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# MEMORANDUM

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Date: May 13, 2016

To: The Honorable Chair and Members  
Pima County Board of Supervisors

From: C.H. Huckelberry   
County Administrator

Re: **Fitch and Standard and Poor's Credit Ratings of the County**

With regard to the County's April 2016 issuance of Certificates of Participation and our anticipated June 2016 issue of General Obligation Refunding Bonds, Street and Highway Revenue Refunding Bonds, and Sewer System Revenue Refunding Obligations, Standard and Poor's and Fitch have assigned the following ratings to Pima County's debt:

### Pima County Credit Ratings

Instrument Type	Standard and Poor's		Fitch	
	Rating	Date	Rating	Date
Certificates of Participation	A +	Feb 2016	AA-	Feb 2016
General Obligation	AA-	May 2016	AA	May 2016
Street and Highway Revenue	AA	May 2016	AA	May 2016
Sewer Revenue Bonds	AA	May 2016	AA	May 2016
Sewer Revenue Obligations	AA	May 2016	AA-	May 2016

All of these ratings are consistent with prior ratings, with the exception of the County's Sewer Revenue Obligations. Standard and Poor's upgraded our Sewer System Obligations rating from AA- to AA.

Details reviews and analyses from Standard and Poor's, as well as from Fitch, are attached to this memorandum for your information and review.

CHH/mjk

Attachments

c: Tom Burke, Deputy County Administrator for Administration  
Keith Dommer, Director, Finance and Risk Management  
Robert Johnson, Budget Manager, Finance and Risk Management

# ATTACHMENT 1

## STANDARD AND POOR'S

# RatingsDirect®

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## Summary:

# Pima County, Arizona; Appropriations; General Obligation

### Primary Credit Analyst:

Sarah Sullivant, New York 415-371-5051; sarah.sullivant@standardandpoors.com

### Secondary Contact:

Kate R Burroughs, San Francisco (1) 415-371-5081; kathleen.burroughs@spglobal.com

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Summary:

# Pima County, Arizona; Appropriations; General Obligation

## Credit Profile

US\$88.255 mil GO rfdg bnds ser 2016 dtd 06/22/2016 due 07/01/2026

*Long Term Rating* AA-/Positive New

### Pima Cnty GO

*Unenhanced Rating* AA-(SPUR)/Positive Affirmed

## Rationale

S&P Global Ratings assigned its 'AA-' long-term rating and underlying rating (SPUR) to Pima County, Ariz.'s general obligation (GO) refunding bonds, series 2016. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the county's GO debt outstanding and its 'A+' rating and SPUR on the county's outstanding certificates of participation (COPs). The outlook is positive.

Revenues from unlimited ad valorem taxes levied on taxable property within the county secure the GO bonds. The county has the power and obligation to levy these taxes without limitation as to rate or amount. The COPs are payable from lease payments made from legally available revenues of the county subject to annual appropriation.

The rating on the COPs reflects the county's covenant to budget and appropriate annual lease payments. In addition, the ratings reflect our local GO criteria, as well as our assessment of the following credit factors:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund and at the total governmental fund level in fiscal 2015;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures, as well as limited capacity to reduce expenditures;
- Very strong liquidity, with total government available cash at 40.9% of total governmental fund expenditures and 3.1x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 13.3% of expenditures and net direct debt that is 63.0% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 91.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### Adequate economy

We consider the county's economy adequate. Pima County, with an estimated population of 1 million, is located in the Tucson, Ariz. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying

income of 91.1% of the national level and per capita market value of \$65,918. Overall, the county's market value fell by 10.6% over the past year to \$67.4 billion in 2016. The county unemployment rate was 6.2% in 2014.

Top employers in the county include the University of Arizona (11,000), Raytheon Missile Systems (9,900), the state of Arizona (9,000), and Davis-Monthan Air Force Base (9,000). While we consider the regional economic base to be diverse, its reliance on the aerospace, defense, and government sectors has contributed to a weaker recovery relative to areas that depend less on federal, state, and local government spending.

Although not as severe as those experienced in other parts of the state, declines in property values during the recession weakened estimated net full cash value (market value) and per capita market value significantly. In fiscal 2016, total estimated net full cash value in the county increased by 5.7% over the prior year, the first increase in four years. Meanwhile, limited property value -- the base for determining property tax levies -- increased by 0.5% to \$7.62 billion. Although market value in 2016 resumed growth, we do not expect growth to translate to per capita market values in excess of \$80,000 within the next two years.

### **Strong management**

We view the county's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Highlights include the following:

- The budget is based on major revenue projections from the county and the state that include property tax revenues and state-shared revenues, while departmental expenditures are built on zero-based budgets.
- Officials review budget-to-actual performance monthly and monitor investment performance monthly, in accordance with an investment management policy that specifies permitted investments, maturities, benchmarks, and objectives.
- A formal debt policy limits the types, permitted uses, maximum maturities, and sources of payment for bonded debt and sets procedures for debt monitoring and oversight.
- The county maintains a comprehensive five-year rolling capital improvement plan, updated annually, and produces informal five-year financial projections as part of its budget development.
- No formal general fund reserve policy exists; however, the county has resolved to maintain a debt service retirement reserve of \$5 million, and informally targets a minimum 5% reserve for contingencies, which is appropriated in its annual budget

### **Strong budgetary performance**

Pima County's budgetary performance is strong in our opinion. The county had balanced operating results of negative 0.3% of expenditures in the general fund and of negative 0.2% across all governmental funds in fiscal 2015.

Top line operating revenues in fiscal 2015, unadjusted for one-time items, grew by \$54 million (11%) in response to an increase in the primary property tax rate and growth in state-shared sales tax revenues. At the same time, however, operating expenditures are increasing as the result of the state shifting costs to the local level and increases in employee benefit costs. After adjusting for one-time expenditures, use of bond proceeds, and recurring transfers, we consider the county's operating performance for fiscal 2015 essentially balanced, with another year of balanced operations budgeted in fiscal 2016. We understand that the county increased its primary property tax rate in fiscal

2016 to offset escalating costs, which we expect will support operating performance in the medium term. We note that the county's fiscal 2017 budget is subject to some uncertainty regarding the state's budget, which has not been passed as of the time of this review. Should the state pass additional costs on to the county without providing corresponding revenue, the county's budget performance could be pressured in the near term.

### **Adequate budgetary flexibility**

Pima County's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures, or \$48.1 million. Negatively affecting budgetary flexibility, in our view, is limited capacity to reduce expenditures.

Based on the county's 2016 budget and our conversations with management, we believe reserve levels have stabilized at about 9% of general fund expenditures, which is below historical levels of roughly 16%. Management reports that it does not expect to alter reserve levels, given that it currently holds an amount equal to its reserve policy targeting 5% of projected revenues plus an additional \$5 million for budget contingencies.

We believe the severe budget cuts made in fiscal years 2011-2014 in response to declining revenues have constrained the county's financial flexibility, leaving it with limited ability to further cut expenditures beyond current levels, many of which are mandated by state law and growing annually. Management's projections for fiscal 2016 suggest that service levels will remain static this year, leading us to believe that limited expenditure flexibility will persist at least through the current year, until major revenue sources recover to levels beyond current operating expenditures.

### **Very strong liquidity**

In our opinion, Pima County's liquidity is very strong, with total government available cash at 40.9% of total governmental fund expenditures and 3.1x governmental debt service in 2015. In our view, the county has exceptional access to external liquidity if necessary.

We believe the county has exceptional access to external liquidity, as evidenced by its consistent and diverse bond programs over the past 15 years, and we have not identified any immediate, short-term risks to liquidity. Arizona statutes permit counties to invest public funds in ways we consider permissive and potentially risky; we note that the county reports \$233 million (28%) of its portfolio is invested in corporate debt rated 'BBB-' by S&P Global Ratings. However, we believe the remaining portfolio balance provides sufficient liquidity to meet the county's operating needs.

