



Fitch Rates Palm Beach County School Board, FL \$121MM COPs 'AA-'; Outlook Stable

Fitch Ratings-New York-13 February 2018: Fitch Ratings has assigned a 'AA-' rating to the following obligations issued by the Palm Beach County School Board (the district), FL:

--Approximately \$121 million certificates of participation (COPs), series 2018C.

The Rating Outlook is Stable.

The COPs will be sold on a negotiated basis on or about Feb. 21. The proceeds will be used to refund the outstanding series 2003B COPs and pay a termination payment under an interest rate swap agreement relating to the 2003B COPs.

SECURITY

The district's COPs are secured by lease payments made to the trustee pursuant to a master lease purchase agreement. Lease payments are payable from legally available funds, subject to annual appropriation by the district. The district is required to appropriate funds for all outstanding leases on an all-or-none basis. In the event of non-appropriation, all leases will terminate, and the district would, at the trustee's option, have to surrender all lease-purchased facilities under the master lease for the benefit of owners of the COPs which financed or refinanced such projects.

ANALYTICAL CONCLUSION

The 'AA' Issuer Default Rating (IDR) reflects the district's solid revenue growth prospects, low long-term liability burden, adequate reserves, and a moderate amount of budgetary flexibility. The 'AA-' rating on the COPs is one

notch below the IDR, reflecting the slightly higher degree of optionality associated with lease payments subject to appropriation.

Economic Resource Base

The school district is coterminous with Palm Beach County, encompassing 2,385 square miles in south Florida on the Atlantic coast. The district is the fifth largest in the state and operates 180 schools with K to 12 student enrollment exceeding 169,000 for the 2017-2018 school year. Traditional school enrollment picked up modestly in recent years, and continued growth is projected at a similar rate. Charter student enrollment growth has eased in recent years and comprises 11% of the total student population. The county's population has experienced over 9% growth since 2010 to an estimated 1.4 million for 2016.

KEY RATING DRIVERS

Revenue Framework: 'a'

District operations are funded through a combination of state aid and local property taxes. The district's 10-year general fund revenue growth rate (through fiscal 2016) exceeded national inflation but was lower than GDP growth. Fitch expects this trend to continue, given moderate enrollment growth projections. The district has very limited independent ability to raise revenues.

Expenditure Framework: 'aa'

The district's natural pace of spending growth is expected to be close to or marginally above that of revenue. Enrollment growth and staffing costs are the main expenditure drivers. Carrying costs associated with debt service and retiree benefits are moderately low.

Long-Term Liability Burden: 'aaa'

The district's long-term liability burden is very low and expected to remain stable even with moderate plans of future debt issuance. The district participates in the adequately-funded Florida Retirement System.

Operating Performance: 'aa'

The district has historically maintained satisfactory reserves despite a history

of mixed operating results. Fitch believes that the district, supported by its solid expenditure flexibility, will maintain reserves at similar levels throughout economic cycles.

RATING SENSITIVITIES

Maintenance of Financial Flexibility: The rating is sensitive to material changes in the district's solid expenditure flexibility, low long-term liability burden, and expectations for maintenance of adequate reserve levels.

CREDIT PROFILE

The local economy is broad and well diversified, and county income levels exceed state and national averages. Unemployment levels are currently below the state and national norms and have shown considerable improvement from their recessionary peak.

Assessed values have increased in the past six years, benefitting from improved home values and economic development. Prospects for additional tax base expansion are good, given the continued increase in permit activity and numerous projects planned and underway.

Following the recent hurricanes (Harvey, Irma & Maria) the district experienced an increase in student enrollment. The district estimates that the recent storms have resulted in an additional 420 students, of which a nominal portion has enrolled in charter schools. Fitch believes this recent trend of enrollment growth will be temporary and may partially reverse as storm damage is repaired.

Revenue Framework

Common to Florida school districts, revenues are almost entirely derived from a combination of state aid and property taxes. The state establishes statewide per-student revenues under the Florida Educational Finance Program (FEFP) equalized per student funding formula. Overall funding for each district in any year is determined by enrollment. The state then determines the level of property taxes to be levied within the district and provides the remainder of funding. Typically, the wealthier a district's tax base, the higher proportion of revenues sourced from property taxes. In fiscal

2017, state funding comprised about 34% of the district's general fund revenues and the property tax component was about 61%.

The district also levies discretionary taxes for operations and capital/maintenance at the statutory maximum rates of 0.748 mills and 1.5 mills, respectively. In addition, the district has a voter-approved 0.25 mill levy designated for art, music, and physical education instruction, choice programs, and career academies. The levy was last approved by voters in 2014, from fiscal 2015 through fiscal 2019, and must be renewed every four years. Voters first approved the millage in 2010. The district plans to seek voter approval to extend the levy of the voted millage in fiscal 2019.

General fund revenue growth has outpaced national inflation over the past decade. Fitch expects revenues to grow at a similar pace due to expectations for mildly positive enrollment trends attributable to continued population growth. Fitch does not believe that the increase in enrollment following the 2017 hurricanes will impact the district's long-term growth.

The district has historically experienced some enrollment loss due to charter school expansion, but recent charter school growth has eased, and management expects this trend to continue. Management attributes the recent slower growth in charter schools to both the school choice options available in Florida and a reduction in the approval of new charter schools. Charter school enrollment currently represents 11% of total district enrollment.

