

 The Florida TaxWatch Center for Competitive Florida Resolving issues vital to Florida's global economic competitiveness.

Florida Retains 'AAA' Rating while Outlook Improves to 'Stable,' Despite U.S. Downgrade

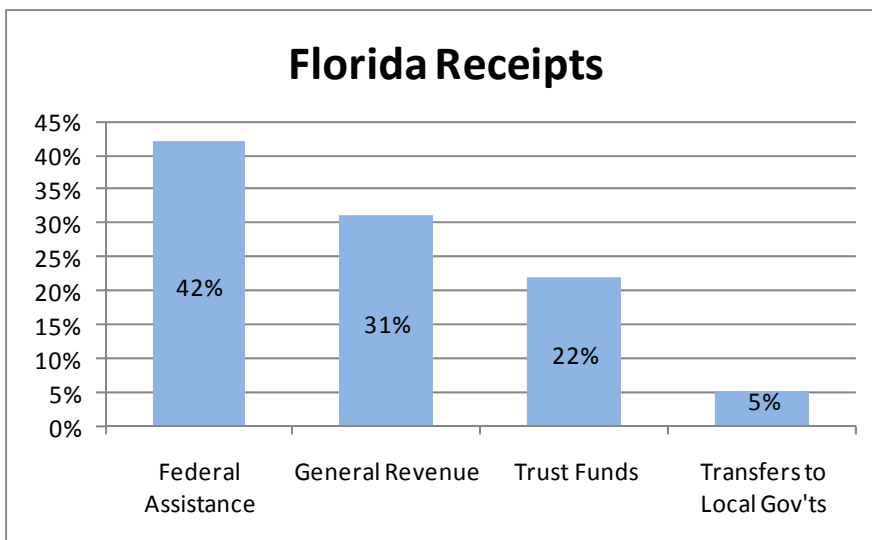
The recent downgrade of the U.S. credit rating by Standard & Poor's (S&P) has been worldwide news, causing stock markets to drop and volatility in financial markets to increase substantially. Investors, both institutional and personal, have watched the values of their stock portfolios become significantly more volatile. Some institutional investors have been required to liquidate U.S. government bonds because they no longer carry the coveted 'AAA' rating.

Since the announcement of the S&P downgrade in early August, it seems appropriate to take a look at Florida's credit rating and see what effects the national downgrade might have on Florida's finances.



Florida, like other states, borrows money on capital markets by selling bonds; however, unlike the Federal Government, Florida's Constitution requires the state to have a balanced budget each year, so debt is not the result of an operating deficit. To analyze Florida's financial situation, we can begin by taking a look at Florida's revenue.

