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SPECIAL COMMENT

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Florida Back on Track

State economy and finances are improving, but hurricane exposure poses credit challenge

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Summary

Florida (rated Aa1 with a stable outlook) was one of hardest hit states in the recent recession, with unemployment spiking to 11.4% and a housing market bubble that burst into one of the worst real estate market declines in the country, leading to significant revenue fall-off and budget strain. Revenue trends, year-end surpluses, and other economic indicators now show that the state's recovery is well under way. This report examines the state's recovery and where its finances and economy are headed, including the following highlights:

» Current financial and economic strengths underscore Florida's resilience and sound fiscal management;

» Reserves are being rebuilt to provide cushion against future downturns;

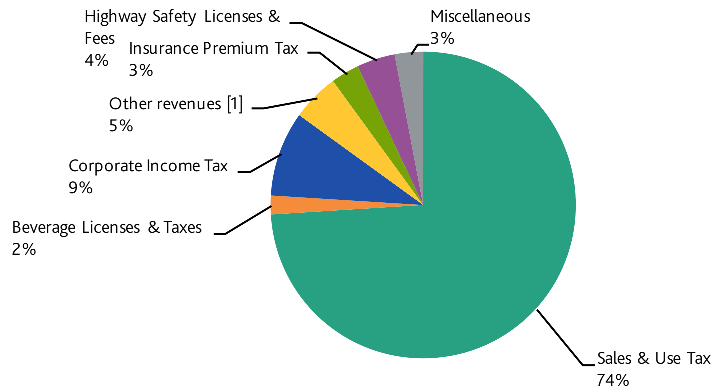
» Revenues are growing and the economy is improving, although recovery in the housing sector is still very slow;

» Florida remains exposed to revenue volatility, as well as hurricane risk through the debt structure created to help insure property losses from future storms.

Strengthening Finances as Recession Ebbs

Prior to the recession, Florida had one of the largest housing run-ups in the country, followed by a bust that contributed to high unemployment and plummeting revenues. With no personal income tax, the state relies heavily on sales taxes for about three-fourths of its General Revenue Fund (GRF) revenues (see Figure 1). This dependence amplified the impact of the falloff in home-related purchases that generally accompany real estate transactions, on top of high unemployment rates and a drop in tourism-related sales taxes as the rest of the country plunged into recession.

FIGURE 1
Florida Depends Heavily on Sales Taxes

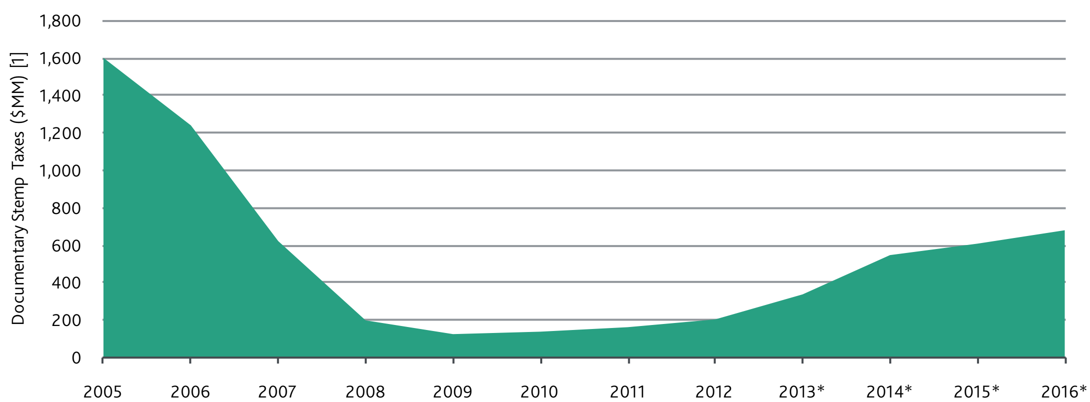


Source: State of Florida, fiscal 2012
[1] Includes documentary stamp, tobacco, intangible personal property taxes, medical & hospital fees, and Indian gaming revenues - all 1% each

