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# MEMORANDUM

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Date: October 2, 2019

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

From: C.H. Huckelberry  
County Administrator 

Re: **Credit Ratings**

The County has received credit rating reviews by Fitch Ratings (Attachment 1) and S&P Global Ratings (Attachment 2) for the Certificates of Participation (COPs) that will be issued later this month to fund the Valencia Road Extension project. Both rating agencies continue to assign the following ratings to Pima County's COPs and General Obligation debt:

Credit Ratings				
	Standard & Poor's		Fitch Ratings	
	Rating	Date	Rating	Date
Certificate of Participations (COPs)	AA-	Sep-19	AA	Sep-19
General Obligation	AA	Sep-19	AAA	Sep-19

In their ratings reports, the two firms spoke highly of County fiscal management and our overall management in general. Here are some of the comments from the ratings reports released in September 2019:

- "Strong management, with good financial policies and practices...." (S&P)
- "Very strong liquidity..." (S&P)
- "Conservative budgeting, solid expenditure flexibility and a commitment to healthy reserves position the county to promptly close any budgetary gaps and maintain a high level of financial flexibility." (Fitch)

CHH/lab

Attachments

c: Jan Leshar, Chief Deputy County Administrator  
Michelle Campagne, Director, Finance and Risk Management

# ATTACHMENT 1



## Fitch Rates Pima County, AZ's \$12.9MM COPs 'AA', Affirms IDR at 'AA+'; Outlook Stable

Fitch Ratings-Austin-20 September 2019: Fitch Ratings has assigned an 'AA' rating to the following obligations of Pima County, Arizona:

--\$12.86 million certificates of participation (COPs), series 2019A.

The COPs are scheduled for a negotiated sale the week of Oct. 14. Proceeds will finance road and bridge improvements.

In addition, Fitch has affirmed the following Pima County ratings:

--Long-Term Issuer Default Rating (IDR) at 'AA+';

--\$227.3 million in outstanding unlimited tax general obligation bonds (ULTGOs) at 'AAA';

--\$117.3 million in outstanding COPs at 'AA'.

The Rating Outlook is Stable.

COP proceeds will finance construction of a new bridge and ancillary road improvements.

### SECURITY

The 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.

Outstanding ULTGO bonds are payable from an unlimited ad valorem tax levied against all taxable property in the county. The ULTGO bonds also benefit from a statutory lien.

### ANALYTICAL CONCLUSION

The 'AA+' IDR and 'AAA' ULTGO bond rating are supported primarily by solid expenditure flexibility, a high level of financial flexibility, and a low long-term debt liability burden. The 'AA' COPs rating, one notch off the IDR, reflects the optionality inherent in an appropriation security structure.

The Arizona legislature in its 2016 and 2017 sessions (52nd and 53rd legislatures) approved amendments to various sections of the Arizona Revised Statutes that provide ULTGO bondholders with a statutory lien on ad valorem taxes of cities, towns, counties, school districts, community college districts and various special districts in the state. Fitch believes the statute provides bondholders with a substantial preferential right in a bankruptcy proceeding, warranting a ULTGO bond rating up to two notches higher than the entity's IDR. The statutory lien applies only to ad valorem tax revenues and applies both to ULTGO bonds previously issued and to be issued in the future. The legislation does not affect Fitch's IDR of the county.

## Economic Resource Base

Pima County has a population of roughly 1 million and is home to Tucson, Arizona's second largest city. 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 and comprise a modest 7% of total fiscal 2019 taxable values.

## KEY RATING DRIVERS

### Revenue Framework: 'aa'

Pima County revenue growth prospects are solid, having rebounded from severe recessionary weakness. Pima County has few legal revenue-raising capabilities for operating purposes but retains unused property tax levy that the state allows to be banked and carried forward.

### Expenditure Framework: 'aa'

Fitch expects the county's pace of spending to remain generally in line with revenue growth. The county's ability and willingness to adjust spending levels provides the capacity to manage specific cost pressures, including pension contributions. Carrying costs are a moderate burden on resources.

### Long-Term Liability Burden: 'aaa'

The combined burden of debt and net pension liabilities in relation to personal income is low at just under 6%. The assessment reflects the county's rapid debt amortization rate (more than 90% retired in 10 years), moderate capital needs, and an elevated unfunded net pension liability over the medium term.

### Operating Performance: 'aaa'

Fitch expects Pima County to retain the highest gap-closing capacity during a typical economic downturn. The combination of bolstered reserves and solid expenditure flexibility gives the county very strong gap closing capacity. Conservative budgeting allows the county to take advantage of economic recovery to replenish reserves promptly if necessary.

