FitchRatings

RATING ACTION COMMENTARY

Fitch Maintains Negative Rating Watch on Hillsborough County FL Schools IDR, COPs & Cap Imp Revs

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Fitch Ratings - New York - 27 Oct 2021: Fitch maintains a Negative Rating Watch on the following Hillsborough County FL School District's ratings:

--Issuer Default Rating (IDR) of 'A';

--Outstanding Hillsborough County FL School Board and Leasing Corp. certificates of participation (COPs) rated 'A-';

--$4 million outstanding capital improvement and refunding revenue bonds, series 2015 rated 'A'.

In addition, Fitch has affirmed the 'A-' rating on the district's outstanding $37 million community investment tax (CIT) sales tax revenue bonds, series 2015B. The Rating Outlook for the sales tax bonds is Stable.

SECURITY

The COPs are payable from lease payments made by the district to the trustee pursuant to a master lease purchase agreement. Lease payments are made from legally available funds of the district, subject to annual appropriation by the board. In the event of less than full appropriation, the trustee may force the district to surrender possession of all leased facilities under the master lease to the trustee for disposition of its interest in such facilities by sale or re-letting.

The capital improvement revenue bonds are payable solely from an annual $446,500 distribution paid to the board from state sales tax revenues, pursuant to Florida statutes; the revenue is a substitute for racetrack revenues previously distributed. The rating on the capital improvement revenue bonds is capped at the lower of the district's IDR or one notch below the state of Florida's IDR (currently rated AAA).

The sales tax revenue bonds are backed by a first lien on the district's share of a one-half cent local infrastructure sales tax or CIT, levied and collected by Hillsborough County. The CIT was approved by voters for a 30-year period ending Dec. 1, 2026, two months after the final maturity of the bonds. The district receives 25% of total revenue collected within the county according to an interlocal agreement between the county and the district.

ANALYTICAL CONCLUSION

The maintenance of the Negative Rating Watch reflects the lack of approved decisions to date to eliminate the projected operating deficit. The district has come up with a variety of potential actions to eliminate the deficit, including new revenue measures, the bulk of which actions will not be approved until early in 2022. A potential new revenue measure would require voter approval, likely in November 2022.

Fitch remains concerned with the successful and timely implementation of the proposed financial recovery plan and its ability to achieve and sustain structural budget balance. The use of a combined approximate total of $100 million of ESSER I and II funds during fiscal 2021 has contributed to the district's improved general fund balance; however, these and future non-recurring stimulus moneys cannot be relied on to eradicate ongoing structural budget gaps.

The removal of the Negative Rating Watch is dependent upon formal board approval of expenditure savings measures and potential new recurring revenue sources which Fitch considers credible to ensure maintenance of at least a 3% minimum general fund balance without a reliance on non-recurring stimulus funds. Fitch will review progress in instituting expenditure savings measures and potential recurring new revenue sources that support stabilization of operating performance and ratings stability.

The 'A' IDR reflects the district's low long-term liability burden and fixed carrying costs, and expectations for the long-term liability to remain low for some time. Prospects for enrollment-driven revenue growth are considered by Fitch to be slow, based on recent trends, growth in charter school enrollment and expectations for state funding.

The 'A' rating on the capital improvement bonds is capped at the lower of the district's IDR or one notch below the state of Florida's IDR (currently AAA). The distributions securing the bonds are derived from state sales taxes allocated to the School Board.

The affirmation of the CIT sales tax revenue bond rating reflects the adequate level of financial resilience of pledged revenues to potential declines and the district's maintenance of surplus CIT revenues available for debt service. The rating is capped by the district's IDR.

Economic Resource Base

The district is coterminous with Hillsborough County (AAA/Stable) which is located on central Florida's western coast and includes the city of Tampa

(AA+/Stable). The county's 2020 census population was 1,460,000, up 18% since 2010.

KEY RATING DRIVERS

Revenue Framework: 'bbb'

District revenues are comprised of a combination of state allocations and local property taxes. The district's general fund revenue growth has been positive over the past decade with some variability due to state funding. Fitch expects growth over the longer term to slow as traditional student enrollment remains stagnant to declining with moderate increases in state per pupil funding. The district has no independent legal ability to raise revenues.

Expenditure Framework: 'a'

Fitch expects the natural pace of spending to exceed revenues without policy action. The district's mandate to provide educational services and need to compete with charter schools places some limitations on its ability to make expenditure reductions in the event of a revenue decline. Nonetheless, the district's relatively low carrying costs and ability to modify class sizes, reduce personnel, adjust curriculum, and make other cuts if needed, provide solid expenditure flexibility.

Carrying costs for debt service, pension contributions and other post-employment benefit (OPEB) contributions represented 7% of total governmental spending in fiscal 2020. Management retains satisfactory ability to control labor costs and staffing levels after engaging in a structured bargaining framework.

Long-Term Liability Burden: 'aaa'

The district's long-term liability burden, including direct and overlapping debt and Fitch-adjusted net pension liabilities, is low at approximately 4% of personal income. Fitch expects the liability burden to remain low based on expectations for limited future debt offerings and a relatively well-funded state pension system, for which the district is paying full actuarially determined contributions.

Operating Performance: 'a'

The district maintains adequate gap-closing capacity; however, operations will likely remain challenged in the near term given the depth of the projected budget gap. District reserves have been reduced from more than 12% of spending in fiscal 2014 to 4% in fiscal 2020 for both one time and ongoing needs. Current projections reflect a still large but slightly improved budget imbalance and improved levels of reserves due to receipt of one-time stimulus funds. A sales tax approved by voters fall of 2018 and an increase in impact fees helps to mitigate spending pressures associated with capital needs.