Documentary Stamp Taxes Show Extreme Volatility

The improved forecast for documentary stamp taxes on real estate related transactions supports other evidence, such as increases in building permits and existing home sales, that Florida's severe housing decline has bottomed out. However, the extreme volatility of this revenue poses significant budgeting and capital planning challenges. Over a three-year period during the recession, documentary stamp taxes plummeted around 73% from a peak of $4 billion in fiscal 2006 to approximately $1.1 billion in fiscal 2010. The out-year forecast shows a steady increase in documentary stamp taxes. Even so, amounts deposited in the GRF will remain well below the sums generated at the height of Florida's housing boom (see Figure 2). In fiscal 2005, documentary stamp taxes represented approximately 6% of GRF receipts but accounted for about 1% of the total in the last six audited fiscal years, through 2012. The forecast for fiscal 2013 show similar results.

FIGURE 2
Documentary Stamp Taxes Fell With Housing Market



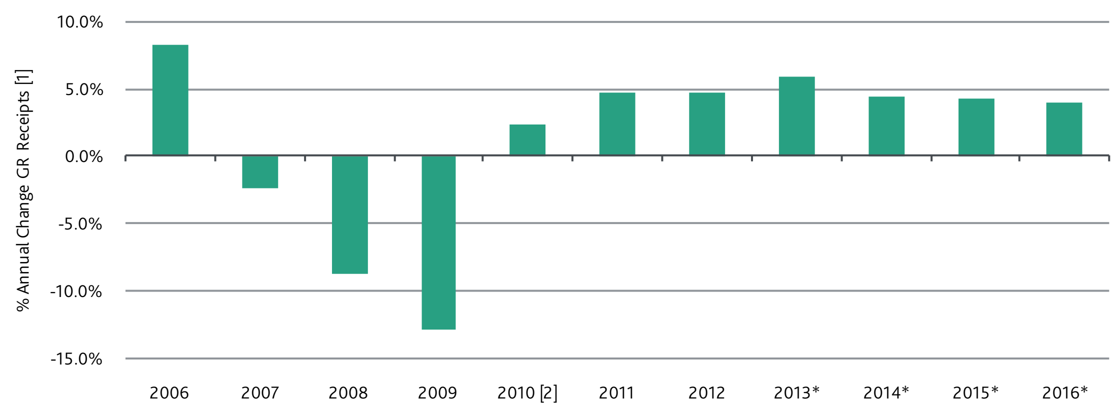
*Estimated - March 2013 Revenue Estimating Conference.
[1] Transferred to General Revenue Fund

Economic and Revenue Growth Ease Budgetary Pressures

For the first time in five years, Florida did not face a budget gap as it began budget deliberations for fiscal 2014. The adopted budget includes $1.7 billion in unspent general revenue at the end of the fiscal year as well as the third consecutive reserve deposit to replenish the state's budget stabilization fund (BSF). Following that deposit, the rainy day fund will total $925 million, which is 3.5% of revenues (compared to its pre-recession level of about 4% at the end of fiscal 2006).

The latest general revenue forecast (March 2013) for fiscal 2013 reflects cumulative upward revenue revisions of close to $400 million since the budget was adopted last spring. Fiscal 2013 revenues are now expected to exceed prior year collections by about $1.4 billion (5.9%). Annual revenue growth of 4.5% is projected for fiscal 2014 and 4.3% for fiscal 2015. Still, Florida is not expected to reach pre-recession (fiscal 2006) peak revenue levels until fiscal 2015 reflecting the magnitude of the downturn in the state (see Figure 3).