## RATING SENSITIVITIES

Financial Resilience and Budget Management: The IDR, GO and COPs ratings are sensitive to Pima County's ability to maintain its overall financial flexibility and manage any service pressures associated with anticipated near-term growth.

## CREDIT PROFILE

Pima County's economy by several measures is firmly in growth mode. Expansion is evidenced by six consecutive years of gains in countywide market values, including a solid 7.4% increase in fiscal 2020 to \$84.1 billion; this gain followed a 6.5% increase in fiscal 2019. Countywide annual retail sales have averaged 4.0% annual increases since 2013, including a 5.5% gain in 2018 to \$9.3 billion. Fitch anticipates additional near-term tax base growth based on current reported construction activity, planned development, and appreciation of existing properties. Steady increases in employment and corresponding declines in the annual unemployment rate further support the expectation for additional economic expansion.

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, and Banner Healthcare. Raytheon is one of several large enterprises that have recently announced new or expanded facilities in Pima County; others include Geico, Caterpillar Surface Mining, and Southern New Hampshire University. Amazon also announced a doubling of headcount at its Tucson distribution center to 3,000 from 1,500.

### Revenue Framework

The county's operating revenues are a mix of locally-generated and state-shared revenues. Property tax revenues contribute about 60% of general fund revenues annually, and intergovernmental revenues are the next largest revenue component at nearly 30% of the total.

The 10-year CAGR of Pima County general fund revenues (adjusted for tax rate changes) was essentially flat through fiscal 2018. Fitch's assessment of solid revenue growth prospects is based on recent healthy tax base and retail sales gains, and ongoing and announced development activity that should generate additional economic expansion in the area. Fitch expects the county's revenue gains to exceed the modest growth rate over the past 10 years, which was muted due to the disproportionately 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 new construction. Additionally, the state allows the banking and carry forward of the 2% maximum levy increase, to the extent not fully used. Pima County had approximately \$95 million of annual unused capacity in this regard in fiscal 2019, equal to nearly 20% of the general fund budget.

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

### Expenditure Framework

The county's largest general fund expenditure areas are general government (45% of fiscal 2018 outlays), public safety (29%), and health and social services (20%).

Fitch expects the county's pace of spending to generally align with revenue growth over time as continued population gains increase service demands. Annual general fund spending over the past several fiscal years has been modest; the slow rate of growth allowed management to both transfer increasing amounts for capital spending and boost operating reserves.

Sound expenditure flexibility is derived primarily from management's strong control over workforce costs. Carrying costs (debt service and retiree benefit outlays) are at the high end of moderate (19.3% of fiscal 2018 governmental spending). The carrying cost incorporates an aggressive debt amortization schedule (more than 90% repaid in 10 years) and recently climbing pension contributions.

Fitch does not anticipate carrying costs to shift materially over the near term due to moderate borrowing plans and the amortization schedule that will accommodate additional debt issues; this combination should offset expected further increases in pension contributions. The county has demonstrated the ability and willingness to make spending cuts when necessary to retain satisfactory budgetary flexibility.

### Long-Term Liability Burden

Pima County's long-term liability burden, comprised of overall debt and Fitch-adjusted net pension liabilities, is low at less than 6% of total personal income. Fitch expects the county's burden to remain affordable based on the rapid debt amortization schedule and moderate near-term borrowing plans. Management reports plans to issue roughly \$80 million in COPs and another \$21 million in highway user revenue bonds over the next two years; \$50 million of the COP proceeds reportedly will finance short-term projects and have final maturities of three years or less.

The county and its employees participate in six separate pension programs administered by four state-sponsored systems. 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 2018 combined net pension liability (NPL) for all plans of \$822 million, with fiduciary assets covering 58% of total pension liabilities. Investment return assumptions for the plans range from 7.5% to 8%. Using a more conservative standard 6% investment return assumption, the combined NPL increases to \$1.17 billion with assets covering 49.5% of total liabilities.

#### Operating Performance

Fitch anticipates that Pima County will demonstrate the highest gap-closing capacity through a typical economic downturn based on its ability and willingness to cut spending and raise tax rates. Conservative budgeting, solid expenditure flexibility and a commitment to healthy reserves position the county to promptly close any budgetary gaps and maintain a high level of financial flexibility.

Fiscal 2018 general fund results were positive and represented the fourth consecutive year of net gains and additions to fund balance. A net operating surplus after transfers of \$11.5 million boosted unrestricted reserves to nearly \$109 million or 20% of spending, comfortably above the formal minimum reserve target of 5%. The recent gains are due primarily to better than expected revenue performance and sound expenditure control.