FEFP funding levels in recent years have lagged the rate of growth in the state's general revenues. The enacted state budget for fiscal 2018 includes a roughly 1.4% increase in the level of per-pupil funding.

Due to the state funding mechanism, Florida school districts have very limited ability to independently increase general fund revenues. However, this limitation as a factor in the revenue framework assessment is somewhat offset by the recognition of K-12 education as fundamentally a state responsibility and the strong foundation of state support for education funding.

Expenditure Framework

Instructional related expenditures, including salaries and benefits, make up the bulk of the district's general fund spending.

The pace of spending growth is expected to match or marginally exceed revenue growth, reflecting enrollment-driven spending needs largely funded by related increases in state-controlled per-student funding.

Carrying costs related to debt service, pensions and other post-employment benefits (OPEB) were about 12% of governmental spending for fiscal 2017, affording the district spending flexibility. Wages and benefits are collectively bargained between the district and unions representing teachers and support staff. Under Florida law a bargaining impasse is ultimately resolved by action of the governing body of the local government following the conclusion of a non-binding mediation process. State class size requirements also can impact personnel decisions, although the penalties for non-compliance are modest. The district is currently meeting its minimum class size mandates.

Long-Term Liability Burden

The district's long-term liability burden, consisting of debt and the district's share of the net pension liability of the Florida Retirement System, is low at about 4% of personal income. The total liability is comprised predominately of direct debt, with a rate of principal amortization of 66% in 10 years. With the proposed transaction, the district will eliminate its variable rate debt and terminate the interest rate swap associated with the series 2003B COPs. The termination payment is approximately 15% of the series 2003B outstanding par amount.

County voters approved a 1-cent sales tax increase in a November 2016 referendum. The tax increase began on Jan. 1, 2017 and will sunset in the earlier of 10 years or when the expected \$2.7 billion in revenue is generated. The district will receive half of the revenue generated through the tax increase (the county receives 30% and cities the remaining 20%). According to the district's fiscal 2018-2027 capital improvement plan (CIP), revenue generated by the tax increase will be used to fund modernization, facility renewal and replacement projects, as well as help fund the construction of five new schools. The CIP also includes an additional \$500 million of COP

issuance (about one-third of currently outstanding direct debt or 13% of total long-term liabilities). Fitch expects the liability burden to remain low even with the anticipated additional debt.

The district has historically paid COPs debt service with revenue from its capital outlay millage, although all legally available revenues are available for this purpose. Current legislation allows Florida school districts to levy 1.5 mills for capital outlay. Three-fourths (1.125 mills) of the 1.5-mill levy is available for COPs debt service associated with new issuances after 2009. The district has not issued any new COPs since 2010. Based on the 2018 assessed valuation, the district plans use about .79 mills of the capital outlay millage for COP debt service.

Florida passed legislation in June 2017 (HB 7069) that requires districts to allocate a portion of the capital outlay millage on a per student basis to support eligible charter school capital projects. The district currently estimates \$9 million will be allocated to the charter schools in fiscal 2018, which represents roughly 2% of the district's capital budget. Management anticipates the amount to be transferred to the charter schools will aggregate to more than \$230 million over the next 10 years. The district's 2018-2027 CIP incorporates the annual allocation of the capital outlay millage.

The district participates in the Florida Retirement System (FRS). FRS reported an asset to liability ratio of 85%, or an estimated 70% when adjusted by Fitch to assume a 6% rate of return (as of the June 30, 2016 measurement date).

Operating Performance

The three-year scenario revenue estimate generated by Fitch's analytical sensitivity tool (FAST) indicates that revenues would decline modestly in a 1% U.S. GDP decline. Fitch expects the district to address a revenue downturn as it has in the past, by implementing expenditure reductions and through the use of reserves to maintain a satisfactory level of financial flexibility. Flexibility is augmented by available balances outside the general fund, specifically capital funds, and Fitch's financial resilience assessment assumes the maintenance of adequate balances in these funds.

The district drew down on its capital reserve fund balances for maintenance needs in lieu of alternative revenue sources or issuing debt over several years (through fiscal 2015). The infusion of additional revenue from an increase in the sales tax rate provides flexibility for the district in addressing its capital needs going forward.

The district has maintained adequate reserve levels despite a history of mixed operating results. The district's planned use of fund balance from fiscal 2012 through fiscal 2014 was primarily due to operational needs associated with declining state aid revenue, salary increases and one-time bonuses paid to employees, and enrollment loss without a commensurate decline in expenditures.

The district's financial operations were positive in fiscal 2016, posting a \$10 million general fund surplus which increased unrestricted reserves to approximately \$102 million or 6% of spending. Audited results for fiscal 2017 depict another general fund surplus of approximately \$11 million (less than 1% of spending), maintaining unrestricted general fund reserves at about 7% of spending. The district's 2018 adopted general fund budget represents a 4% increase over the prior year's budget. The adopted budget incorporates continued growth in enrollment and FEFP funding, as well as an increased allocation to charter schools and higher costs for salaries and benefits. District officials indicate year-to-date results are tracking in line with the budget. The district anticipates the maintenance of unrestricted reserves at similar levels, above the 3% recommended by the state.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
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