FIGURE 3
Steady Recovery Although Revenues Remain Below Pre-Recession Peak



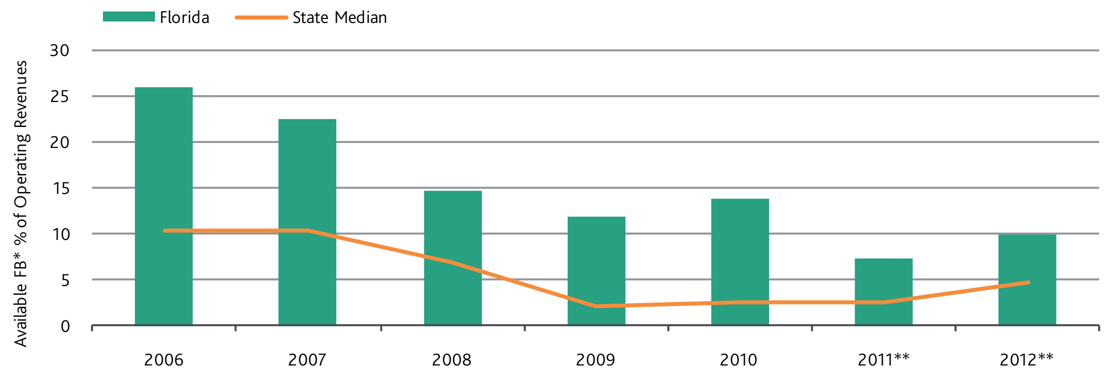
*Estimated - March 2013 Revenue Estimating Conference.
[1] Net of service charges and refunds
[2] FY2010 increase reflects implementation of rate increases adopted by 2009 legislature.

Financial Flexibility Enhanced by History of Strong Reserve Levels

Florida's financial strength is underscored by efforts to replenish its reserves even though the state's economic recovery has been slower than originally expected, as in many states. Prior to the current recession, available balances[1] peaked at 26% of operating revenues in fiscal 2006. This compares to a national median of 10% for states in that year. As the recession took hold the state used reserves to balance its budget, and levels declined to 11.8% of operating revenues by the end of fiscal 2009. Fiscal 2012 audited results show available balances at 9.9% of operating revenues, incorporating the GASB 54 accounting change, twice the 50-state median of 4.8% (see Figure 4). Even at reduced levels, Florida's reserve levels are impressive given the magnitude of the revenue deterioration that the state experienced during the recession.

[1] Defined as Unreserved, Undesignated Fund Balance (or the newer designation Unassigned Balance), plus any additional Rainy Day Funds not accounted for in those funds.

FIGURE 4
Strong Reserves Maintained Despite Draws



Source: Moody's data
*Unreserved, undesignated or unassigned GRF balances plus rainy day fund
**Reflects GASB 54 accounting change.

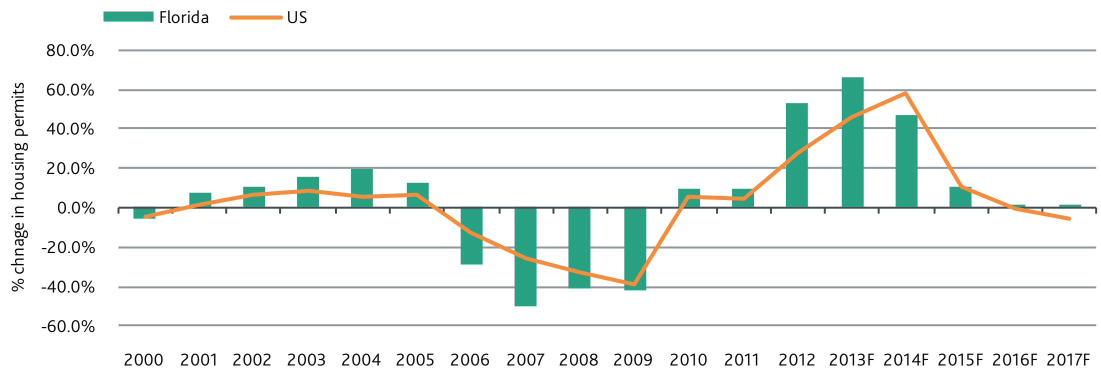
Florida has a constitutional mandate to fund the BSF at no less than 5% of prior year revenues, up to 10%, and the obligation to restore any draws in five equal annual installments from general revenues, commencing in the third fiscal year after the withdrawal, unless the legislature establishes a different schedule. State statute requires the repayment of the distribution from the Lawton Chiles Trust Fund in the first year that recurring revenues exceed prior year receipts by 5% up to $150 million in each year. The demonstrated willingness of lawmakers to restore the BSF as well as other reserves during a prolonged recovery underscores the state's strong governance attributes.