RATING SENSITIVITIES

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

--Policy action that addresses the projected budget imbalance, leading to a sustained level of unrestricted general fund balance of at least 3% to 5% of spending;

--An upward change in the credit quality of the district would cause a corresponding change in the rating on the capital improvement revenue bonds;

--Sales Tax Bonds: A sustained improvement in pledged revenues beyond expectations leading to a significant upward change in debt service coverage levels absent additional debt could increase the rating up to the level of the District's IDR.

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

--A response by management that fails to address the district's budget gap in a conclusive and structural manner resulting in an expected reduction in unrestricted general fund balance closer to or below 3% of spending and weakening of financial flexibility;

--Sales Tax bonds: A sustained decline in pledged revenues weakening the bond structure's financial resilience.

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

The district's unaudited fiscal 2021 (ended June 30) general fund results show a $29 million net operating surplus and unrestricted fund balance of $91 million or 5% of spending. Management had been projecting as large as a $140 million operating deficit back in January 2021. A combination of expenditure savings and use of approximately $100 million in stimulus funds supported the results.

Management began fiscal 2022 with an estimated $70 million general fund operating imbalance. The district has identified immediate general fund savings measures as well as recurring costs that are eligible for reimbursement from capital outlay millage revenues. Fitch estimates that when combined, these would cut the projected deficit by approximately 45%. Other current fiscal year items that were not budgeted such as savings from employee attrition, elimination of vacant positions and state reimbursement due to an estimated over-counting of charter and private school students should help reduce the deficit further.

Management continues to work on the institution of recurring expenditure savings to reduce the operating imbalance, which Fitch believes may require reducing staffing levels if additional recurring revenues do not materialize. New revenue measures being considered include a referendum in 2022 for a separate operating millage. A half mill would generate approximately $63 million (3% of budget) and a full mill, $127 million, based on current tax base values.

The district received $190 million (excluding charter school allocations) in ESSER II grants of which $61 million was used during fiscal 2021. The remainder is available to support eligible spending through September 2023 and could help improve fund balance levels further. Additionally, the district's designated portion of American Rescue Plan Act (ARPA) moneys is $402 million, which has yet to be distributed by the state. The ARPA moneys are available for eligible items through September 2024. Stabilization of the district's ratings relies on improvement in structural budget balance without a reliance on such funds.

The district's fiscal 2022 general fund operating budget of $1.97 billion is up 2.4% from the prior year's final budget and reflects an approximate 2% decrease in Florida Education Finance Program (FEFP) student allocated revenues. Current enrollment (excluding charter students) is up 1% yoy after an approximate 3.5% drop in in fiscal 2021.

DEDICATED TAX KEY RATING DRIVERS

Solid Revenue Growth Prospects: Fitch expects pledged revenue growth to generally align with changes in the population, employment and income levels of residents in the county based on historical growth performance and future expectations for economic expansion.

Adequate Coverage Cushion: Unaudited fiscal 2021 pledged revenues are projected at $34.6 million and provide 1.65x MADS coverage. Fitch believes debt service coverage will remain adequate through the remainder of the current tax authorization period (2026). The district does not have near-term borrowing plans.

CIT Sales Tax Update

Debt service coverage of MADS (occurring in 2025) was sound at 1.5x based on fiscal 2020 pledged revenues but improved to 1.65x based on unaudited fiscal 2021 pledged revenues of $34.6 million. Debt service is essentially level through final maturity in 2026. Pledged revenues experienced a decline of close to 7% for fiscal year 2020 following nine years of growth at close to or in excess of GDP. Pledged revenues are up 11% for fiscal 2021 compared with fiscal 2020 and up 4% when compared with fiscal 2019 pledged revenues.

District officials have indicated they do not have any additional debt plans at this time. Fitch does not expect further leveraging of the pledged revenues, as in 2018 voters approved a separate half cent sales tax for the next ten years to help support district capital and facility needs.

The series 2015B sales tax revenue bonds have a debt service reserve fund surety bond provided by Assured Guaranty. Fitch does not rate Assured Guaranty and does not include the surety in its analysis.

The dedicated taxes pledged to the bonds do not meet the requirements set out in Fitch criteria for treatment as "pledged special revenue" under Section 902(2) of the Bankruptcy Code and are not otherwise insulated from the operating risk of the district. Therefore, the ratings on the CIT revenue bonds are capped at the district's IDR.

CREDIT PROFILE

The county is located along the western coast of Florida. The county, along with its largest city, Tampa, serves as the economic center for Florida's Gulf Coast with major sectors of business services, government, health care, education and tourism. MacDill Air Force Base and the Tampa Port are major economic engines.

Following the prior downturn, the county had been experiencing a sustained and vigorous recovery, characterized by strong and consistent job growth the past decade, a strong rebound in housing and the resumption of tax base growth since fiscal 2014. Taxable values have grown by over 50% since fiscal 2014 and exceed pre-recession levels. However, economic activity has been dampened and unemployment levels heightened as a result of the pandemic.

A large upgrade and expansion project at Tampa International Airport and a proposed $3 billion waterfront mixed use development project in Tampa are expected to support new job growth. Fitch believes that post-pandemic, underlying economic characteristics of the county point to favorable prospects for continued growth in the tax base and sales tax revenues.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

Hillsborough County School District (FL) has an ESG Relevance Score of '4' for Rule of Law, Institutional & Regulatory Quality, Control of Corruption due to due to governmental effectiveness surrounding budget management decisions, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Hillsborough County School District (FL)	LT IDR	A Rating Watch Negative	Rating Watch Maintained	A Rating Watch Negative
•	LT	A Rating Watch Negative		

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Hillsborough County School Board (FL)	EU Endorsed, UK Endorsed

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