FITCH UPGRADES ESCAMBIA COUNTY SCHOOL DISTRICT, FL'S SALES TAX REVS TO 'AA'; AFFIRMS IDR AT 'AA'

Fitch Ratings-New York-16 December 2016: Fitch Ratings has upgraded to 'AA' from 'AA-' the rating on approximately $51.9 million of Escambia County School District, FL (the district) sales tax revenue bonds.

In addition, Fitch affirms the following:

--$19.8 million refunding certificates of participation (COPS), series 2014 at 'AA-';
--Issuer Default Rating (IDR) at 'AA'.

SECURITY
Sales tax revenue bonds are payable from the proceeds of a voted one-half cent school capital outlay discretionary sales surtax (capital outlay sales tax) levied within the district. The sales tax extends through Dec. 31, 2027.

The COPs are supported by lease payments subject to annual appropriation by the school board under a master lease-purchase agreement with the Florida School Boards Association. Upon certain events of default or the school board's failure to appropriate funds all leases under the master lease will terminate, and the school board is required to immediately surrender possession of all facilities subject to the master lease.

KEY RATING DRIVERS

The 'AA' IDR reflects the district's slow revenue growth prospects, solid expenditure flexibility, and very limited independent ability to raise revenues. In addition, the rating reflects maintenance of an adequate reserve position despite some reliance on fund balance. Carrying costs associated with pension, other post-employment benefits (OPEB), and debt service spending are low, as are long-term debt and pension liabilities. There are currently no near-term plans to issue additional debt.

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.

The upgrade to 'AA' from 'AA-' of the sales tax revenue bond rating reflects the application of Fitch's new 'U.S. Tax-Supported Rating Criteria' published on April 18, 2016, specifically the enhanced sensitivity analysis of the pledged revenue stream to cyclical declines. The 'AA' rating reflects growth prospects for pledged revenues while incorporating an assessment of resilience to economic downturns. The rating also assumes that the revenue stream will not be leveraged down to the 1.25x maximum annual debt service (MADS) additional bonds test (ABT). Fitch believes the rating on the sales tax revenue bonds is capped by the IDR on the district, as the pledged revenues do not constitute special revenues under Chapter 9 of the U.S. Bankruptcy Code.

Economic Resource Base
The district is coterminous with Escambia County, which is located in the extreme northwest corner of Florida, bordering Alabama and the Gulf of Mexico, and spans approximately 661 square miles. Pensacola (IDR AA+/ Stable Outlook) is the largest city and the county seat. District enrollment was about 40,125 students in 2016, including about 974 students in charter schools.

The local economy is dependent upon the military, with the Naval Air Station Pensacola providing significant uniformed and civilian employment. Health care and tourism are also major economic sectors. The county's population (estimated at 311,003 in 2015) has grown by about 4.5% since 2010.

Revenue Framework: 'bbb' factor assessment
District general fund 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 2015) was lower than GDP growth and just below inflation. Fitch expects a similar near-term trend given projections for essentially flat enrollment and a somewhat improved environment for state school funding. The district has very limited independent ability to raise revenues.

Expenditure Framework: 'aa' factor assessment
The district's natural pace of spending growth is expected to be close to or marginally above that of revenue. Staffing costs are the main expenditure drivers. The district has good control over employee- related expenditures, with some constraints related to class size requirements and maintenance of adequate staff compensation levels. Carrying costs associated with debt service and retiree costs are expected to remain modest.

Long-Term Liability Burden: 'aaa' factor assessment
The district's long-term liability burden related to debt and pensions is low, estimated at about 3% of personal income. The district participates in the adequately-funded Florida Retirement System (FRS). There are no near term additional debt issuance plans.

Operating Performance: 'aa' factor assessment
The district has historically maintained sound fund balance levels relative to revenue volatility and inherent budget flexibility, even with recent year draw-downs. Fitch believes that the district, supported by its solid expenditure flexibility and reserves, would maintain a satisfactory safety margin in a moderate economic decline scenario.

RATING SENSITIVITIES
Maintenance of Financial Flexibility: The IDR and COPs ratings are sensitive to material changes in the district's expenditure flexibility, modest debt and low overall long-term liabilities, and maintenance of adequate reserve levels through a typical economic cycle.

Debt Service Coverage: The sales tax rating is sensitive to changes in debt service coverage resulting from pledged revenue trends or further issuance of debt.

CREDIT PROFILE

In addition to federal, state, and local government, and the Navy Federal Credit Union, major county employers include various healthcare facilities, a chemical manufacturer, university, and a utility. County unemployment has been declining, but remains above state and national averages. County income and wealth levels are below state and national averages, partially reflecting the large military presence. In addition to the Pensacola Naval Air Station, navy facilities in the county include Saufley Field and Corry Station.

Following annual declines /flat performance in fiscal years 2010 through 2013, taxable assessed value (TAV) returned to annual growth. Most recently, TAV grew by about 4% in fiscal years 2015 and 2016. The district expects continued moderate TAV growth, which seems reasonable given ongoing residential and commercial expansions.