At the end of fiscal 2013, the state expects the BSF balance to grow to $710.5 million (from $496 million the prior year) and projects a GRF balance of approximately $2.4 billion in combined surplus plus unspent General Revenue funds. In addition, total trust fund reserve balances are projected to be $1.7 billion at the end of fiscal 2013.

Economic Recovery Taking Shape; State Expected to Outperform Nation Long Term

Florida entered the recession earlier than many states as its housing market began to decline in fiscal 2006. According to Moody's Analytics, single-family housing starts were as high as 209,000 in calendar year 2005, declining to around 26,600 in 2009. Multi-family permits followed a similar pattern of decline. Housing permits have increased modestly in recent years although the forecast for 2016 shows both single and multi-family permits at least 30% below peak levels in 2005. During the recession, Florida's median home prices declined significantly and state foreclosure rates were among the highest in the nation. Since residential permits bottomed out at about 35,300 in 2010, they are expected to double in 2013 and reach 97,200 in 2014. Foreclosures have slowed considerably and the state's housing market appears to be stabilizing (see Figure 5). Increased affordability and foreign investment are boosting demand, which could limit house price declines.

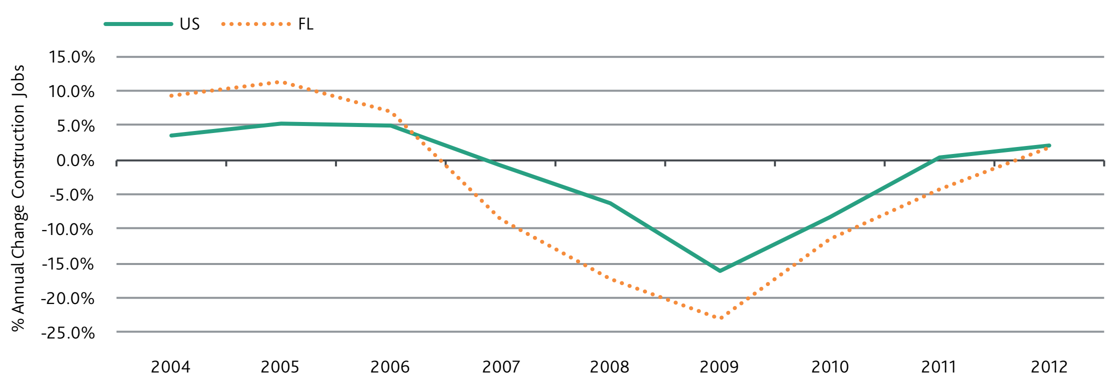
FIGURE 5
Housing Trends Show Signs of Stabilization



Source: Moody's Analytics

Weakness in the state's housing market affected construction sector employment, which lost significantly more jobs in Florida than the nation (see Figure 6). Florida began gaining construction jobs in 2012, a year later than the nation although sector employment remains 50% below its 2006 peak in Florida versus 27% below peak for the nation.