Florida's Revenue

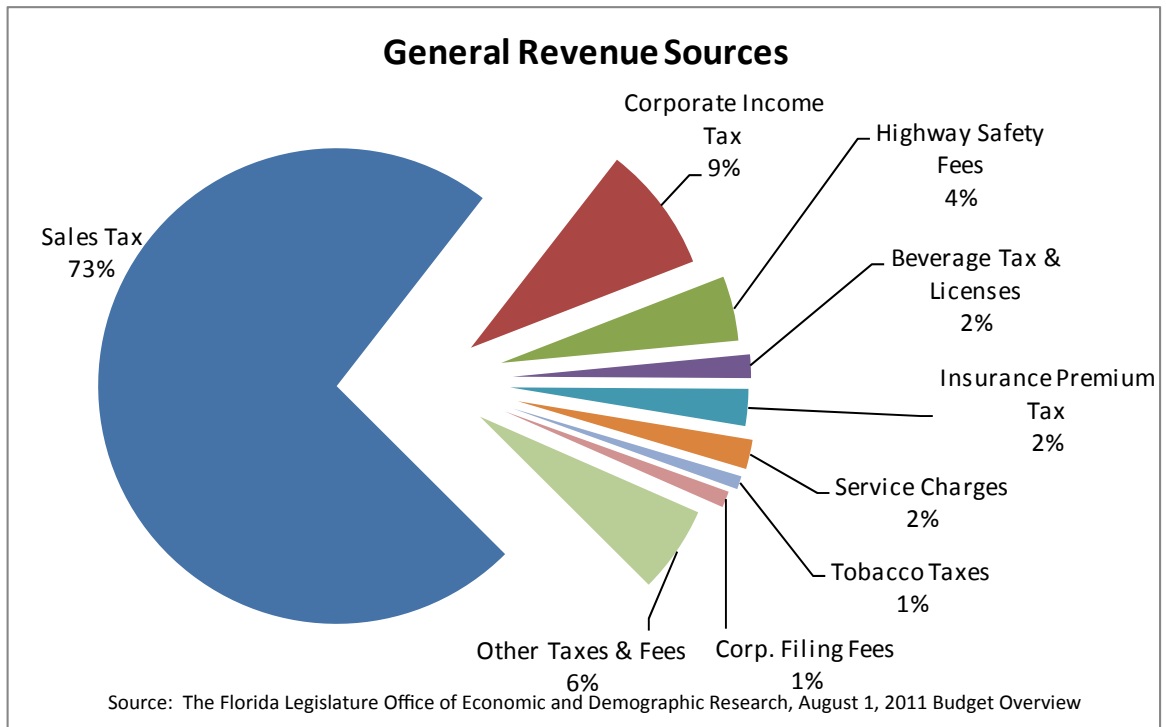


Florida's state income is deposited into Trust Funds or the General Revenue Fund. Various Trust Funds, such as the Educational Enhancement Trust Fund, which receives income from the Florida Lottery, account for around 22 percent of state receipts. As the chart on the left shows, approximately 31 percent of state receipts are General Revenue. Federal assistance makes up 42 percent of state receipts. Another 5 percent is state revenue that is earmarked for

distribution to local governments.

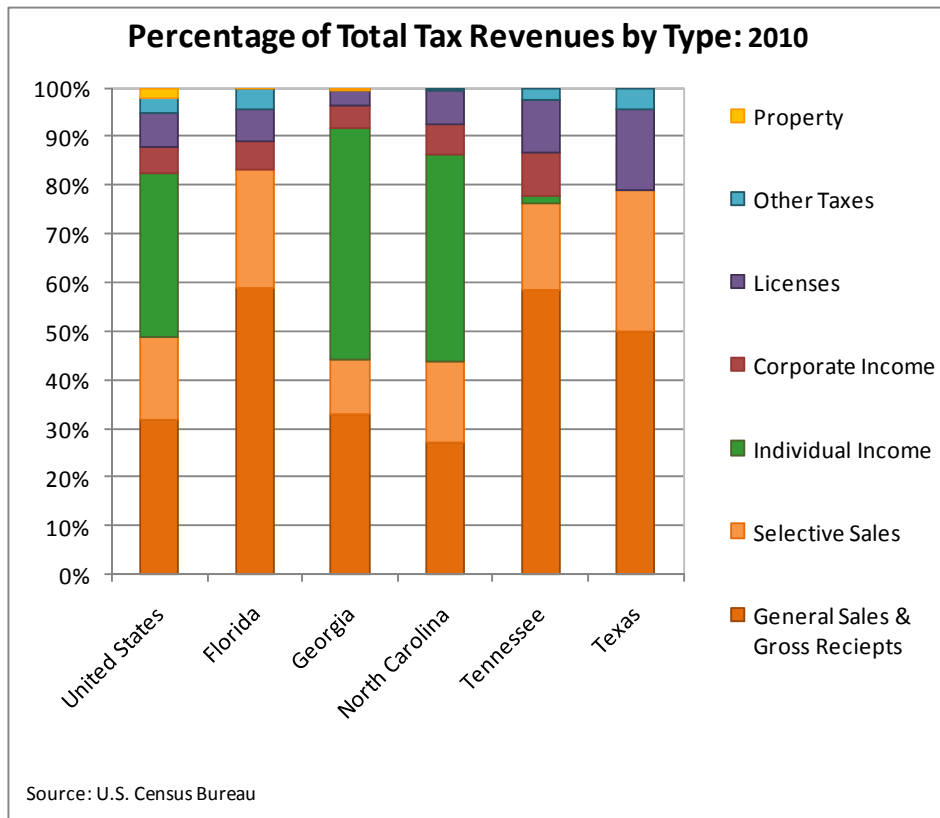
Net General Revenue collections in the current year (FY2011-12) are estimated at \$ 23.8. billion.