We have not identified any contingent liquidity risks in the form of direct purchase or variable-rate debt or significant contingent liabilities.

### **Strong debt and contingent liability profile**

In our view, Pima County's debt and contingent liability profile is strong. Total governmental fund debt service is 13.3% of total governmental fund expenditures, and net direct debt is 63.0% of total governmental fund revenue. Overall net debt is low at 2.0% of market value, and approximately 91.8% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

We understand the county plans to issue its remaining \$25 million in authorized GO debt in fiscal 2017, but this issuance would not substantially alter our opinion of its debt profile. The county's debt management policy calls for a maximum amortization period of 15 years for GO, appropriation, and revenue debt, and we understand that any future

GO authorization would comply with the policy.

Pima County's combined required pension and actual other postemployment benefits (OPEBs) contributions totaled 5.5% of total governmental fund expenditures in 2015. The county made its full annual required pension contribution in 2015.

The county contributes to four multiple employer pension plans and has historically consistently funded its annual required contributions, as well as a portion of employees' statutorily required contributions. We consider the actuarially determined contribution made in 2015 under GASB 68 to be analogous to the actuarially required contribution in that it is sufficient to amortize a portion of unfunded liability over a period of time.

Pima County reported an aggregate net pension liability of \$653 million in fiscal 2015. The Arizona State Retirement System (ASRS), the largest single retirement plan, represents 65% of the county's current annual pension expenditures. As of June 30 2015, the ASRS plan was 69% funded. The Public Safety Personnel Retirement Plan was 55% funded, and the Corrections Officer Retirement System was 62% funded.

OPEBs for certain retired employees are provided through these state retirement systems and financed on a pay-as-you-go basis, and we understand that the county closed retiree health benefit plans to new members several years ago, which lowered its unfunded OPEB liability. Combined pension and OPEB expenditures in fiscal 2015 totaled 5.3% of total governmental funds expenditures. We consider this to be a low carrying charge for pension obligations, although future increases in contribution rates, if not accompanied by funding progress, could elevate the county's pension burden.

### **Strong institutional framework**

The institutional framework score for Arizona counties is strong.

## **Outlook**

The positive outlook reflects our view of the county's recent efforts to stabilize primary property tax revenues and financial performance, which, together with growth in economically sensitive revenues, increase to at least one in three the chance of a higher rating within the next two years.

We could revise the outlook to stable during the next two years if the county's financial performance were to deteriorate beyond levels we consider adequate, suggesting it may be having trouble maintaining operating balance in light of limited expenditure flexibility and slow revenue growth.

## **Related Criteria And Research**

### **Related Criteria**

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

### Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Institutional Framework Overview: Arizona Local Governments

### Ratings Detail (As Of May 6, 2016)

Pima Cnty certs of part		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty certs of part ser 2016A due 12/01/2021		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty certs of part ser 2016B due 12/01/2030		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty rfdg certs of part		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty GO bnds		
<i>Long Term Rating</i>	AA-/Positive	Affirmed
Pima Cnty GO bnds		
<i>Long Term Rating</i>	AA-/Positive	Affirmed
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Affirmed
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Affirmed
<b>Pima Cnty certs of part (Justice Bldg Proj) ser 2007</b>		
<i>Unenhanced Rating</i>	A+(SPUR)/Positive	Affirmed
<b>Pima Cnty GO</b>		
<i>Unenhanced Rating</i>	AA-(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on the S&P Global Ratings public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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## Summary:

# Pima County, Arizona; Appropriations; General Obligation

### Primary Credit Analyst:

Sarah Sullivan, New York 415-371-5051; sarah.sullivan@standardandpoors.com

### Secondary Contact:

Kate R Burroughs, San Francisco (1) 415-371-5081; kathleen.burroughs@standardandpoors.com

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## Summary:

# Pima County, Arizona; Appropriations; General Obligation

### Credit Profile

US\$29.505 mil certs of part ser 2016A due 12/01/2021

<i>Long Term Rating</i>	A+/Positive	New
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US\$15.175 mil certs of part ser 2016B due 12/01/2030

<i>Long Term Rating</i>	A+/Positive	New
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#### **Pima Cnty GO**

<i>Unenhanced Rating</i>	AA-(SPUR)/Positive	Outlook Revised
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## Rationale

Standard & Poor's Ratings Services revised its outlook to positive from stable on Pima County, Ariz.'s existing general obligation (GO) bonds and certificates of participation (COPs). At the same time, Standard & Poor's affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the county's outstanding GO bonds, and its 'A+' rating on the county's outstanding COPs. Standard & Poor's also assigned its 'A+' rating and positive outlook to the county's 2016 COPs.

The outlook revision reflects our opinion of the county's recently stabilized financial performance, bolstered by a permanent increase in its property tax rate, as well as our expectation of improving expenditure flexibility, which we believe raises the chance of a higher rating within the next two years to at least one in three.

Proceeds from the COPs will finance improvements to the county wastewater system and a new company headquarters for an aerospace manufacturing employer, as well as for refunding existing COPs of the county for debt service savings. The COPs are payable from legally available revenues of the county; however, we understand the county expects to rely on its wastewater enterprise revenues to pay debt service on the COPs being issued for wastewater improvements, and its general fund to pay debt service on the remaining COPs. The certificates represent an interest in lease payments made by the county, as lessor, to U.S. Bank N.A., for the use of certain leased property, including the county's public works building, the legal services building, two parking garages, a public service center office tower, and certain adult detention (jail) facilities of the county. Lease payments are subject to annual appropriation.

Revenues from unlimited ad valorem taxes levied on taxable property within the county secure the GO bonds. The county has the power and obligation to levy these taxes without limitation as to rate or amount.

The rating on the COPs reflects the county's covenant to budget and appropriate annual lease payments. In addition, the ratings reflect our local GO criteria, as well as our assessment of the following credit factors:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund and at the total governmental fund level in fiscal 2015;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures, as well as limited capacity to reduce expenditures;
- Very strong liquidity, with total government available cash at 34.8% of total governmental fund expenditures and 2.6x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 13.3% of expenditures and net direct debt that is 63.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with all debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### **Adequate economy**

We consider the county's economy adequate. Pima County, with an estimated population of 1 million, is located in the Tucson, Ariz. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 91.6% of the national level and per capita market value of \$65,918. Overall, the county's market value fell by 10.6% over the past year to \$67.4 billion in 2016. The county unemployment rate was 6.2% in 2014.

Top employers in the county include the University of Arizona (11,000), Raytheon Missile Systems (9,900), the state of Arizona (9,000), and Davis-Monthan Air Force Base (9,000). While we consider the regional economic base to be diverse, its reliance on the aerospace, defense and government sectors has contributed to a weaker recovery relative to areas less dependent on federal, state, and local government spending.

Although not as severe as those experienced in other parts of the state, declines in property values during the recession weakened estimated net full cash value (market value) and per capita market value significantly. In fiscal 2016, total estimated net full cash value in the county increased by 5.7% over the prior year, the first increase in four years. Meanwhile, limited property value -- the base for determining property tax levies -- increased by 0.5% to \$7.62 billion. Although market value in 2016 resumed growth, we do not expect growth to translate to per capita market values in excess of \$80,000 within the next two years.

### **Strong management**

We view the county's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Highlights include the following:

- The budget is based upon major revenue projections from the county and the state that include property tax revenues and state-shared revenues, while departmental expenditures are built on zero-based budgets.
- Officials review budget-to-actual performance on a monthly basis and monitor investment performance monthly, in accordance with an investment management policy that specifies permitted investments, maturities, benchmarks, and objectives.
- A formal debt policy limits the types, permitted uses, maximum maturities, and sources of payment for bonded debt

and sets procedures for debt monitoring and oversight.