County officials report fiscal 2019 operating revenues and spending both outperformed budget. They currently project audited year-end general fund results to show little change in fund balance due to the application of a portion of reserves towards various capital projects (including renovation of the county courthouse). This practice is scheduled to continue over the next several years, which likely will produce a moderate reduction in operating reserves.

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

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

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

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# ATTACHMENT 2

# RatingsDirect®

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## Summary:

# Pima County, Arizona; Appropriations; General Obligation

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## Summary:

# Pima County, Arizona; Appropriations; General Obligation

### Credit Profile

US\$12.86 mil certs of part ser 2019A due 12/01/2033

<i>Long Term Rating</i>	AA-/Stable	New
Pima Cnty approp		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed

## Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Pima County, Ariz.'s series 2019A certificates of participation (COPs; par amount: \$12.86 million). At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the county's general obligation (GO) debt outstanding and its 'AA-' rating on the county's outstanding COPs. The outlook on all ratings is stable.

The 'AA' rating reflects the county's growing and stable economy, as employers are expanding or moving into the community, along with strong residential and commercial activity leading to good assessed value (AV) growth in recent years. Financially, the county's positive operational performance has led to very strong general fund reserves, supporting our view of the county's creditworthiness. The rating also reflects our view of the county's manageable overall debt profile, including rapid amortization of debt and low overall net debt at less than 2% of full cash value (market value).

## Security and purpose

The COPs are payable from lease payments made from legally available revenue of the county subject to annual appropriation. The ratings on the COPs reflect the county's covenant to budget and appropriate annual lease payments. We rate this obligation one notch lower than the county's general creditworthiness to account for the appropriation risk associated with the lease payment. Proceeds from the sale of the series 2019A COPs will be used to fund various capital projects throughout the county.

Revenue from unlimited ad valorem taxes levied on taxable property within the county secures the GO bonds. The county has the power and obligation to levy these taxes without limitation as to rate or amount. Following the issuance of the series 2019A COPs, the county will have approximately \$927.7 million in total direct debt outstanding.

## Credit fundamentals

The 'AA' ratings reflect our view of the county's:

- Strong 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;
- Adequate budgetary performance, with an operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2018;
- Very strong liquidity, with total government available cash at 67.2% of total governmental fund expenditures and 5.1x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability profile, with debt service carrying charges at 13.1% of expenditures and net direct debt that is 50.4% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 93.1% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### **Strong economy**

Pima County, with an estimated population of 1 million, is located in the Tucson, Ariz., MSA, which we consider to be broad and diverse. Pima County encompasses 9,184 square miles of southern Arizona, and roughly half of its population resides in Tucson. Education and health care, defense, and government are the county's primary employment sectors. The county has a projected per capita effective buying income of 86.7% of the national level and per capita market value of \$82,014. The county's market value grew by 7.4% over the past year to \$84.1 billion in 2020. The county unemployment rate was 4.5% in 2018.

The University of Arizona is the leading employer (12,500 estimated employees), followed by Davis-Monthan Air Force Base (11,800) and Raytheon Missile Systems (11,500). Davis-Monthan Air Force Base supports a variety of missions; one of the largest plane groups at the base is the A-10. The Pentagon extended funding for the A-10, which had previously been at risk for near-term retirement. Retirement has since been extended until 2022. Management reports that the F-35 is a probable replacement, and the base benefits from the competitive advantages provided by the airspace availability and weather. At this time, we understand that there are no consolidation concerns for the base. While we consider the regional economic base to be diverse, its reliance on the aerospace, defense, and government sectors contributed to a weaker recovery relative to those of areas that depend less on federal, state, and local government spending.

According to management, residential and commercial development has been quite strong recently, which we believe will lead to tax base growth and higher sales tax collections in the next several years. The county has experienced four consecutive years of valuation growth, and limited property AV grew by 5% in fiscal 2020, reaching \$8.7 billion. The top 10 taxpayers for the county represent 7% of AV in fiscal 2020, which we consider very diverse.

### **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 regularly monitor all of them.

Highlights include the following:

- The budget is based on major revenue projections from the county and the state that include property tax revenue

and state-shared revenue, 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.
- 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.

### **Adequate budgetary performance**

Pima County's budgetary performance is adequate, in our opinion. The county had surplus operating results in the general fund of 2.1% of expenditures, but a deficit result across all governmental funds of 1.9% in fiscal 2018.