Looking more closely at General Revenue portion, the chart to the right shows that Florida's General Revenues are highly dependent upon sales taxes. Around 73 percent of General Revenue is generated from sales taxes.



Of those sales tax revenues, taxes from non-durables sales tax make up approximately 24 percent, tourism sales 16 percent, and automobile sales 11 percent.

The chart below shows the tax receipts profile of the U.S. and Florida, as well as other select southern states' tax collections in 2010.



For consistency and comparability across states, total tax revenue collection data was used rather than general revenue sources. Compared to these other southern states and to the U.S. as a whole, Florida has the highest percent of total tax collections from consumption taxes as denoted in the two shades of orange (general sales tax and selective sales, or excise taxes). Because sales taxes make up such a large portion of total tax collection, and sales taxes are highly correlated to increases and decreases of economic activity, it is a driving force behind the Florida's revenue volatility.

Florida's Financial Fitness

According to The Florida Division of Bond Finance in their December 2010 report, Florida's outstanding debt was \$28.2 billion. That figure includes some revenue bonds that are self-supporting. The figure for tax-supported debt was \$23.6 billion. These figures do not include indirect debt, some of which is borrowed for liquidity purposes such as pre-event bonding for potential hurricane losses by the Citizens Property and Casualty (CPIC) and the Florida Hurricane Catastrophe Fund (FHCF).

The Florida legislature adopted a target that the debt service carrying charge should be no more than 6 percent of general revenues with 7 percent of general revenue being the cap. Debt issuance above the 7 percent cap can be authorized if the legislature deems it necessary for the state. In FY2010, the debt service carrying charge was 7.86 percent of general revenues and is projected to remain above the 7 percent cap through the current fiscal year.

Credit rating agencies like S&P, Fitch, and Moody's evaluate the financial position of a state when they issue their ratings on bonds. States need to have a good financial position, as well as reliable income for their debt service and operations. States that run deficits or have impairments to their revenue collections face the possibility of receiving warnings from these agencies or being given a negative economic outlook on the state's future. If these deficits or impairments are significant, the state will be subject to a downgrade by a rating agency.

Standard & Poor's has given Florida the highest credit rating, 'AAA', on its bonds, meaning Florida's ability to meet its financial obligations is strong. Recently, according to S&P's *Global Credit Portal Ratings Direct*, Florida's outlook moved from 'Negative' to 'Stable'. Reasons cited include "significant progress in restoring structural budget balance" to losses in Federal stimulus spending and other pressures on Florida's budget. Another reason is that the FY2011-12 budget includes the first of five annual payments of \$214.5 million back into the budget stabilization reserves, to begin to replace the large withdrawal made in FY2008-09.

This financial stability allows Florida to enjoy low borrowing costs. Other states such as California and Illinois, however, have not fared so well. California currently has an 'A-' rating from S&P, with a stable outlook. Illinois has an 'A+' rating from S&P, but has a negative outlook. As shown in the table to the right, compared to select other southern states, Florida fares relatively well.

State	S&P Rating	S&P Outlook
Florida	AAA	Stable
Georgia	AAA	Stable
North Carolina	AAA	Stable
Tennessee	AA+	Positive
Texas	AA+	Stable
Source: Morgan Stanley Smith Barney Municipal Bond Monthly		

Conclusion

The U.S. credit rating downgrade and implications on various sectors of the nation's economy have been a central concern nationwide, but what is likely to be the effect on Florida? One effect will be that as debt service becomes more expensive for the federal government, there will be less money available for the states. The larger effect is the possibility that as the Federal budget is reduced, the Federal government will pass along more obligations to the states and less Federal Assistance. Just as Florida has been required to adjust to the recent loss of Federal stimulus spending, we should expect and plan for decreases in Federal dollars in the future.

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