to Stable from Negative.

SECURITY
The bonds are limited obligations of the FMLC. There are two separate loans, both payable solely from payments equal to the debt service made by the borrower, the city of Deerfield Beach, FL.

The loan agreement securing the 2012B-1 bonds is backed by the city's covenant to budget and appropriate (CB&A), by amendment, if required, non-ad valorem revenues. There is no reserve fund associated with the CB&A bonds.

The loan agreement securing the 2012B-2 bonds is secured by the full faith and credit and unlimited taxing power of the city (GO).

KEY RATING DRIVERS

The upgrade of the IDR and GO bond rating to 'AA' from 'A' reflects both the application of Fitch's revised criteria for U.S. state and local governments, which was released on April 18, 2016 and an improvement in credit quality. Application of the revised criteria result in a more focused recognition of the city's strong revenue framework, moderate carrying costs, low long-term liability burden, and improvement of the city's reserves to provide sound financial resilience to manage through economic downturns. Credit improvement centers on the city's improved financial flexibility, and adherence to a more stringent reserve policy, revenue growth attributable to higher taxable values and property rate increases, and prudent efforts to reduce spending.

The 'AA-' rating on the CB&A bonds is one notch below the IDR as the bonds are not general obligations but viewed as an ongoing and enforceable obligation of the city payable from a broad base of resources.

Economic Resource Base
Deerfield Beach is on the southeastern coast of Florida, adjacent to Boca Raton and north of Fort Lauderdale. The city has an estimated 2015 population of 79,768, an increase of over 6% from 2010.

Revenue Framework: 'aa' factor assessment
General fund revenues are expected to grow at a solid pace given development projects planned or underway. The city has considerable revenue raising ability with current millage rates well below the 10 mill statutory limit.

Expenditure Framework: 'aa' factor assessment
City spending is expected to be in line with or marginally above revenue trends in the absence of policy action. Carrying costs for debt and retiree liabilities are moderate. The city benefits from relatively strong control over employee benefits, wages & contracts.

Long-Term Liability Burden: 'aaa' factor assessment
The city's long term liability burden should remain low given manageable debt plans, rapid amortization, and the closure of its three pension plans.

Operating Performance: 'aa' factor assessment
Management has implemented various measures to achieve long term cost savings and rebuild reserves to their current sizeable level. Fitch believes that the city is well positioned to maintain financial flexibility through the economic cycle, given its strong revenue and economic growth prospects.

RATING SENSITIVITIES

Financial Flexibility: The rating is sensitive to shifts in fundamental credit characteristics, including the city's management of expenditure pressures and maintenance of reserves at a level sufficient to support operations and gap closing ability.

CREDIT PROFILE

The local economy is primarily residential, with residents commuting to Fort Lauderdale for employment. The city's unemployment rate has significantly improved to 4% in May, 2016 from the peak levels of 9.8% experienced during the recession. The improvement reflects robust growth in employment and compares favorably to state and national averages. Median home values were relatively hard hit by the recession and have since recovered from the period of steep declines, but still remain below the 2006 peak. The tax base has grown in recent years, and expansion in the tax base is expected to continue with numerous residential, commercial and light industrial projects planned and underway. City wealth levels are below state and national norms, likely due to its service based economy.

Revenue Framework
Property tax revenues are the city's largest revenue source, representing 35% of total general fund revenues. Property tax revenues were negatively impacted by the recession and state property tax law reform, although some rate increases were implemented to mitigate some of the decline. License and permit fee revenues are the next largest revenue source, equal to almost 21% of general fund revenues.

The city's historical general fund revenue growth has exceeded national GDP due to a combination of tax base gains from the improving economy and policy action by the city to increase property tax revenues. Prospects for revenue growth are solid but slower due to continued growth in population growth which has exceeded national trends and ongoing economic development.

The city has ample legal revenue raising authority. The city is subject to a statutory property tax cap of 10 mills. The adopted tax rate for fiscal 2016 was 6.7688 mills. Fitch estimates the city could generate roughly $50 million in additional revenue through an increase in the property tax rate to the maximum legal rate, the equivalent of about 50% of the total general fund budget.

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, this limitation may be overridden by vote of the county governing body. 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.

In response to declining property and sales tax revenues, city management pursued other means to diversify its revenue base. The city, similar to many other Florida local governments, implemented a 10% public utility tax in fiscal 2012; this provides an additional $7 million in annual revenues.

Expenditure Framework
The city provides a broad range of services, including public safety, sanitation, water & sewer, recreational & cultural activities, public improvements, planning and highway and streets. Public safety is the city's largest spending item, accounting for 67% of total general fund spending.

Spending is expected to be in line with to marginally above revenue trends, given spending needs for maintenance and population growth trends.