- The county maintains a comprehensive five-year rolling capital improvement plan, updated annually, and produces informal five-year financial projections as part of its budget development.
- No formal general fund reserve policy exists; however, the county has resolved to maintain a debt service retirement reserve of \$5 million, and informally targets a minimum 5% reserve for contingencies, which is appropriated in its annual budget.

### **Strong budgetary performance**

Pima County's budgetary performance is strong in our opinion. The county had balanced operating results of negative 0.3% of expenditures in the general fund and of negative 0.2% across all governmental funds in fiscal 2015.

Top line operating revenues in fiscal 2015, unadjusted for one-time items, grew by \$54 million (11%) in response to an increase in the primary property tax rate and growth in state-shared sales tax revenues. At the same time, however, operating expenditures are increasing as the result of the state shifting costs to the local level and increases in employee benefit costs. After adjusting for one-time expenditures, use of bond proceeds, and recurring transfers, we consider the county's operating performance for fiscal 2015 essentially balanced, with another year of balanced operations budgeted in fiscal 2016. We understand that the county increased its primary property tax rate in fiscal 2016 to offset escalating costs, and we expect operating performance to remain strong over the near term.

### **Adequate budgetary flexibility**

Pima County's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2015 of 9.0% of operating expenditures, or \$48.1 million. Negatively affecting budgetary flexibility, in our view, is limited capacity to reduce expenditures.

Based on the county's 2016 budget and our conversations with management, we believe reserve levels have stabilized at about 9% of general fund expenditures, which is below historical levels of roughly 16%. Management reports that it does not expect to alter reserve levels, given that it currently holds an amount equal to its reserve policy targeting 5% of projected revenues plus an additional \$5 million for budget contingencies.

We believe the severe budget cuts made in fiscal years 2011-2014 in response to declining revenues have constrained the county's financial flexibility, leaving it with limited ability to further cut expenditures beyond current levels, many of which are mandated by state law and growing annually. Management's projections for fiscal 2016 suggest that service levels will remain static this year, leading us to believe that limited expenditure flexibility will persist at least through the current year, until major revenue sources recover to levels beyond current operating expenditures.

### **Very strong liquidity**

In our opinion, Pima County's liquidity is very strong, with total government available cash at 34.8% of total governmental fund expenditures and 2.6x governmental debt service in 2015. In our view, the county has exceptional access to external liquidity if necessary.

We believe the county has exceptional access to external liquidity as evidenced by its consistent and diverse bond programs over the last 15 years, and we have not identified any immediate, short-term risks to liquidity. Arizona statutes permit counties to invest public funds in ways we consider permissive and potentially risky; we note that the county reports \$233 million (28%) of its portfolio is invested in corporate debt rated 'BBB-' by Standard & Poor's.

However, we believe the remaining portfolio balance provides sufficient liquidity to meet the county's operating needs.

We have not identified any contingent liquidity risks in the form of direct purchase or variable-rate debt or significant contingent liabilities.

### **Strong debt and contingent liability profile**

In our view, Pima County's debt and contingent liability profile is strong. Total governmental fund debt service is 13.3% of total governmental fund expenditures, and net direct debt is 63.2% of total governmental fund revenue. Overall net debt is low at 2.0% of market value, and all of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

We understand the county plans to issue its remaining \$25 million in authorized GO debt in fiscal 2017, but this issuance would not substantially alter our opinion of its debt profile. The county's debt management policy calls for a maximum amortization period of 15 years for GO, appropriation, and revenue debt, and we understand that any future GO authorization would comply with the policy.

Pima County's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 5.3% of total governmental fund expenditures in 2015. The county made its full annual required pension contribution in 2015.

The county contributes to four multiple employer pension plans and has consistently funded its annual required contributions, as well as a portion of employees' statutorily required contributions. It reported an aggregate net pension liability of \$653 million in fiscal 2015. The Arizona State Retirement System (ASRS), the largest single retirement plan, represents 65% of the county's current annual pension expenditures. As of June 30 2015, the ASRS plan was 75% funded. The Public Safety Personnel Retirement Plan was 55% funded, and the Corrections Officer Retirement System was 62% funded.

OPEBs for certain retired employees are provided through these state retirement systems and financed on a pay-as-you-go basis, and we understand that the county closed retiree health benefit plans to new members several years ago, which lowered its unfunded OPEB liability. Combined pension and OPEB expenditures in fiscal 2015 totaled 5.3% of total governmental funds expenditures. We consider this to be a low carrying charge for pension obligations although future increases in contribution rates, if not accompanied by funding progress, could elevate the county's pension burden.

### **Strong institutional framework**

The institutional framework score for Arizona counties is strong.

## **Outlook**

The positive outlook reflects our view of the county's recent efforts to stabilize primary property tax revenues and financial performance, which, together with growth in economically sensitive revenues, increases the chance of a higher rating within the next two years to at least one in three.

We could revise the outlook to stable during the next two years if the county's financial performance were to deteriorate beyond levels we consider adequate, suggesting it may be having trouble maintaining operating balance in light of limited expenditure flexibility and slow revenue growth.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

### Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Institutional Framework Overview: Arizona Local Governments

### Ratings Detail (As Of February 18, 2016)

Pima Cnty certs of part		
<i>Long Term Rating</i>	A+/Positive	Outlook Revised
Pima Cnty rfdg certs of part		
<i>Long Term Rating</i>	A+/Positive	Outlook Revised
Pima Cnty GO bnds		
<i>Long Term Rating</i>	AA-/Positive	Outlook Revised
Pima Cnty GO bnds		
<i>Long Term Rating</i>	AA-/Positive	Outlook Revised
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Outlook Revised
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Outlook Revised
Pima Cnty APPROP		
<i>Long Term Rating</i>	A+/Positive	Outlook Revised
<b>Pima Cnty certs of part (Justice Bldg Proj) ser 2007</b>		
<i>Unenhanced Rating</i>	A+(SPUR)/Positive	Outlook Revised
<b>Pima Cnty GO</b>		
<i>Unenhanced Rating</i>	AA-(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,

have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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## Summary:

# Pima County, Arizona; Gas Tax

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Pima County, Arizona; Gas Tax

### Credit Profile

US\$24.795 mil street and hwy rev rfdg bnnds ser 2016 dtd 06/22/2016 due 07/01/2024

<i>Long Term Rating</i>	AA/Stable	New
Pima Cnty GASTAX		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<b>Pima Cnty Gas Tax (street &amp; hwy)</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Pima County, Ariz.'s series 2016 street and highway user revenue refunding (HURF) bonds. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the county's parity street and highway revenue debt. The outlook is stable.

The ratings reflect our view of the county's:

- Strong debt service coverage of 2.84x maximum annual debt service (MADS) based on audited fiscal 2016 pledged revenues;
- Recent growth in pledged state shared street and highway revenue; and
- Large and diverse economic base, made up of government, defense, tourism, higher education, and services.

Partly offsetting the above strengths, in our view, is the uncertainty with respect to state interception of street and highway revenues, the lack of a debt service reserve on the bonds, and a planned issuance of additional debt.

The HURF bonds are secured by a first lien on revenues received by the county from taxes, fees, charges, and other moneys collected by the state and returned to the county for street and highway purposes pursuant to Arizona law. Proceeds of the 2016 bonds will be used to refund existing maturities for debt service savings, and will not result in an extension of maturities.

Pledged street and highway revenue includes revenue from state-shared fuel taxes, vehicle registration fees, and license fees. Street and highway revenues are collected by the state and distributed monthly to local agencies based on a statutory formula, with 19% allocated to counties. Of the 19%, 72% is allocated based on point of sale, with the remainder based on population in unincorporated areas of the county relative to population in unincorporated areas of the state. Therefore, pledged revenue may vary as a function of statewide sales and collections, local sale volume, and county population relative to the state. The state may also alter the distribution formula or intercept revenues to the detriment of local agencies, as it has done in the past.