We have adjusted the county's revenue and expenditures to reflect recurring transfers in and out of the general fund that we believe function like ongoing activity, including relatively large reoccurring transfers out for debt service and support for certain special revenue funds. The county's operations are stable, in our view, supported by a third consecutive general fund surplus. Management attributes the stable budget results in recent years to departmental efficiencies, along with conservative and comprehensive budgeting, including budgeting for all contingencies spent, which historically never occurs. Moreover, the county's revenue profile has continued to increase year over year, largely due to an increase in the primary property tax rate and growth in state-shared sales tax revenue. We understand that the county raised its primary property tax rate in fiscal 2018 to mitigate an attempt from the state to shift certain expenses onto the county, which the state ultimately did not do. We note that the county did lower the tax rate back down to \$5.65 in 2019 from \$6.02 in fiscal 2018. From 2014 to 2018, the county's general fund revenue grew an aggregate 18.7%, largely due to the good growth in local sales taxes. The county is anticipating to end fiscal 2019 with balanced operations. However, audited results are likely to be negative, due to some one-time spending that occurred during the year, notably a \$7 million transfer out of the general fund for technology upgrades. Furthermore, the county expects to spend an additional portion of available reserves in fiscal 2020 for street improvements.

### **Very strong budgetary flexibility**

Pima County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 20% of operating expenditures, or \$108.9 million.

Our calculation of available fund balance combines assigned and unassigned portions of the general fund balance. The county's reserves have increased year over year since 2015, and the county added \$11.2 million to its available fund balance in 2018. According to management, the county accumulated reserves in previous years to help fund upcoming road improvements. Although the county intends to spend down a portion of reserves in the near term, we anticipate available fund balances will remain at least strong in the next several years.

### **Very strong liquidity**

In our opinion, Pima County's liquidity is very strong, with total government available cash at 67.2% of total governmental fund expenditures and 5.1x governmental debt service in 2018.

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. We do not consider the county's investments aggressive, as it invests primarily in federal agency securities and the state pool. Although the county has a sizable number of investments in corporate bonds, the majority hold investment-grade ratings by S&P Global Ratings. We have not identified any contingent liquidity risks in the form of variable-rate debt or significant contingent liabilities.

In 2017, the county entered into a private placement agreement with JP Morgan Chase Bank in the amount of \$25.7 million. The privately placed bonds are secured by revenue from unlimited ad valorem taxes levied on taxable property in the county, and are also on parity with the county's existing GO bonds. We understand that JP Morgan Chase Bank lacks the ability to accelerate debt service payments under the agreement.

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

In our view, Pima County's debt and contingent liability profile is very strong. Total governmental fund debt service is 13.1% of total governmental fund expenditures, and net direct debt is 50.4% of total governmental fund revenue. Overall net debt is low at 1.5% of market value, and approximately 93.1% 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 approximately \$45 million in additional COP debt in calendar year 2020, along with potential COP and street and highway revenue bond issuances in 2021. 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 COP or revenue bond would comply with the policy.

Pima County's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 6.1% of total governmental fund expenditures in 2018. 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. The county made 100% of its annual required pension contribution in 2018.

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. Pima County reported an aggregate net pension liability of \$822 million in fiscal 2018. The Arizona State Retirement System (ASRS), the largest single retirement plan, represents roughly 50% of the county's aggregate net pension liability. As of June 30 2018, the ASRS plan was 73% funded. The Public Safety Personnel Retirement Plan is only 41% funded, and the Corrections Officer Retirement System was 48% 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.

## Strong institutional framework

The institutional framework score for Arizona counties is strong.

## Outlook

The stable outlook reflects our view of the county's large taxing area and strong economic activity in recent years, which has boosted property and sales tax collections. The stable outlook also reflects our view of the county's recent positive operations and corresponding fund balance increases. Although we expect the county will issue additional debt in the near term, we anticipate the county's overall debt position will remain manageable. We do not expect to change the ratings within the two-year outlook horizon.

### Upside scenario

Should the county's key economic indicators improve to levels comparable with those of higher-rated peers, while the county sustains positive operational performances and fund balances at levels we consider very strong, we could raise the ratings.

### Downside scenario

If the county is unable to achieve operational balance for multiple years, resulting in reserves falling below a strong level, we could lower the ratings.

## Related Research

2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of September 23, 2019)		
Pima Cnty approp		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty approp		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty certs of part		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty Certs of part		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty Certs of part		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Pima Cnty GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Pima Cnty APPROP		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
<b>Pima Cnty GO</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

*Summary: Pima County, Arizona; Appropriations; General Obligation*

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