FIGURE 6
Construction Sector Making Gains But Recovery is Slow

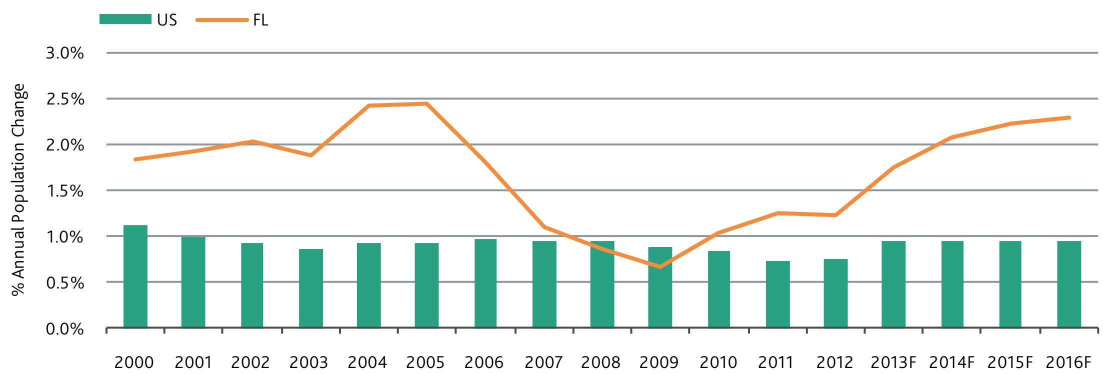


Source: Bureau of Labor Statistics

As the economic recovery takes hold, education, healthcare, and tourism sector jobs are driving employment gains. According to Moody's Analytics, Florida's 2013 employment growth is expected to increase 1.9%, surpassing the national rate of 1.3%, and remain higher than the nation over the forecast period through 2017. Over the long term, Florida's economic performance is expected to be strong due to robust population growth and solid economic fundamentals. The state's unemployment rate has declined slowly but steadily from a peak of 11.4% in early 2010 to 7.1% as of May 2013, below the national rate of 7.6% the same month.

High population growth in Florida over the last several decades has given strength to the state's economy. The national recession hampered in-migration although net population trends still remained positive. Over the long term, Florida's pace of growth is expected to outpace the nation due to the state's favorable climate and low cost of living as well as strong demographic and economic fundamentals, driven by the tourism, healthcare, and education sectors (see Figure 7). Those positive attributes are also expected to make Florida an attractive location for baby boomers as they start to retire.

FIGURE 7
Strong Long-Term Population Trends Expected to Resume



Source: Moody's Analytics

Boom-Bust Cycles Underscore Volatile Nature of Florida's Economy

Periodic fluctuations in economic indicators and revenue trends highlight Florida's above average exposure to boom-bust cycles. Medium term projections show a return to strong net in-migration that will support revenue growth, employment gains, and housing construction once the state works off its excess inventory. However, the magnitude of Florida's volatility is underscored by the fact that the state is still recovering from the impact of the recent housing crisis on employment and the sales tax revenues that drive the state's budget. Like the rest of the country, Florida could be vulnerable to a new housing bubble if national and international investors continue to drive home prices up. The state's significant tourism industry is another economic driver that is subject to national as well as international fluctuations, as reflected in the fall-off in sales tax related revenues during the recent recession.

Hurricane Risk Presents Ongoing Challenge

Florida has the second largest coastline (after Alaska) in the country, and its location makes it prone to hurricane damage. Over time, some private insurance companies have chosen to leave Florida or to stop writing new insurance policies in the state because they were unable to raise property insurance rates high enough to offset their exposure to potential storm-related losses. The state responded by creating hurricane insurance vehicles, including: the Citizens Property Insurance Company (CPIC or Citizens, rated A2/stable); the Florida Hurricane Catastrophe Fund (FHCF or Cat Fund, rated Aa3/stable); and the Florida Insurance Assistance Interlocal Agency (FIAIA, issuer rating A2/stable), which was created as a conduit issuer for the Florida Insurance Guaranty Association (FIGA).

These entities were created to provide insurance of last resort and reinsurance. As necessary, they can issue bonds secured by various assessments to pay policyholders' hurricane-related claims. Assessments levied to pay bond debt service are tax-like in nature because the assessment base includes nearly all property and casualty insurance written in Florida, except for insurance pertaining to medical malpractice, workers' compensation, and accident and health. That is an important distinction from most other states: in Florida following a hurricane, taxpayers ultimately will bear much of the claims paying burden that elsewhere would be paid through private insurance. A major storm or series of storms would test both the viability of the emergency assessment procedure during a period of great stress and the ability of the Florida economy to withstand such an event or series of events. If a significant hurricane were to strike, the three entities (CPIC, FHCF, and FIGA) could all face challenges as they seek to bring large amounts of debt to the market and impose overlapping regular assessments and emergency assessments on a potentially depleted or ravaged assessment base to pay for it. This very broad assessment potential, combined with Florida's known hurricane risk, makes the state unique among similar statewide insurance programs and poses a credit challenge that is factored into the rating.

Moody's Related Research

Rating Methodology:

» US States Rating Methodology, April 2013 (129816)

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