Pledged revenues have recovered since fiscal 2012 following a roughly three-year period of decline attributable to the

recession as well as state diversion of HURF revenues to other state uses. Since fiscal 2012, the county's pledged revenues have increased a total of 18.5%, or by roughly 5.8% annually, through fiscal 2015 to approach fiscal 2009 levels. We understand that the state has not diverted additional HURF revenues since fiscal 2012, although uncertainty remains regarding future state interception of HURF revenues upstream from counties. Management projects that these revenues will continue to grow by approximately 4% in fiscal 2016.

Fiscal 2015 pledged revenues provide strong coverage of MADS, in our view, at 2.8x on all outstanding parity debt. Bond documents require MADS coverage of at least 2x by the preceding year's pledged revenue in order for the county to issue additional parity debt. Additionally, Arizona statutes require annual debt service coverage of at least 1.5x for additional parity bonds. The bonds do not have a debt service reserve fund.

The county's population grew at an average annual rate of 1.6% between 2000 and 2010, and growth has since slowed to an average rate of about 0.5%, compared with the state's 1.1% growth rate from 2010-2015. A slower rate of population growth relative to the state could adversely affect the county's share of street and highway revenues, although the majority of funds (72%) are distributed according to the proportion of local sales and consumption. According to the Arizona Department of Transportation, total gallons of fuel taxed in Pima County have declined 2.6% between 2011 and 2014 (the most recent information available), while at the state level gallons taxed have remained relatively flat. Motor fuel tax revenue makes up roughly half of pledged revenue received by the county, while vehicle registration and in-lieu fees, which are based upon local registrations, make up another 42% of pledged revenue and have increased by about 4% over the same period.

Pima County encompasses 9,184 square miles of southern Arizona and has an estimated population of approximately 1.1 million, roughly half of whom reside in Tucson. Education and health care, defense, and government are the county's primary employment sectors. The University of Arizona is the leading employer, followed by Raytheon Missile Systems and Davis-Monthan Air Force Base. The local economy has been slower to recover than other parts of the state, particularly with respect to taxable property values; however, we understand that some of the most economically sensitive revenues of the county -- including local sales taxes and building permit fees -- have been increasing since fiscal 2014. The county's unemployment rate was 5.6% in 2014, and income indicators are good, in our view, with per capita effective buying income measuring 91% of the national level.

The county currently has \$73.4 million in authorized but unissued street and highway revenue bond capacity approved by voters in 1997. We understand that the county may issue additional parity bonds as revenue growth permits.

## Outlook

The stable outlook reflects our anticipation that the county will maintain at least strong MADS coverage over the two-year outlook horizon, with additional debt issuance as revenue growth permits.

### Upside scenario

We could raise the ratings should we come to believe that the county has limited need for additional parity debt, leading to an increase in projected MADS coverage, and that the risk of further state diversion of HURF revenue is significantly diminished.

### **Downside scenario**

Should pledged MADS coverage fall below levels we consider strong as a result of declining motor fuel sales activity or state interference with pledged HURF revenue, we could lower the ratings.

## **Related Criteria And Research**

### **Related Criteria**

- USPF Criteria: Special Tax Bonds, June 13, 2007
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

### **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, April 19, 2016
- Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015

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## Summary:

# Pima County, Arizona; Water/Sewer

### Primary Credit Analyst:

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Pima County, Arizona; Water/Sewer

### Credit Profile

US\$139.525 mil swr sys rev rfdg oblig ser 2016 due 07/01/2024

<i>Long Term Rating</i>	AA/Stable	New
Pima Cnty swr subord (AGM) <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
Pima Cnty swr sys rev rfdg bnds <i>Long Term Rating</i>	AA/Stable	Upgraded
Pima Cnty swr sys (AGM) <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
Pima Cnty swr (AGM) <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Pima Cnty swr (ASSURED GTY) <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings has raised its long-term rating on Pima County, Ariz.'s subordinate-lien sewer system revenue obligations to 'AA' from 'AA-'. S&P Global Ratings has also assigned its 'AA' long-term rating to the county's series 2016 sewer system revenue refunding obligations.

At the same time, we have affirmed our 'AA' rating on Pima County's prior-lien (senior) sewer improvement and refunding revenue bonds. The outlook on all ratings is stable.

We base the upgrade on the county's diverse economy and strong liquidity position, as well as the application of our revised criteria, "Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds," published Jan. 19, 2016, on RatingsDirect. The ratings also reflect our application of criteria, "Assigning Issue Credit Ratings of Operating Entities," published May 20, 2015, on RatingsDirect, that the remaining principal on the closed senior-lien as a percent of total principal outstanding is minimal (estimated around 10%) and so we are not applying a one-notch adjustor below the senior-lien.

In addition, the ratings reflect what we consider the system's extremely strong enterprise risk profile and strong financial risk profile. The enterprise risk profile is the result of the system's:

- Growing, primarily residential, and diverse customer base;
- Service area economy, which has strong ties to the broad and diverse Tucson, Ariz. metropolitan region, as demonstrated by the county's very strong median household effective buying income (MHEBI) of 90% of the national level;

- Affordable rates representing 1.2% of median household income; and
- Strong operational management policies and practices.

The financial risk profile reflects the system's:

- Strong historical total debt service coverage (DSC) metrics that we believe the county will continue to produce based on its multiyear forecast;
- Extremely strong liquidity position that we believe is sustainable even with planned significant drawdowns in the near term to pay debt service on certificates of participation (COPs);
- Moderate leverage based on a debt-to-capitalization of about 47%, with additional debt plans in the near term; and
- Good financial management policies and practices.

The series 2016 obligations are being issued to refund an estimated \$67 million of prior obligations and \$79 million of parity obligations.

After the proposed obligations issue, Pima County will have approximately \$61 million of prior-lien obligations and approximately \$539 million of total parity obligations. The county's sewer system has no variable-rate debt, swaps, or direct purchase obligations outstanding.

We view the bond provisions as credit neutral. The bonds are payable from installment payments secured by the net revenues and unrestricted cash balances of the county's sewer system. Pima County's obligation to make the installment payments is absolute and unconditional. Key provisions include a 1.2x rate covenant and a 1.2x additional bonds test. There is no debt service reserve fund established for the proposed 2016 obligations.

### **Enterprise risk**

Our assessment of the system's enterprise risk profile as extremely strong reflects the county's stable and predictable revenue and cash flow streams from low-risk water and sewer service, a natural monopoly in its service area, and a good operational management framework.

The Pima County Regional Wastewater Reclamation Department provides wastewater collection and treatment services to 270,051 customers in the Tucson metropolitan statistical and outlying service areas. The customer base is primarily residential, with close to 70% of revenue coming from residential fees. The wastewater system's customer base increased an average of 3% a year from fiscal years 2005-2007 before slowing to 1.7% in fiscal 2008, 0.1%-0.8% in fiscal years 2009-2014, and 0.8% in fiscal 2015. New construction activity, particularly in the residential sector, had been what we view as very strong until slowing to moderate growth in the past few years. Connection fees revenues have fallen gradually, to about \$13 million in fiscal 2015 from a high of \$31 million in fiscal 2007. We attribute the decrease to slowed economic activity, population growth, and construction activity. System officials project connection fees of about \$13.4 million-\$13.9 million annually from fiscal years 2016-2018. The system is very diverse, in our view, with the 10 leading customers in fiscal 2015 generating less than 10% of total system operating revenues.

As growth and connection fees have dropped off, county officials have consistently demonstrated a willingness to increase rates to meet operational and debt service needs. The county does an internal annual comprehensive financial plan, which incorporates financial projections based on a 4% sewer rate increase in 2017 and annual increases of 4% for 2018-2019. Although these rate recommendations from the advisory committee need to be

approved by the county's board, the board has historically approved the recommendations. Given county income levels, we view the current rates as affordable, at about \$41 per month for an average residential customer using 6,000 gallons. When annualized, this amount represents about 1.2% of MHEBI. Pima County is also commissioning an independent rate study in 2016 to analyze the rate structure and future financial needs.