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. Discretionary taxes for operations and capital/maintenance may also be levied by the district up to the statutory maximum rates of 0.748 mills and 1.5 mills, respectively. The district's current capital outlay millage rate is 1.462 mills. State aid made up over 60% of the district's fiscal 2015 general fund revenues, with over 30% 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 revenue prospects 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 as low as a 1% increase for fiscal 2017. 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 economy, demographic patterns, and competition from non-traditional public schools, among other factors.

District general fund revenue growth over a 10-year period (through fiscal 2015) was lower than GDP growth and just under inflation. Going forward, the natural pace of revenue growth is expected to exhibit a similar trend, given expectations for flat enrollment for the non-charter school population.

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
Salaries and benefits accounted for over 80% of general fund spending in fiscal 2016.

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 funding, and increased local revenues driven by TAV growth.

Carrying costs related to debt service, pensions and OPEB benefits are modest, estimated at about 7% of governmental spending for fiscal 2016, affording the district some spending flexibility. Factors limiting 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 long-term liability burden, related to debt and the district's share of the net pension liability of the FRS, is modest at about 3% of personal income in fiscal 2016. The total long-term liability is made up largely of the district's outstanding debt. No additional new money debt issuance is planned for the near term.

Pensions are provided through the state run FRS, which is well funded, with a reported asset to liability ratio of 86.5% on a reported basis as of July 1, 2015 or an estimated 80.7% when adjusted by Fitch to assume a 7% rate of return.

Operating Performance

Even with recent year reserve draw-downs, the district has maintained adequate reserve levels, well in excess of its 3.5% unrestricted fund balance policy. Fitch expects the district to respond to a potential revenue decline by taking actions to control spending while maintaining an adequate level of fundamental financial flexibility. Flexibility is augmented by available balances in capital funds, which have totaled over $10 million since fiscal 2010.

In recent years, the district has relied on reserve draws to balance the budget and allow for salary increases and other priority spending. Preliminary unaudited estimates for fiscal 2016 indicate another draw-down of about $2.7 million (vs. an initially budgeted $10.2 million), in part driven by mandated spending for underperforming schools. The unrestricted ending balance is estimated at about 11.5% of spending. The fiscal 2017 budget assumes another draw-down of about $7.6 million, which would reduce the unrestricted ending balance to about 9.2%. However, the district expects better than budget revenue and expenditure performance to result in a lower draw. The district is targeting maintenance of an unrestricted fund balance of about 10% of spending.

Certificates of Participation

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 mills levy is available for COPs debt service associated with new issuance after 2009. The district currently levies 1.462 mills (an increase from 1.366 mills in fiscal 2016) and expects to use about .29 mills of the capital outlay millage for COPs MADS.

The master lease structure on the district's COPs is strong, requiring an all-or-none appropriation. In the case of non-appropriation, the trustee is authorized to require the district to surrender use of all facilities under the master lease. The master lease covers projects in 20 of the district's schools.

Sales Tax Bonds

MADS coverage in fiscal 2015 was about 4x. To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP stress scenario) and the largest consecutive decline in actual collected revenue since fiscal 2001. FAST generates a 4% scenario decline in sales tax revenue. The largest actual cumulative decline in historical sales tax revenues is about 18% for fiscal years 2007 through 2010, due to the recession.

Fitch considers the scenario results consistent with an 'aa' assessment. While the ABT allows for leverage up to 1.25x, the district reports no additional expected issuance and has opted to fund recent and planned new school construction and other capital projects via pay-go financing. Enrollment is projected to be flat in the near term, and should not pressure capital spending. The sales tax authorization expires in 2027.

Even if MADS coverage were to drop to 2x, sales tax revenue could tolerate a 50% decline before MADS coverage fell to 1x. This level of tolerance is equivalent to 11.9x the FAST results and 2.8x the largest historical decline in the review period. Given the outsized impact of the housing market collapse on the Florida economy, the rating incorporates Fitch's expectation that such a large decline in pledged revenues would not reoccur in future economic downturns

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Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's 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/site/re/879478

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December 22, 2015

Mr. Terry St. Cyr
Assistant Superintendent for Finance & Business Services
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75 North Pace Boulevard
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Dear Mr. St. Cyr:

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Nothing in this letter is intended to or should be construed as creating a fiduciary relationship between Fitch and you or between us and any user of the ratings.

In this letter, "Fitch" means Fitch Ratings, Inc. and any successor in interest.

We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please feel free to contact us at any time.

Jeff Schaub
Managing Director, Operations
U.S. Public Finance /
Global Infrastructure & Project Finance

JS/mb

Enc: Notice of Rating Action
(Doc ID: 200560)

Notice of Rating Action

Bond Description	Rating Type	Action	Rating	Outlook/ Watch	Eff Date	Notes
Escambia County School Board (FL) sales tax rev bonds ser 2016	Long Term	New Rating	AA-	RO:Sta	22-Dec-2015	

Key: RO: Rating Outlook, RW: Rating Watch; Pos: Positive, Neg: Negative, Sta: Stable, Evo: Evolving