MOODY'S
INVESTORS SERVICE

Rating Update: Moody's upgrades Hernando County, FL Capital Improvement Bonds to Aa3 from A1; outlook is stable

Global Credit Research - 25 Nov 2014

Aa2 Issuer Rating and Aa3 Non Ad Valorem rating affirmed; outlooks are stable

HERNANDO (COUNTY OF) FL
Counties
FL

Opinion

NEW YORK, November 25, 2014 --Moody's Investors Service has upgraded Hernando County's (FL) $3.6 million outstanding Capital Improvement (sales tax) Bonds to Aa3. The bonds are secured by the county's portion of the state-shared local government half-cent sales tax; the outlook is stable. Concurrently, we have affirmed the Aa2 issuer long-term rating and the Aa3 rating on the non ad valorem revenue bonds. The outlooks are stable. The rating action affects $7 million of Moody's rated debt. The non ad valorem bonds are secured by a covenant to budget and appropriately legally-available non ad valorem revenues.

SUMMARY RATING RATIONALE

The rating upgrade of the capital improvement bonds is based on strong coverage and satisfactory legal protections. Despite declines related to the recent recession, sales tax collections have improved over the past five fiscal years, and has provided historically solid debt service coverage. The rating also reflects the favorable legal protections including a 1.25 times additional bonds test and a debt service reserve funded at MADS in cash.

The rating affirmation of the issuer long-term rating is based on the county's moderately-sized tax base, which is expected to improve in the medium-term, as well as narrowing, but still satisfactory, financial position that is expected to strengthen. The rating further incorporates low debt burden, manageable pension and fixed cost burdens, and weak socioeconomic profile.

STRENGTHS

-Sizeable tax base, experiencing renewed growth

-Positive financial projections moving-forward

-Modest debt with no expected borrowing

CHALLENGES

-Slow economic recovery compared to state peers

-Inconsistent financial performance, resulting in significant reduction in General Fund balance and reserves

DETAILED CREDIT DISCUSSION

FINANCES EXPECTED TO IMPROVE

With the exception of fiscal 2012, the county has only reported spending deficits, drawing General Fund balance from a high of $37.4 million, or 39.7% of revenues, in fiscal 2008 to $18.7 million, or 26.7% of revenues, in fiscal 2013. The reduction in General Fund balance is not due solely to structural imbalance, but spending on capital improvement projects or transfers out to other reserve funds. In recent years, the county has made significant improvement in continued education programs and facilities, including SunTech, an adult technical education center, Tampa Bay Advanced Manufacturing Skills Initiative, an apprentice program, and Aviation and Aerospace Academy. Officials report the $8.3 million drawdown of reserves in fiscal 2013 was intentionally used for one-time expenses and operations; the board opted to spend fund balance as the county was in excess of its reserve policy, which requires 18.5% be held in General Fund balance.

Operations are reported to improve in fiscal 2014, with the county expecting to report a $2.4 million surplus, increasing General Fund balance to $21.1 million, or 29.2% of 2014 budgeted revenues. The surplus is due to a 0.95 property millage increase in conjunction with conservative budget management. Moving forward, the county is projecting another $2 million surplus in fiscal 2015 due to increased property tax collections, improving General Fund balance to $23.1 million, or 30.2% of 2015 budgeted revenues. Additionally, starting fiscal 2015, officials report that the county will no longer rely on one-time revenues to fund operations, but rather, will balance the budget with sustainable revenue streams.

Of note, officials report the county implemented new park user fees in fiscal 2013, which is expected to generate $1 million per year moving forward. Additionally, the county has approximately $900,000 in excess liquidity outside the General Fund, held in the Capital Improvement Fund. These monies are unrestricted, and can be used for general purpose, a credit positive.

While positive operations are expected moving forward, the county is being outpaced by state and national peers. As such, future credit reviews will focus on the county's ability to manage expenditure growth without use of reserves. Further draws on General Fund balance could result in downward rating action.

SUFFICIENT AVAILABLE REVENUES TO PAY NON AD VALOREM OBLIGATIONS

The county has sufficient revenues to repay non ad valorem debt. The county has identified $37 million gross non-ad valorem revenues ($28.1 million net of essential service payments) in relation to the maximum debt service of $4.1 million on all non-ad valorem obligations. Annual debt service increased from $734,000 in fiscal 2012 to $1.2 million in fiscal 2013 due to issuance of a revenue refunding note. Legal protections include an anti-dilution test requiring total non-ad valorem revenues be at least 1.5 times maximum annual debt service (MADs) for outstanding non-ad valorem bonds. Additionally, MADS for all debt will not exceed 20% of General Fund revenues.

COVERAGE OF CAPITAL IMPROVEMENT BONDS IMPROVES

The capital improvement bonds, secured by the county's portion of the state-shared local government half-cent sales tax, were issued in 2004 to build a new jail facility and emergency operations center. Throughout the life of the bonds, the county has maintained strong coverage levels in excess of two times, despite declines in sales tax collections during 2006 through 2009. In fiscal 2012, coverage was a satisfactory 2.55x annual debt service.

