



MEMORANDUM

Date: May 16, 2016

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

From: C.H. Huckelberry
County Administrator

A handwritten signature in black ink, appearing to read "CHH", is written over the printed name "C.H. Huckelberry".

Re: **Standard and Poor's Global Rating of Pima County, Arizona; Gas Tax**

I previously provided the Board of Supervisors with a summary of Standard and Poor's (S&P) credit ratings. Of some significance is the language contained in some of the ratings. I am providing commentary on some of the more significant findings.

Some have trivialized the diversion of Highway User Revenue Funds (HURF) by the State for their purposes. The attached May 6, 2016 rating by S&P puts this diversion in perspective. They consider additional HURF diversions by the State and a continuation of the existing diversions as the largest single threat to the County's credit rating associated with HURF. The report states:

"...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."

The report also continues with:

"...uncertainty remains regarding future state interception of HURF revenues upstream of the counties."

In the Outlook section of the report, S&P describes a downside scenario as ***"state interference with pledged HURF revenue,"*** which they conclude would constitute the reason for lowering the credit rating.

For your information, I have attached the published credit rating by S&P Global Rating for Gas Tax. S&P's credit rating concerns clearly do not trivialize the diversion of HURF revenues to the State for their budget purposes as opposed to supporting the use of HURF for transportation purposes.

CHH/anc

Attachment

c: Tom Burke, Deputy County Administrator for Administration
John Bernal, Deputy County Administrator for Public Works
Keith Dommer, Director, Finance and Risk Management
Priscilla Cornelio, Director, Department of Transportation

RatingsDirect®

Summary:

Pima County, Arizona; Gas Tax

Primary Credit Analyst:

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Credit Profile

US\$24.795 mil street and hwy rev rfdg bn ds 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
Pima Cnty Gas Tax (street & hwy)		
<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

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at 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. Use the Ratings search box located in the left column.

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