The city maintains healthy expenditure flexibility with moderate carrying costs. In order to control costs, the city has moved towards a hybrid business model for its operations, utilizing both in-house and contractual resources. The city merged its police and fire operations with the Broward County Sheriff's Office and also chose to outsource its building department, landscape and park maintenance operations as a proactive measure to manage costs in the event of a future downturn. Management retains relatively strong control over labor, including the ability to institute workforce reductions or freeze wages when necessary. Management has indicated that it plans to modify medical benefits for additional cost savings in the near term.

Long-Term Liability Burden
Overall debt and pension liabilities are equal to a low 6.1% of personal income. The city's liability burden is primarily driven by overlapping debt of the county. The county's debt borrowing plans are manageable with county capital projects to be largely funded on a pay-as-you-go basis and a majority of borrowing planned for its self-supporting enterprises. The city's 2016-2020 capital improvement plan is estimated at $96 million and will address

the city's aging infrastructure, equipment fleet and facilities. About one-third of the plan will be funded by future debt issuances, with the balance to be covered by grants and a combination of various enterprise fund sources. Given the city's current low direct debt levels and rapid amortization, the additional debt will not materially impact the long term liability burden.

In July 2016, the city council approved new ordinance granting the city ability to charge
a parks and recreation and public safety impact fee for the construction of new residential and hotel units. The collection of the impact fee will help support the development the city's parks and public safety capital improvements, as permitted by state statute.

City management has indicated that Broward County will place two separate sales taxes to be levied for 30 years on the ballot for voter approval in November 2016. This referendum will include a half-cent sales tax for local city infrastructure projects and a separate half-cent sales tax to fund the county's transportation projects. If approved, the half-cent infrastructure tax will provide the city with long term bonding capacity in support of its capital improvement plan for the next 20 years. The final 10 years of sales tax collections will be split 60-40 between the county and city governments. The city estimates that the new infrastructure sales tax may generate approximately $6 million beginning in FY 2017 and may vary as economic conditions permit.

The city participates in three closed single employer defined benefit pension plans for its fire, police and non-uniformed employees. The city's aggregate unfunded pension liabilities are equal to about $54 million as of the most recent valuation (Fitch-adjusted, using a 7% investment return) or approximately 2% of personal income. The city funds the actuarially required contribution in each year. New public safety employees may participate in the state pension plan, while all other non-uniformed employees have the option to participate in a defined contribution plan.

Operating Performance
Given the city's relatively low revenue volatility, solid inherent budget flexibility, and ample revenue raising ability Fitch believes the city would be able to maintain reserves at a level consistent with a 'aaa' financial resilience assessment throughout economic cycles. The city ended fiscal 2015 with a nearly $5 million net operating surplus after transfers, bringing the unrestricted fiscal 2015 fund balance to over $18 million or 21% of spending, in excess of its 10% unassigned reserve policy. Fiscal 2015 results mark the city's second year of surplus operations, benefitting from a continued increase in taxable property values, with no millage rate increase.

The city has proactively sought measures to manage expenditures and improve its revenue diversity. In order to manage rising costs during the recession, the city reduced its workforce, froze hiring, and reduced wages, but still had four consecutive, sizable operating deficits. The city also closed its pension plans and now offers a defined contribution plan to employees, outsourced certain city operations and recently modified healthcare benefits in order establish long-term cost savings. The city instituted new utility tax and raised various city fees to help offset some of revenues declines experienced in property and sales taxes. These measures, in combination with improving home values, tax base expansion and property tax rate increases helped the city to rebuild reserves to their current healthy levels.

The city hired a risk analysis manager and a budget analyst to improve budgetary accuracy and provide multi-year financial forecasting in order to better address and anticipate costs. The city also adopted more conservative reserve policy by raising the unassigned fund balance reserve policy from 5% to 10%, and established a separate 5% emergency fund that will be committed to help maintain city services in the event of a natural disaster or storm related event. In aggregate, these actions will help the city better monitor and manage budgetary needs.

The city's fiscal 2016 budget is 7% over the prior year's budget, with a reduction in the property tax rate by 1/10 of a mill to 6.6688 mills. Current year-to-date operating results are positive relative to the budget, with reserve levels comfortably exceeding policy levels. The budget also includes a separate 5% emergency reserve which may be used to meet critical and spending needs.

Contact:

Primary Analyst
Grace Wong
Director
+1-212-908-0652
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Michael Rinaldi
Senior Director
+1-212-908-0833

Committee Chairperson
Amy Laskey
Managing Director
+1-212-908-0568

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

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/creditdesk/reports/report_frame.cfm?
rpt_id=879478&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiRzE2REZSR1c2T080N0NKS0xCTUp

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?
pr_id=1009733&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiRzE2REZSR1c2T080N0NKS0xCTU
Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1009733)
Endorsement Policy (https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31)

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.