FitchRatings

Fitch Rates Deerfield Beach, FL $39MM Capital Improvement Revenue Bonds 'AA-' ; Stable Outlook

Fitch Ratings-New York-14 February 2018: Fitch Ratings has assigned a 'AA-' to the following bonds issued by the city of Deerfield Beach, FL:

--Approximately $39 million capital improvement revenue bonds, series 2018.

Fitch has affirmed the following obligations issued by the Florida Municipal Loan Council (FMLC) on behalf of the city:

--$15.1 million refunding and improvement revenue bonds (Deerfield Beach), series 2012B-1 at 'AA-';
--$11.5 million refunding and improvement revenue bonds (Deerfield Beach), series 2012B-2 at 'AA'.

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

The Rating Outlook is Stable.

The bonds will be sold on a negotiated basis on March 12. Bond proceeds will finance certain capital improvements, including: street, parks and related recreational projects, improvements to the Center for Active Aging, the City Hall, and to refund the city's portion of the outstanding FMLC revenue bonds, series 2006 (not rated by Fitch).

SECURITY

The city covenants to budget and appropriate non-ad valorem revenues (NAV), by amendment if necessary, in an amount sufficient to pay debt service on the proposed series 2018 and outstanding 2012B-1 bonds. Such covenant shall be cumulative to the extent not paid, and shall continue until such NAV or other legally available funds in amounts sufficient to make all such required payments shall have been budgeted, appropriated, and actually paid.

The outstanding FMLC bonds are backed by payments from the city pursuant to two separate loan agreements. The loan agreement relating to the 2012B-1 bonds is backed by the city's covenant to budget and appropriate NAV revenue, whereas the loan agreement related to the 2012B-2 bonds is backed by the full faith and credit and unlimited taxing power of the city.

ANALYTICAL CONCLUSION

The 'AA' IDR and GO rating reflect the city's strong gap closing ability, revenue framework and expenditure control, moderate carrying costs, and low long-term liability burden. Fitch expects the city to maintain solid financial resilience throughout economic cycles.

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 2016 population of 79,764, an increase of over 6% from 2010.

KEY RATING DRIVERS

Revenue Framework: 'aa'
General fund revenues are expected to grow at a solid pace, supported by continued population gains, property appreciation and development. The city has considerable revenue raising ability with current millage rates well below the 10 mill statutory limit.

Expenditure Framework: 'aa'
Fitch believes city spending will be manageable relative to revenue growth

trends. Solid expenditure flexibility is derived from a combination of moderate fixed carrying costs and strong legal control over employee benefits, wages & contracts.

Long-Term Liability Burden: 'aaa'
The city's long-term liability burden is low relative to personal income and should remain low given limited debt plans and rapid amortization of existing debt, and the closure of its three pension plans.

Operating Performance: 'aa'
Fitch believes that the city is well positioned to maintain financial flexibility through the economic cycle, given its solid revenue framework, and management's implementation of various measures to achieve long-term cost savings and rebuild reserves.

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 and retail/tourism oriented. Broader employment opportunities are available in Fort Lauderdale, which is about 20 miles to the south via I-95. The city's unemployment rate has significantly improved, with the current rate at roughly half of the 2009 peak. The improvement reflects robust growth in employment and is below the state and national averages. Home values, as reported by Zillow.com, were relatively hard hit by the recession but have steadily risen since 2012 and nearly recovered to the pre-recession high mark. The tax base has grown in recent years as well, 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 which tends to pay lower wages. Post Hurricane Irma estimates provided by the city indicate no significant damage to city infrastructure or properties.

Revenue Framework

Property tax revenues are the city's largest revenue source, representing 37% of fiscal 2018 budgeted general fund revenues, followed by license and permit fee revenues equal to 21%.

The city's historical general fund revenue growth 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. Common to all Florida local governments, city property tax revenues experienced significant declines during the recent recession due to deterioration of the housing market and state property tax law reform; although some rate increases were implemented to mitigate the decline. Prospects for revenue growth are solid but slower, supported by population gains, property appreciation and development.

The city maintains significant independent legal revenue raising ability with the fiscal 2018 adopted millage rate of 6.5 comfortably below the 10 mill statutory limit. 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 city governing body, and is therefore within its control. 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 order to diversify its revenue base the city implemented a 10% public utility tax in fiscal 2012; this generates $8 million in revenue or about 8% of fiscal 2018 budgeted general fund revenues. In 2016, the city council approved a 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. The various new fees adopted by the city are comparable to those charged by neighboring municipalities and do not appear to have had an adverse impact on the city's business or residential community.

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 outsourced 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 flexibility with respect to services delivered via third party contract and control over labor, including the ability to institute workforce reductions or freeze wages when necessary.

Long-Term Liability Burden

Fitch estimates the city's overall debt and pension liability burden at roughly 8% of personal income. The city's current direct debt amortizes rapidly, with over 70% of principal to be repaid within 10 years. The overlapping debt obligations of the county and the school district are not expected to pressure the liability burden.

The city's 2018-2022 capital improvement plan is estimated at $88 million, of which two-thirds is focused on the city's infrastructure, equipment, facility and transportation improvements, with the remainder of projects earmarked for self-supporting enterprise utility needs. Nearly half of the city projects will be funded by debt, inclusive of the proposed issuance, with the balance to be covered by general fund revenues and grants. Given the city's low direct debt and rapid principal amortization, the additional debt will not materially affect the long term liability burden.

The city participates in three closed single employer defined benefit pension plans for its fire, police and non-uniformed employees. The city's aggregate pension asset to liability ratio approximates 78% as of the most recent valuation, or 69% when adjusted by Fitch to assume a 6% investment rate of return. New public safety employees are contracted by the city but employed by the county and may participate in the state pension plan. 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 2016 with almost a $6 million net operating surplus after transfers (or approximately 6% of spending), bringing the unrestricted fund balance to $24 million or 26% of spending, in excess of its 10% unassigned reserve policy. Management estimates for fiscal 2017 indicate stable results.

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 closed its pension plans and now offers a defined contribution plan to employees. The city has also 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 2018 budget represents a less than 1% increase over the prior year's budget, with no change in the millage rate. The city experienced no significant damage to infrastructure or property as a result of Hurricane Irma. City estimates for damage and cleanup were estimated at $4 million for fiscal 2018. The city will cover the costs from its unassigned reserves, and plans to recoup a majority of its costs through FEMA reimbursements.

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
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