Based on our operational management assessment, we view the system to be a '1' on a scale of 1-6, with '1' being the strongest. We view the operational management of the system as strong. Rates are reviewed annually, and the county has proactively analyzed the rate structure and typically approves rates increases necessary to maintain strong financial performance. In our view, the system has sufficient operational capacity to meet demand during the medium-term horizon. The Agua Nueva Wastewater Reclamation Facility (which replaced the Roger Road facility) and the Tres Rios Wastewater Reclamation Facility (formerly known as the Ina Road facility) serve metropolitan Pima County. Together, the two metropolitan facilities have a combined, current treatment capacity of approximately 82 million gallons per day (mgd). The non-metropolitan Pima County areas are served by separate wastewater reclamation facilities: Green Valley, Avra Valley, Corona de Tucson, Arivaca Junction, Mt. Lemmon, and the Pima County Fairgrounds. These non-metropolitan facilities have a current treatment capacity of approximately 9.6 mgd, for a total capacity for all facilities of about 91.6 mgd. The sewer system's average daily flow is about 61 mgd, which allows for sufficient capacity of the overall system. The county has a 15-year contract with CH2M to operate the Agua Nueva Wastewater Reclamation Facility with five-year renewals. Although we see potential for future financial adjustments based on contractual changes, we do not see any significant financial pressure from CH2M in the near-term.

### **Financial risk profile**

Our assessment of the system's financial risk profile as strong reflects Pima County's historically strong liquidity position that we expect will stay consistent over time, a manageable debt structure, and a good financial management framework.

The system's financial performance has been strong, in our view, during the past three fiscal years. Based on the county's audited financial statements, we calculate that total DSC including connection fees decreased to 1.3x in fiscal 2015 from 1.5x in fiscal 2013. In our opinion, the financial metrics remained strong, although trending down slightly during this period despite rising annual debt service requirements, because of enhanced operating revenues driven by implemented rate increases. Connection fees have remained steady ranging from \$11 million in 2013 to \$13 million in 2015. Total DSC without connection fees from fiscal years 2013-2015 is 1.1x-1.3x. The system also supports its allocable share of the county's COPs debt service, and when we take this additional obligation into consideration, we calculate all-in DSC at an insufficient .9x for both fiscal years 2014 and 2015. Although no sewer revenues are pledged for the repayment of these COPs, the county intends to repay that portion of the COP issue from the sewer system's available unrestricted cash reserves.

Based on projections and proposed rate increases, we expect that financial performance will remain strong over the next three years with anticipated total DSC ranging from 1.2x-1.3x for 2016-2018. These projections incorporate future annual rate increases of roughly 4%, a cash defeasance on the Water Infrastructure Finance Authority series 2004 loan in fiscal 2017, and debt service from this obligation issue and future obligation issues. Future all-in coverage, which

incorporates the COPs, is projected to be at 1.04, 0.93x, and 0.95x for fiscal years 2016, 2017, and 2018, respectively. The repayment schedule on the COPs is fixed with the sewer system making payments of \$22 million in fiscal 2016, \$24 million in fiscal 2017, and \$23 million in fiscal 2018. Our expectation that the system will maintain a strong liquidity position mitigates the insufficient all-in coverage.

Liquidity has been very strong in the past three fiscal years, and we anticipate that it will likely remain strong in the future. Unrestricted cash at the end of fiscal 2015 totaled \$111 million, equivalent to 485 days of operating expenses, which we consider very strong. The system's liquidity position has trended down slightly over the past three fiscal years, down from \$129 million, or 654 days, in fiscal 2013. While we do expect system liquidity to remain very strong in the medium term, we expect a significant drawdown in liquidity as Pima County uses cash to pay down the COPs. According to management, unrestricted cash will be drawn down to \$111 million, \$101 million, and \$70 million for 2016, 2017, and 2018, respectively. Management targets cash levels at an estimated \$50 million-\$60 million in the long term.

Based on our financial management assessment, we view the system to be a '2' on a scale of 1-6, with '1' being the strongest. We view the system as good, meaning policies are embedded and likely sustainable. Long-term financial planning is detailed and reasonable. Pima County has a four-year capital improvement plan that totals approximately \$150 million. Management plans to fund these projects from COPs and system revenue obligation proceeds. Additional revenue obligations are expected in the near term to fund numerous projects. In our view, the system's debt-to-capitalization ratio was moderate in fiscal year 2015, at 47%. The county represents that it does not have any direct purchase obligations or bank loans outstanding.

## Outlook

The stable outlook reflects our expectation that management will adjust sewer rates and fees as needed to maintain DSC, excluding COPs, at or above 1.2x, while maintaining a strong liquidity position close to forecast.

### Upside scenario

Any potential for an upgrade, which would most likely be beyond our outlook horizon, would be based on significantly stronger debt coverage metrics when including all debt obligations (prior, parity, COPs).

### Downside scenario

We don't expect to lower the rating in that period either, unless the system's liquidity position falls materially below forecast levels.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

**Related Research**

- U.S. State And Local Government Credit Conditions Forecast, April 19, 2016
- U.S. Municipal Water Utilities: No News is (Probably) Good News; The Outlook is Stable, Jan. 20, 2016

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# ATTACHMENT 2

FITCH

## **FITCH RATES PIMA COUNTY, AZ'S COPS 'AA-'; OUTLOOK STABLE**

Fitch Ratings-Austin-16 February 2016: Fitch Ratings has assigned an 'AA-' rating to the following Pima County, AZ (the county) securities:

--\$29.49 million certificates of participation (COPs) series 2016A;  
--\$15.195 million COPs, taxable series 2016B.

The COPs are scheduled for a negotiated sale the week of March 7. Proceeds from series A will finance wastewater system improvements and refund outstanding debt for savings. Series B will finance a new aeronautics facility.

In addition, Fitch affirms the following county ratings:

--\$383.9 million outstanding GO bonds at 'AA';  
--\$139.35 million outstanding COPs at 'AA-'.

The Rating Outlook is Stable.

### **SECURITY**

The series 2016 and outstanding COPs are payable from payments from the county under a master lease agreement with a security interest in mostly essential assets. The lease is subject to annual appropriation and the trustee has the right to seize the assets in the event of less than full appropriation. GO bonds are payable from an unlimited ad valorem tax levied against all taxable property in the county.

### **KEY RATING DRIVERS**

**STABILIZED FINANCES:** Modest improvement in fiscal 2015 reserves reflects strong revenue growth mirroring the expansionary economic cycle. Fitch expects that conservative budgeting and the county's commitment to reserve adequacy will continue to generate an improved financial cushion over the next several years.

**TAX BASE BOTTOMS OUT:** Fiscal 2016 tax base growth begins to reverse a trend of precipitous multi-year declines. Fitch expects further tax base gains based on development underway and the two year lag from market value.

**LARGE, DIVERSE REGIONAL ECONOMY:** The local economy remains a positive long-term credit consideration, with its diverse and stable elements providing a sound foundation.

**MODERATE LONG-TERM LIABILITIES:** Fitch anticipates the county's long-term liabilities to remain moderate based on a rapid debt amortization schedule and current issuance plans. Pension plan obligations are manageable.

**RATING DISTINCTION ON COPs:** The COP rating is one notch lower than the unlimited tax (ULT) rating. Although lease payments are subject to annual appropriation, Fitch believes the incentive to continue to appropriate is strong. The county is a regular COP issuer and most of the leased assets are essential to core governmental purposes.

## RATING SENSITIVITIES

**ADEQUATE FINANCIAL FLEXIBILITY:** The ratings reflect Fitch's expectation that the county will be successful in its plans to replenish operating reserves to historical levels.

## CREDIT PROFILE

Pima County is home to Tucson, Arizona's second largest city, with an approximate population of about 1 million.