In 2013, the county issued a non ad valorem revenue refunding note, refunding a large portion of outstanding capital improvement bonded debt. As such, sales tax debt service declined from $2.8 million in fiscal 2012 to $956,000 in fiscal 2013. The declines in debt service requirements are coupled with improved sales tax collections: the county reports that they collected $8 million sales tax receipts in 2014, an increase of 5.2% to prior year, and are budgeting collections of $8.2 million in 2015. As such, coverage is projected to be 8.37x in fiscal 2014 and 8.6x in fiscal 2015. After debt service is paid, the county uses the remaining monies for operations. Legal protections remain satisfactory, requiring a 1.25x (MADS) additional bonds test and a cash debt service reserve fund equal to MADS. The remaining sales tax bonds expire in 2017, and no additional borrowing is anticipated at this time.

MODERATELY SIZED TAX BASE SLOW TO RECOVER FROM RECESSION

The county is located in west-central Florida on the Gulf of Mexico, north of Tampa (Aa1/NOO) and west of Orlando (Aa1/STA). The county's tax base experienced significant contraction over an extended six-year period from 2008 to 2014, losing 47.3% of assessed value (AV) on aggregate. Fiscal year 2015 shows signs of stabilization, with AV reported at $7.2 billion, a 3.1% growth over prior year. The county has adjusted tax rates as necessary to ensure stable property tax collections. In 2015, the tax rate was 7.81 mills, up from 7.69 mills in 2014. Officials attribute slow economic recovery in part to prevalence of sink holes, which adversely impacts real market value of residential properties. Officials report the number of sink holes has dropped from 1,957 in 2012 to 347 in 2014.

Moving forward, officials expect the tax base to continue to improve due to residential and commercial development. In Brooksville, the county seat, several existing subdivisions, such as Trillium and Avalon, have expanded. Additionally, a 98-unit senior housing center is under construction. Major commercial developments include construction of a neighborhood Wal-Mart, Beacon Theatre, Dick's Sporting Goods and Hobby Lobby. Officials report that five developments of regional impact were recently approved by the State of Florida. Projects include communities of Sunrise, Hickory Hill, Lake Hideaway, Quarry Preserve and Seville. Developers have yet to break ground, but are expected to do so in the near-term.

The county's socioeconomic profile is weak compared to peers. Per capita income (PCI) and median family income (MFI) are reported at 83.3% and 79.6% of US, respectively, per the 2010 US Census. Moody's notes that wealth levels are average compared to state medians, with PCI and MFI of 85.5% and 87.6%, respectively. Unemployment rates are elevated, reported at 8.1% compared to the state's 6.1% as of September 2014. The tax base is slightly concentrated, with top ten taxpayers comprising 12.9% of 2014 AV.

MANAGEABLE DEBT BURDEN; NO PLANS TO ISSUE IN THE NEAR-TERM

The county's direct debt burden is low at 0.3% of 2015 just value. Principal payout is above average at 81% retired in ten years. The county has no variable rate debt or swaps. Included in the county's debt profile are two lines of credit, used to finance improvement projects. Principal and interest is paid from special assessment fees, not General Fund monies. Officials report the county has no plans to issue debt in the near- to medium-term.

The county participates in the Florida Retirement System, a cost-sharing, multiple employer, defined benefit public retirement system administered by the State of Florida, Division of Retirement. The county's combined annual required contribution (ARC) for the plans was $6.6 million in fiscal 2013, or 5.7% of total operating expenditures. Moody's notes that the $6.6 million payment is county-wide, including employees whose salaries are covered by special assessment fees or enterprise revenues. As such, only $3.8 million, or 3.3% of total operating expenditures, directly relates to governmental employees. Moody's adjusted net pension liability (ANPL) for the county, net of enterprise support, is $183.1 million, or a slightly elevated 1.73 times operating revenues for fiscal 2013. The county's fixed cost burden, including total pension contributions, OPEB and debt service, regardless of security, is manageable at 10.8% of fiscal 2013 operating expenditures.

WHAT COULD MAKE THE RATING GO UP

-Continued tax base growth

-Significant increases in cash and General Fund balance

WHAT COULD MAKE THE RATING GO DOWN

-Tax base contraction

-Further reduction in General Fund balance

-Fiscal 2014 and fiscal 2015 results that do not match expectations

KEY STATISTICS

Full value, 2015: $12 billion

Full value per capita, 2015: $69,069

Median family income: 79.6% of U.S.

Available fund balance, FY 2013: 54.2% of operating revenues

5-year change in fund balance: -53.6% of operating revenues

Net cash, FY 2013: 103.91%

5-year change in cash balance: -15.95% of operating revenues

Institutional framework: A

5-year average of operating revenues / expenditures: 1.02x

Net direct debt burden % of full value: 0.33%

Net direct debt burden / operating revenues: 0.36x

3-year average Moody's adjusted net pension liability % of full value: 1.30%

3-year average Moody's adjusted net pension liability / operating revenues: 1.44x

The principal methodology used in the issuer and non ad valorem rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in this special tax rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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