MOODY'S
INVESTORS SERVICE

Rating Update: Moody's downgrades Clay County School District's, FL Issuer Rating to A1, COPs to A2

Global Credit Research - 27 Aug 2014

Downgrade affects $51M in COP obligations

CLAY COUNTY SCHOOL DISTRICT, FL
Public K-12 School Districts
FL

Opinion

NEW YORK, August 27, 2014 --Moody's Investors Service has downgraded to A1 from Aa3 Clay County School District's (FL) issuer long term rating. Moody's has also downgraded the certificates of participation (COPs) to A2 from A1, affecting $51 million in outstanding debt. The issuer long term rating is Moody's assessment of the district's implied unlimited general obligation pledge; no general obligation debt is currently outstanding. The COPs are secured by annually-appropriated lease payments.

SUMMARY RATING RATIONALE

The Issuer Rating downgrade to A1 reflects the district's significantly narrowed reserves following two years of structural imbalance, and the protracted expected recovery period. The rating also incorporates the district's sizeable tax base, average socioeconomic profile, and modest debt profile, albeit with an elevated pension liability.

The A2 on the certificates of participation is supported by the decline in the overall credit quality of the district, the strength of the master lease, the essential nature of the projects, and an effective, dedicated revenue source used to make lease payments.

STRENGTHS

- Sizeable tax base showing signs of renewed growth

- Modest debt burden with limited future needs

- Average socioeconomic profile

CHALLENGES

- Narrowed reserves

- Multi-year plan to return to state minimum reserve levels

- Elevated pension liability

DETAILED CREDIT DISCUSSION

DISTRICT FUND BALANCE NARROWED BELOW STATE MINIMUM

The district's General Fund balance declined in recent years to below the state required minimum, and we expect reserves will remain narrow moving forward. The state requires the combined assigned and unassigned fund balance to equal 3% of revenues (excluding transfers). Following two years of surpluses, the district realized a deficit in fiscal year 2012 of $9.3 million, reducing the combined fund balance to $9.6 million, a still satisfactory 4.2% of revenues. This deficit was largely attributed to the loss of Federal Jobs funding. In fiscal year 2013, the district realized another deficit of $6 million attributed to revenue declines following a decrease in enrollment and property values and increased salary and benefit expenditures. This deficit resulted in an ending assigned plus unassigned fund balance of $4.9 million or 2.1% of revenues, below the state required minimum. Consequently, the district was required to submit a letter to the state in which it has committed to return reserves above 3% by fiscal year 2016. Despite the expiration of the critical millage and local revenue performance below budget, the district is

projecting a slight surplus in fiscal year 2014 with reserves equaling 2.24% of revenues. Officials report the loss of the critical millage was offset by operational cuts, freezing positions, and using capital outlay millage revenues to support maintenance personnel.

For fiscal year 2015, officials have budgeted an ending fund balance at 2.58% of revenues. The budget includes increased local effort millage to offset 2014 shortfalls, flat enrollment, and increased pension contributions. The district anticipates increased enrollment will lead to positive state aid revenue variance. The rapid deterioration of the district's reserves as well as the multiple years required to rebuild reserves are key considerations in the downgrade. We note that the district intends to rebuild reserves to a target of 5%-7% of revenues, exceeding the state minimum, but reserves will remain narrow in the near term. Future reviews will focus on the district's ability to return to and maintain structural balance and improve reserves.

SIZEABLE TAX BASE SHOWING EARLY SIGNS OF RENEWED GROWTH

Serving as a bedroom community for Jacksonville (Aa2/stable), we expect the district's tax base will experience moderate growth moving forward. The sizeable $12.6 billion tax base realized its first year of growth in FY 2014 following five consecutive years of decline. Officials report significant residential development planned or in progress that will drive future growth. While enrollment has seen slight declines in recent years, the district anticipates level enrollment or modest growth moving forward given ongoing residential development.

The district's socioeconomic indicators are consistent with national averages. Per the Census Bureau's 2006-2010 American Community Survey, the district's per capita income and median family income were 98.3% and 107.8% of the US respectively. Unemployment in the district was a low 5.3% as of June 2014, compared to the state (6.2%) and the nation (6.3%) for the same period.

MODEST DEBT BURDEN; COPS SUPPORTED BY STRONG LEGAL PROVISIONS AND CAPITAL OUTLAY MILLAGE

The district's debt burden as of fiscal year 2013 is a modest 0.5% of full value and should remain manageable given no future debt issuance plans. In addition to $54 million in COPs outstanding, the district has about $2.6 million outstanding in revenue bonds secured by pari-mutuel tax revenues distributed annually to the county. Debt service expenditures are a modest 2.2% of operating expenditures. Officials report no debt issuances are included in the five-year capital improvement plan and that land and facilities are sufficient for future needs. The COPs fully mature in 2028 while the revenue bonds mature in 2032.

The COPs benefit from strong legal protections and the ability of the district to utilize the capital outlay millage for debt service. The master lease program under which the certificates were issued requires that unless the School Board gives notice of intent not to appropriate, the superintendent budget for all of the lease payments associated with the COPs. The outstanding leases were issued for land or school construction projects, and the master is fully asset backed. These legal provisions coupled with the essential nature of the projects provide strong incentive to appropriate. Additionally, the district expects to make lease payments with revenues generated from the 1.5 mill discretionary capital outlay levy. Using the fiscal year 2014 values, one mill, at a 96% collection rate, generates $8.8 million in relation to a maximum annual debt service payment of $5.4 million. Officials report that strong impact fee collections have minimized the district's use of capital outlay revenues for debt service, only requiring about 0.25 mills.

ELEVATED PENSION LIABILITY

The district consistently makes its full statutorily required contribution to the Florida Retirement System (FRS), a multi-employer cost-sharing defined benefit plan and has an elevated pension liability. The district's contribution in fiscal year 2013 of $14.6 million was a manageable 5.9% of operating expenditures. The district's fiscal year 2013 adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is $698 million, or an elevated 2.89 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities. The district has reported increased required contribution rates for fiscal year 2015. Further increases could pressure district operations. Future reviews will assess the district's ability to manage required pension contributions while maintaining structural balance.

WHAT COULD CHANGE THE RATING UP

- Substantial improvement in reserves

WHAT COULD CHANGE THE RATING DOWN

- Continued structural imbalance and deterioration of reserves

- Significant leveraging on capital outlay millage

KEY STATISTICS

FY 2014 Full Value: $12.6 billion

FY 2014 Full Value Per Capita: $66,246

Median Family Income as % of US: 107.8%

FY 2013 Operating Fund Balance as % of Revenues: 2.04%

5- Year Dollar Change in Fund Balance as % of Revenues: -7.27%

FY 2013 Operating Funds Cash Balance as % of Revenues: 3.24%

5-Year Dollar Change in Cash Balance as % of Revenues: -7.20%

Institutional Framework: "A"

5-Year Average Operating Revenues/Operating Expenditures: 0.98x

Net Direct Debt as % of Full Value: 0.47%

Net Direct Debt / Operating Revenues: 0.25x

3-Year Average ANPL as % of Full Value: 4.74%

3-Year Average ANPL / Operating Revenues: 2.48x

PRINCIPAL METHODOLOGY

The principal methodology used in the issuer rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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