## IMPROVING FINANCES MIRROR ECONOMIC RECOVERY

Fiscal 2015 unrestricted reserves of \$48.1 million represent 8.9% of spending, above the county's minimum reserve target of 5%. Fitch considers the target low given the demonstrated revenue volatility of the last economic cycle. The county increased its fiscal 2015 primary tax rate by 16.7%, which yielded about a 15.7% levy increase, to address expenditure growth coming out of reduced spending during the recession.

Property tax revenues contribute 62% of fiscal 2015 general fund revenues. Officials project fiscal year-end 2016 reserves to approximate \$48.5 million (9.1% of spending). The county typically outperforms its conservative budget assumptions and Fitch expects the county will take advantage of improving economic trends to rebuild reserves.

## MANAGEABLE DEBT BURDEN

Series 2016A proceeds will fund waste water improvements and refund outstanding obligations for savings. The taxable series 2016B COPs will finance a new aeronautics facility to be leased to a private entity as part of an economic development initiative of the County.

Overall debt is moderate at 2.2% of fiscal 2016 market value. Fitch expects the county's debt burden to remain moderate based on a rapid amortization schedule and modest near term issuance plans. Fiscal 2017 issuance plans include routine GOs, \$10 million in transportation bonds, and an estimated \$45 million in sewer revenue obligations.

## UNDERFUNDED STATE PENSION PLANS

The county participates in five state-sponsored pension programs for its retirees. The three most significant of these are the Arizona State Retirement System (ASRS), a cost-sharing multiple-employer plan; the Public Safety Personnel Retirement system (PSPRS), an agent multiple-employer (AME) plan; and the Corrections Officer Retirement Plan (CORP), also an AME plan.

Under GASB 67 and 68, the county reports a fiscal 2015 ASRS net pension liability (NPL) of \$379 million, with fiduciary assets covering 69.5% of total pension liabilities at the plan's 8% investment return assumption (approximately 63% based on a lower 7% investment rate assumption). The NPL for the county's PSPRS plan is \$185 million, with fiduciary assets covering 43.1% of total pension liabilities at the plan's 7.85% investment return assumption (approximately 39.4% based on a lower 7% investment rate assumption). The NPL for the county's CORP is \$52 million, with fiduciary assets covering 48.2% of total pension liabilities at the plan's 7.85% investment return assumption (approximately 44.1% based on a lower 7% investment rate assumption).

The NPL of all county plans represent a modest 1.4% of the city's fiscal 2015 market value. The unfunded OPEB liability is de minimus. Fitch will continue to evaluate efforts at the state level to improve the sustainability of the PSPRS plan.

The county's fiscal 2015 carrying costs, including debt service, state pension and OPEB contributions are moderate at 17.2% of fiscal 2015 governmental spending.

## LARGE, DIVERSE REGIONAL ECONOMY

The county's diverse economy features higher education, healthcare, government, technology, tourism and manufacturing as primary anchors. The top 10 taxpayers represent retail, healthcare, utility and mining sectors, comprising a modest 7.0% of total fiscal 2015 assessed valuation.

Expansion of the local economy is evidenced by 6% growth in fiscal 2016 market value and Fitch anticipates additional near term tax base growth based on regional trends and new development. Major southern Arizona employers include the University of Arizona, Raytheon Missile Systems, Davis-Monthan Air Force Base, state and local government, Wal-Mart Stores Inc., Tucson Unified School District, U.S. Customs & Border Protection/U.S. Border Patrol, Freeport-McMoRan Copper, and UA Healthcare.

An unemployment rate of 5% as of December 2015 is favorable to the state average of 5.5% for the same period. The county's housing market continues to strengthen as evidenced by a reported uptick in permits and housing starts. County wealth levels are moderately below state and national averages.

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Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published by the end of the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating

review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and the Zillow Group

#### Applicable Criteria

Exposure Draft: Incorporating Enhanced Recovery Prospects into US Local Tax-Supported Ratings (pub. 02 Feb 2016)

[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=875108](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=875108)

Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)

[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=869942](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942)

Tax-Supported Rating Criteria (pub. 14 Aug 2012)

[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=686015](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015)

U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)

[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=685314](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314)

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## **FITCH RATES PIMA CO., AZ'S GOS AND STREET & HIGHWAY REVS 'AA'; OUTLOOK STABLE**

Fitch Ratings-Austin-02 May 2016: Fitch Ratings has assigned an 'AA' rating to the following Pima County, Arizona obligations:

- \$112.63 million general obligation (general obligation) refunding bonds, series 2016;
- \$26.17 million street and highway revenue refunding bonds, series 2016.

The bonds are scheduled for separate negotiated sales the week of May 30. Proceeds of each series will be used to refund certain outstanding obligations for savings.

In addition, Fitch has affirmed the following ratings:

- Issuer Default Rating (IDR) at 'AA';
- \$383.9 million GO bonds outstanding (pre-refunded) at 'AA';
- \$113.87 million street and highway revenue bonds (pre-refunded) at 'AA';
- \$172.9 million certificates of participation (COPs) at 'AA-'.

The Rating Outlook is Stable.

### **SECURITY**

GO bonds are payable from an unlimited ad valorem tax levied against all taxable property in the county.

Outstanding COPs are payable from payments from the county under a master lease agreement with a security interest in mostly essential assets. The lease is subject to annual appropriation and the trustee has the right to seize the assets in the event of less than full appropriation.

The street and highway revenue bonds are payable from an irrevocable lien on and first pledge of all revenues received by the county from a statutory allocation of street and highway taxes, fees, and charges, and state motor vehicle license taxes (VLTs) collected by the state and returned to the county for street and highway purposes.

### **KEY RATING DRIVERS**

The 'AA' IDR and GO ratings are supported by the county's sound revenue framework, strong expenditure flexibility, demonstrated gap-closing capabilities, and a low long-term debt liability burden. The 'AA-' COPs rating, one notch off the IDR, reflects the options inherent in an appropriation security structure. The 'AA' street and highway revenue bond rating reflects a solid coverage cushion, strong additional bonds test of 2x, and Fitch's solid expectations for the pledged revenue stream.

### **Economic Resource Base:**

Pima County is home to Tucson, Arizona's second largest city, with a population of about 1 million. The county's diverse economy features higher education, healthcare, government, technology, tourism and manufacturing as primary anchors. The top 10 taxpayers represent retail, healthcare, utility and mining sectors, comprising a modest 7% of total fiscal 2016 assessed valuation.

Revenue Framework: 'aa' factor assessment

Pima County revenue growth prospects are strong, benefitting from a diverse and relatively stable regional economy and recent transportation infrastructure improvements. Pima County has modest revenue-raising capabilities for operating purposes.

**Expenditure Framework: 'aa' factor assessment**

Fitch expects the county's pace of spending to remain generally in line with revenue growth. The county's ability and willingness to undertake spending cuts provides the capacity to manage potential state funding mandates and increasing pension contributions.

**Long-Term Liability Burden: 'aaa' factor assessment**

The combined burden of debt and unfunded pension liabilities in relation to personal income is low at 6%. The assessment reflects the county's rapid debt amortization rate (about 87% retired in 10 years), moderate capital needs, and an elevated unfunded net pension liability over the medium term.

**Operating Performance: 'aa' factor assessment**

Pima County has demonstrated the capacity to close funding gaps through spending cuts and tax rate hikes. The county's budget takes advantage of economic recovery to replenish reserves.

**RATING SENSITIVITIES**

**Financial Resilience:** The IDR, GO and COPS ratings are sensitive to Pima County's ability to maintain adequate financial flexibility as demonstrated by reserve adequacy throughout the economic cycle.

**Street & Highway Bond Financial Cushion:** Material erosion of the county's solid coverage cushion could pressure the current rating.

**CREDIT PROFILE**

Pima County's economy continues to perform well. Expansion is evidenced by 6% growth in fiscal 2016 market value, and Fitch anticipates additional near-term tax base growth based on regional trends and new development. The county's housing market continues to strengthen, as evidenced by a reported uptick in permits and housing starts.

