FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Hernando County School Board's COPs at 'A+'; Outlook Stable

Tue 18 Aug, 2020 - 4:07 PM ET

Fitch Ratings - New York - 18 Aug 2020: Fitch Ratings has affirmed the 'A+' rating on Hernando County School Board, FL approximately $100 million certificate of participation (COPs):

Fitch has also affirmed the Hernando County School District, FL's (the district) Issuer Default Rating (IDR) at 'AA-'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Hernando County School Board (FL)	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Hernando County School Board (FL) /Issuer Default Rating/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Hernando County School Board (FL) /Lease Obligations - Standard/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The board's COPs are payable from lease payments made by the district to the trustee pursuant to a master lease purchase agreement. Lease payments are payable from legally available funds of the district, subject to annual appropriation. 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 that financed or refinanced such projects.

ANALYTICAL CONCLUSION

The 'AA-' IDR reflects the district's low long-term liability burden, solid expenditure framework and limited independent ability to increase revenues. The district has solid expenditure flexibility, which should allow management to implement cost controls to maintain structurally balanced operations. The rating also considers the district's recently-implemented strong budgeting practices including budgeting contingency reserves to address any shifts in enrollment. Management is holding back 20% of departmental budget appropriations, or a total of about 3% of total appropriations, as a modest safeguard against unanticipated revenue shortfalls related to the current economic downturn.

KEY RATING DRIVERS

Revenue Framework: 'a'

Revenue growth is predicated primarily on the level of state education funding provided by the state legislature and district enrollment trends. Fitch expects solid revenue growth based on expectations for these trends. The district lacks independent revenue raising authority.

Expenditure Framework: 'aa'

Fitch believes that spending growth will remain in line with to marginally above revenue growth. The district has a solid ability to reduce its spending as necessary. Labor agreements provide for some flexibility and carrying costs are low.

Long-Term Liability Burden: 'aaa'

Debt and pension liabilities are low relative to personal income.

Operating Performance: 'aa'

The district's financial resilience has improved in recent years, as management's efforts to streamline financial operations and strengthen budgeting practices have resulted in a significant increase in reserves. The district also benefited from increased state spending on education.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--The district's ability to demonstrate consistently superior gap-closing ability after the current economic downturn subsides.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Operating pressures resulting from a material decline in state K-12 education funding that lead to notably weaker financial resilience once recovery from the coronavirus pandemic takes hold.

--An economic contraction extending well into the 2H20 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained, and deeper than expected, tax revenue losses and materially erodes the district's gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector-wide Coronavirus Implications

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report titled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published on April 29, 2020 on www.fitchratings.com.

The state legislature recently passed a fiscal 2021 budget that funds an increase of $137 million in K-12 per-pupil funding, including $500 million for teacher pay raises. However, a special legislative session is expected to be called by either the Governor or the legislative leadership following the August Revenue Estimating Conference (REC) to address expected revenue shortfalls associated with the coronavirus and related economic downturn. Education aid is a significant budgetary item for the state, increasing the likelihood of cuts to per pupil funding if the state enacts midyear reductions to the general fund budget.

School District Budget Impacts

The district's 2020 fiscal year unaudited results point to a balanced budget with unrestricted general fund reserve levels consistent with the fiscal 2019 ending fund balance of $27.8 million or nearly 16% of general fund spending. Although the timing and extent of a potential state aid cut in fiscal 2021 is unknown, the district has identified several spending adjustments that it could make, including a budgeted $1 million (1% spending) contingency to offset any changes in enrollment. Management plans to release only 80% of departmental budget appropriations, holding 20% back (approximately $2 million) for the greater part of the fiscal year for budgetary cushion, which could slightly reduce the use of general fund reserves in the event of budgetary pressure. The district anticipates $4.9 million in Coronavirus Aid, Relief, and Economic Security (CARES) Act relief funds (2.8% of fiscal 2019 general fund revenue) that the state has allocated to the district. The district believes that these funds and other budget actions would enable it to absorb revenue cuts without a significant reduction in general fund reserves.

The district will ask voters for an additional mill in property taxes for the purpose of maintaining strong educational services. If passed the additional mill would generate approximately $10 million to $11 million in additional operating revenue (6% of fiscal 2019 general fund revenue).

CREDIT PROFILE

Located north of Tampa on the central-west coast of Florida, the county is mainly residential. The district, which is coterminous with the county, experienced rapid enrollment growth prior to the Great Recession as the county's population grew. Enrollment then declined for several years before resuming modest to moderate growth, which is expected to continue over the next several years.