Accelerated private investment in Tucson has been sparked by the 2014 completion of the city's streetcar rail system that extends from downtown to the University of Arizona campus. Major southern Arizona employers include the University of Arizona, Raytheon Missile Systems, Davis-Monthan Air Force Base, state and local government, Wal-Mart Stores Inc., Tucson Unified School District, U.S. Customs & Border Protection/U.S. Border Patrol, Freeport-McMoRan Copper and UA Healthcare.

**Revenue Framework**

Pima County general fund revenues have grown at a greater-than-inflation 10-year compound annual growth rate (CAGR) of 2.6% through fiscal 2014 and a stronger 3.0% rate through fiscal 2015. Property tax revenues contribute about 60% general fund revenues and have rebounded strongly from moderate declines during the great recession.

Fitch's assessment of strong revenue growth prospects is based on Pima County's diverse and relatively stable economy and the expectation for continued private investment spurred by transportation infrastructure improvements. Fitch expects Pima County's growth to exceed that realized in its 10-year history, which was muted due to the unusually large impact of the great recession throughout Arizona.

State law limits the county's ability to make changes to certain revenues. Primary property tax levies, used for operations, are limited to a 2% per annum increase over the maximum allowable

levy in the prior year plus taxes on any property not subject to taxes in the prior year. Additionally, the state allows banking and carry forward of the 2% maximum levy increase, to the extent not fully used. Pima County has approximately \$50 million of annual unused capacity in this regard. Though limited, the 2% allowable increase, in conjunction with the county's control over other miscellaneous revenues, compares favorably to a 1.1% decline in revenues indicated for the county from Fitch's analytical sensitivity tool (FAST) modeling of a 1% decline in a U.S. GDP moderate downturn scenario.

Fitch notes that there is no limitation on annual secondary property tax levies, used for voter-approved bond indebtedness, although such levies are not available to support operations.

#### Expenditure Framework

The county's largest general fund expenditure areas are general government (44%), public safety (28%), and health and social services (19%). Fitch expects the county's pace of spending to generally align with revenue growth over time.

Expenditure flexibility is derived from management's strong control over workforce costs and moderate carrying costs, 17% of fiscal 2015 governmental spending. Fitch expects Pima County's carrying costs to remain manageable based on a rapid 10-year debt amortization rate of 87% which provides bandwidth for moderate capital needs, the potential for increasing pension contributions associated with state-wide plans that are currently underfunded, and the potential for state funding mandates. The county has demonstrated the ability and willingness to make spending cuts.

#### Long-Term Liability Burden

Pima County's long-term liability burden is low as reflected in a long-term liability-to-personal income metric of only 6%. Fitch expects the county's burden to remain affordable based on the rapid debt amortization schedule and modest near-term issuance plans. Fiscal 2017 issuance plans include routine GOs, \$10 million in transportation bonds, in relation to total governmental debt of \$600 million, and an estimated \$45 million in sewer revenue obligations in relation to \$592 million of sewer bonds and obligations currently outstanding.

The county participates in five state-sponsored pension programs for its retirees. The three most significant of these are the Arizona State Retirement System (ASRS), a cost-sharing multiple-employer plan; the Public Safety Personnel Retirement System (PSPRS), an agent multiple-employer (AME) plan; and the Corrections Officer Retirement Plan (CORP), also an AME plan. Proposed legislation provides modest PSPRS reforms applicable to new hires and eliminates the automatic cost of living adjustments currently in place, which Fitch anticipates could, if implemented improve long-term plan affordability.

Under GASB 67 and 68, the county reports a fiscal 2015 ASRS net pension liability (NPL) of \$379 million, with fiduciary assets covering 69.5% of total pension liabilities at the plan's 8% investment return assumption (approximately 63% based on a lower 7% investment rate assumption). The NPL for the county's PSPRS plan is \$185 million, with fiduciary assets covering 43.1% of total pension liabilities at the plan's 7.85% investment return assumption (approximately 39.4% based on a lower 7% investment rate assumption). The NPL for the county's CORP is \$52 million, with fiduciary assets covering 48.2% of total pension liabilities at the plan's 7.85% investment return assumption (approximately 44.1% based on a lower 7% investment rate assumption).

#### Operating Performance

Fitch anticipates that Pima County will maintain an adequate financial cushion in an economic downturn based on its ability and willingness to cut spending and raise tax rates. Modest improvement in fiscal 2015 reserves reflects strong revenue growth mirroring the expansionary economic cycle.

Fiscal 2015 unrestricted reserves of \$48 million represent 8.9% of spending, above the county's minimum reserve target of 5%. The county increased its fiscal 2015 primary tax rate by 16.7%, which yielded about a 15.7% levy increase, to address expenditure growth coming out of reduced spending during the recession. Pima County officials project fiscal year-end 2016 reserves to be approximately \$42 million based on an increase in state-mandated support for Tucson Unified School District. The county is planning to increase property taxes in fiscal 2017 and projects \$46 million in unrestricted reserves in fiscal 2017. The county typically outperforms its conservative budget assumptions, and Fitch expects the county will take advantage of improving economic trends to rebuild reserves. The assessment reflects Fitch's expectation that despite occasional reserve draws, the county will maintain reserves at or above its 5% minimum reserve target.

### Street and Highway Revenue Bonds

The street and highway revenue bonds are payable from revenues received by the county from a statutory allocation of street and highway taxes, fees, and charges, and state vehicle license taxes collected by the state and returned to the county for street and highway purposes. Fitch believes that there are sound growth prospects for this revenue stream, driven primarily by expected population growth in Pima County.

Highway user tax revenues include motor vehicle fuel taxes, motor vehicle registration fees, motor vehicle licenses taxes, motor carrier fees, motor vehicle operator's license fees, and other miscellaneous fees and revenues. Highway user tax revenues are collected by the state and deposited into the state highway user fund until distributed. Arizona counties currently receive 19% of the monthly revenue distributions, and the state Department of Transportation, the cities and towns and other state uses receive the remaining 81%. Of the money distributed to counties in the state, 72% is distributed in proportion to the sale and consumption of fuel within each county, and the remainder is distributed on the basis of the proportionate population within the unincorporated areas of each county.

Legal provisions provide adequate bondholder protections. They include an additional bonds test (ABT) of 2x maximum annual debt service (MADS; using an historical test) for bonds outstanding plus bonds to be issued. After debt service payments, residual highway user tax revenues are used by the county for capital projects and for staffing, maintenance and contractual expenses related to county streets and highways. The rating incorporates the possibility of future diversions of highway revenues by the state of Arizona that would reduce distributions to municipalities, although the amount previously diverted was associated with state-wide budget stress during the great recession. Additionally, the state legislature retains the authority to alter the rate of fees that are constitutionally required to be deposited into the state highway user fund, as well as the allocation of such monies between state purposes and the distribution to local governments. However, the Arizona Supreme Court has indicated that these revenues cannot be reduced in a manner which impairs an issuer's ability to meet debt service requirements on the bonds.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using the same 1% decline in national GDP scenario that supports assessments in the IDR framework) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on the county's 15-year pledged revenue history, Fitch's analytical sensitivity tool (FAST) generates a 6.5% scenario decline in pledged revenues. The largest actual cumulative decline in historical revenues is a steep 25.6% decline from fiscal 2007-2011. The pledged revenues have been sensitive to both economic downturns and diversion by the state for public safety spending during times of state budgetary stress; the historical analysis reflects both factors.

Assuming issuance up to the 2x ABT, well below actual current coverage, the structure could tolerate a 50% drop in revenues, 7.7x the scenario results and 1.95x the largest actual revenue

decline in the review period. Fitch believes that these results are consistent with a 'AA' rating (noting that the fiscal 2007-2011 performance reflected a housing bust that disproportionately affected Arizona to an extent that Fitch believes is less likely to be repeated in the future).