The county serves as a bedroom community due to its proximity and direct access via the Suncoast Parkway to the City of Tampa. The area economy remains fairly narrow with concentrations in agriculture, citrus products, cattle production, limestone mining and cement production. The county's unemployment rate improved prior to the current recession but is consistently above the state and national rates.

Revenue Framework

The Florida Education Finance Program (FEFP) is the primary mechanism for funding the operating costs of Florida school districts. The FEFP process determines a base per-student funding level. The funding is split between state funds, largely derived from statewide sales tax revenue, and local funds via the required local millage rate established pursuant to state statutory procedure. The district levies discretionary taxes for operations and capital/maintenance at the statutory maximum rates of 0.7480 mills and 1.5 mills, respectively. State aid made up around 70% of the district's fiscal 2019 general fund revenues, with over 27% generated by property taxes.

Fitch's view of school district revenue prospects considers the revenue performance of the state as a starting point given its fundamental responsibility for public education funding. Fitch believes Florida's revenues will grow at a pace that is above the rate of inflation but below U.S. economic performance based on a resumption of population growth and stronger economic expansion. School district revenue expectations are somewhat tempered by the state's education funding commitments, which have been variable in recent history with annual changes in the base student allocation averaging an approximate 2.4% increase for the past five fiscal years through 2020. FEFP funding levels in recent years have lagged the rate of growth in the state's general revenues. The impact on state educational aid of the coronavirus pandemic is not clear at this time; however, state relief from mandates as well as federal stimulus programs could help mitigate a decline in revenues as occurred in the prior downturn.

Enrollment trends and expectations are the second key determinant of a school district's revenue growth prospects and are based on Fitch's view of the local

Due to the state funding mechanism, Florida school districts have very limited to no ability to independently increase general fund revenues. Fitch believes that the risk presented by this limitation is offset to some degree by recognition of K-12 education as fundamentally a state responsibility and the strong foundation of state support for education funding.

Expenditure Framework

Instruction-related expenditures, including salaries and employee benefits, comprise the bulk of the district's spending needs.

Fitch expects expenditure growth to generally be in line with to modestly above expected revenue growth in the absence of policy action.

Carrying costs related to debt service, pensions and other post-emplyment benefits (OPEB) are modest at about 7.9% of governmental spending for fiscal 2019, affording the district solid spending flexibility. Factors that place some limits to district spending flexibility include class size requirements that can dictate staffing levels and the need to maintain adequate salary and benefit levels. The district is currently meeting its minimum class size mandates. 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.

Long-Term Liability Burden

The district's overall debt and pension liability burden is very low at roughly 4.7% of personal income. The district received voter approval in September 2015 to renew its half-cent sales tax dedicated to capital improvements. The county-wide sales tax is estimated to generate approximately $11 million in annual proceeds over the 10-year term. District officials do not plan to issue debt supported by the sales tax. Fitch is not aware of any near-term debt plans.

The district participates in the adequately funded Florida Retirement System (FRS). FRS reported an asset to liability ratio of 84%, or an estimated 75% when adjusted by Fitch to assume a 6% rate of return, as of the June 30, 2019 measurement date.

Operating Performance

The district's overall financial results have improved in recent years and Fitch believes they provide very strong resilience to offset revenue declines in the event of a moderate economic downturn. The improvement was driven by the district's more conservative budgeting practices, improved state funding levels and recent cost control efforts. Recent improvements in state funding and conservative budgeted assumptions have led to consecutive surpluses in fiscal 2016 through 2019. Unrestricted general fund reserves at the end of fiscal 2019 were $27.8 million or approximately 16.3% of general fund spending and the district estimated fiscal 2020 results indicate that the district will end with reserves over 16.0% of spending.

The district has historically retained sound unrestricted fund balance levels. The balance declined during fiscal years 2012-2015 due in large part to lower than anticipated state aid; however, the district increased reserves with operating surpluses in fiscal 2016 through 2019. Financial resilience improved through a combination of improved state funding and reduced expenses as a result of operational changes. Fitch expects the improved financial resilience to continue once the nation has recovered from the current recession. The fiscal 2020 budget assumed a 5% increase in state aid and an $8.9 million general fund balance appropriation. The district has out-performed its budgeted estimates in most years and anticipates ending fiscal 2020 with a balanced budget. The fiscal 2021 budget is conservative and includes contingency items to address potential budgetary pressure throughout the year.

The district maintains reserves outside of the general fund including $11.9 million in the capital projects fund, which can be used to offset some capital related general fund expenditures for budgetary relief.

Criteria Variation

None

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria -- Effective 3/27/20--5/4/21 (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Hernando County School Board (FL) EU Endorsed

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