Fiscal 2015 pledged revenues of \$53.2 million are up for the fourth consecutive year and cover MADS (2017) a solid 2.85x.

#### Issuing Entity Exposure

Fitch views the pledged street and highway revenues as special revenues under section 902(2)(B) of the bankruptcy code, which defines "special excise taxes imposed on particular activities or transactions" as special revenues. Therefore, the rating is not capped by the county's IDR. Fitch believes special revenue status is unaffected by the state's, rather than the county's, responsibility for the levy, collection, and appropriation of the revenues to the county, or the state's discretion as to the distribution of the revenues among local government units.

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Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

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

#### Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)  
[https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=879478](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478)

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## Fitch Rates Pima County, AZ's Sewer System Revenue Rfdg Obligations 'AA-'; Outlook Stable

Fitch Ratings-Austin-02 May 2016: Fitch Ratings has assigned its 'AA-' rating to Pima County, Arizona's (the county) revenue obligations as follows:

--Approximately \$139.53 million sewer system revenue refunding obligations, series 2016.

The bonds are scheduled to sell via negotiation the week of May 30. Proceeds will be used to refund outstanding obligations for debt service savings and to pay issuance costs.

In addition, Fitch affirms the county's sewer system revenue obligations as follows (pre-refunding):

--\$114.9 million in outstanding senior lien revenue bonds at 'AA';

--\$477.5 million in outstanding subordinate lien sewer system revenue obligations at 'AA-'.

The Rating Outlook is Stable.

### SECURITY

The senior bonds are payable from payments made by the county to the trustee. The county's obligation to make payments is secured by net revenues of the county's sewer system (the system). The senior lien is closed. The subordinate obligations have a subordinate security interest in the pledged revenues and are additionally secured by the system's unrestricted cash balances.

### KEY RATING DRIVERS

**BELOW-AVERAGE DEBT SERVICE COVERAGE:** Debt service coverage (DSC), exclusive of pledged unrestricted cash balances, has weakened in recent years due to increased debt service costs. Ongoing DSC is expected to remain below-average in the near to mid-term as maximum annual debt service costs occur in fiscal 2023 and then descend thereafter.

**HIGH LIQUIDITY ENHANCES FINANCIAL PROFILE:** The system's very strong cash balances, combined with a very rapid pay-out, somewhat mitigates near to mid-term below-average DSC levels.

**HIGH DEBT AND CAPITAL COSTS DECLINING:** Debt levels are high but are expected to decline rapidly in the coming years due to declining capital needs and very rapid amortization schedule.

**PRESSURED RATE BASE:** Upon embarking on its large capital plan in 2010, the county prudently adopted a series of automatic annual rate increases to counter the rise in fixed costs. However, user charges at 1.1% of median household income (MHI) now slightly exceed Fitch's affordability threshold, somewhat limiting future rate flexibility.

**STABLE ECONOMY:** The service area is anchored by the presence of the military and defense industry that provide some stability. County unemployment rates are below state but above national levels.

## RATING SENSITIVITIES

**STRONG CASH BALANCES KEY:** Maintenance of strong liquidity is key to the rating given the system's below-average DSC through the forecast period.

## CREDIT PROFILE

The system provides wastewater service to a population of more than 1 million through more than 265,000 connections in the Tucson metropolitan statistical area (MSA) and separate outlying areas in eastern Pima County (general obligation [GO] bonds rated 'AA'/Stable). Tucson (GO bonds rated 'AA-/Negative) is the county seat and Arizona's second largest city. The system wastewater facilities have ample combined capacity of 91.6 million gallons per day (MGD), with sewer flows averaging 61 MGD.

## MIXED FINANCIAL METRICS

The county embarked on a substantial capital program six years ago that resulted in the issuance of \$531 million subordinate revenue obligations since 2010. The debt was issued in four installments from 2010 to 2014, with relatively short maturity schedules. The county adopted large service rate increases to cover the corresponding rise in fixed costs associated with the new debt. This rapid pace of debt issuance resulted in debt service requirements that more than doubled from 2010 levels.

While the county adopted large rate increases for this capital undertaking, coverage has declined gradually as previously forecast, with total DSC (exclusive of pledged unrestricted cash balances) coming in at 1.3x in fiscal 2015. Including planned issuances totaling \$150 million over the next five years and assuming moderate annual rate increases, Fitch-calculated all-in DSC is forecast to hover around 1.2x to 1.4x (excluding pledged unrestricted cash). Given the county's history of enacting rate increases, in some cases up to two rate hikes within one fiscal year, Fitch believes management will take the necessary steps to maintain the system's good financial performance.

Counterbalancing the downward DSC trend, unrestricted cash levels steadily rose from \$11.2 million in fiscal 2010 to \$110.7 million in fiscal 2015. The county also maintained \$39.4 million in available restricted emergency and operating reserves as of fiscal 2015, which combined with unrestricted cash, equaled 657 days cash on hand for the year.

Unrestricted cash balances are legally pledged to the subordinate lien sewer system revenue obligations and can only be used to pay debt service or provide rate relief. The increase in reserve amounts, combined with the unrestricted cash spending limitations, should help maintain strong liquidity levels and/or facilitate the acceleration of debt payments. In fact, the county plans to use some of its excess cash reserves to retire between \$10 million and \$38 million in debt when it becomes callable in fiscal 2017.

## CAPITAL IMPROVEMENT PLAN RAMPING DOWN

The county is in the seventh year of implementation of its capital improvement plan (CIP) that was projected to cost a total of \$974 million. The massive capital undertaking was necessary to address its aging infrastructure and comply with regulatory requirements. Some of the major projects included the demolition and replacement of one of the county's wastewater reclamation facilities that was more than 50 years old as well as major rehab and expansion of another wastewater treatment plant. These projects were completed ahead of schedule and below budget. To date the system has spent about \$750 million of the total project costs.

Capital needs over the next five years are expected to cost an estimated \$200 million and are primarily for conveyance system upgrades and replacements. The county has substantially met future permitting

requirements for environmental compliance, and consequently most of its major capacity and compliance needs will have been met when this plan is completed unless growth-related pressures emerge.

#### DEBT LEVELS TEMPERED BY RAPID AMORTIZATION

Given the constitutional limitations on cash spending for capital, the county plans to primarily debt-fund its CIP over the next five years. Debt levels currently are high with debt per customer at \$2,430. The county plans to issue an additional \$150 million in subordinate lien debt over the next five years.

However, due to the rapid amortization of debt and the decline in capital needs, debt levels are projected to descend at a moderately rapid pace post-2016, assuming future capital needs remain low as currently planned. Debt per customer is projected at \$2,277 in fiscal 2020. Amortization of debt is very rapid, with principal payout at 47% in five years and 91% in 10 years. Moreover, management utilizes excess reserves to retire debt early.

#### GROWING DEBT SERVICE REQUIREMENTS PRESSURE RATES

To cover the anticipated rise in debt service costs, the county enacted automatic annual rate hikes over fiscal years 2011-2014. No rate increases were implemented in fiscals 2015 or 2016, but management is proposing 4% or greater rate increases for calendar years 2017, 2018, and 2019. Management performs a monthly comprehensive review of rate adequacy and has indicated it would recommend larger rate increases if deemed necessary. The current monthly bill at \$40.90 (assuming sewer flows of 6,000 gallons per month) is now at 1.1% of MHI, slightly above Fitch's 1.0% affordability threshold.

#### SERVICE AREA BENEFITS FROM STABLE ECONOMY

The area's economy is diverse, featuring military and defense, higher education, healthcare, government, and manufacturing as primary anchors. County unemployment levels at 4.8% as of February 2016 are below the 5.2% state and national average. County wealth levels are slightly below state and national levels.

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Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from CreditScope.

#### **Applicable Criteria**

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=750012&cft=0](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012&cft=0))

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 03 Sep 2015)

([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=869223&cft=0](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869223&cft=0))

#### **Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form

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