FITCH RATES $19MM BERNALILLO COUNTY, NM GO BONDS 'AAA'; OUTLOOK STABLE

Fitch Ratings-Austin-14 February 2017: Fitch Ratings has assigned a 'AAA' rating to the following Bernalillo County bonds:

--$19.3 million general obligation (GO) bonds, series 2017.

Fitch also has affirmed the following ratings:
--The county's Issuer Default Rating (IDR) at 'AAA';
--$108 million GO bonds at 'AAA';
--$108 million gross receipts tax (GRT) revenue bonds at 'AA+'.

The Rating Outlook is Stable.

The series 2017 bonds are scheduled to sell competitively on Feb. 21. The bond proceeds will be used to finance various public improvements.

SECURITY

The GO bonds are payable from an annual unlimited property tax levy.

The GRT bonds are payable from the county's first 1/8% GRT for general purposes, the county's second 1/8% GRT for general purposes, and the county's first hold-harmless 1/8% GRT, excepting $1 million annually for indigent care ($83,333 per month).

KEY RATING DRIVERS

The 'AAA' IDR and GO ratings are based on the county's ample revenue-raising flexibility, strong expenditure flexibility, low liability burden, and exceptionally strong financial resilience through economic downturns relative to expected revenue volatility.

The 'AA+' GRT bond rating reflects the positive pledged revenue growth prospects and ample resilience to revenue declines.

Economic Resource Base
Bernalillo County is the largest county in New Mexico and is the home to one-third (estimated at about 677,000) of the state's population. The county's population grew by a notable 19% from 2000 to 2010, spurred in part by the area's recent development as a technology hub. Recent population growth trends have moderated. The city of Albuquerque comprises about 80% of the county's population.

Revenue Framework: 'aaa' factor assessment
The pace of revenue growth will likely modestly exceed US GDP due to ongoing albeit uneven economic expansion. Gross receipts tax revenue-raising flexibility is ample.

Expenditure Framework: 'aa' factor assessment
Fitch expects the pace of expenditure growth to generally track revenue gains. Expenditure flexibility is aided by prudent budgeting, annual pay-go capital outlays, and moderate carrying costs for debt service and retiree benefits.

Long-Term Liability Burden: 'aaa' factor assessment
The combined overall debt and unfunded pension liability burden is modest at about 6% of personal income. Overlapping debt comprises the majority of the liability. Overlapping debt issuances may increase the overall liability burden, but Fitch expects it to remain low.

Operating Performance: 'aaa' factor assessment
The combination of revenue and expenditure flexibility, supplemented by reserve funding, should enable the maintenance of a high level of financial flexibility during cyclical downturns.

RATING SENSITIVITIES

Shift in Fundamentals: The IDR rating is sensitive to material changes in the county's strong revenue growth prospects, expenditure flexibility, and solid financial position, which Fitch expects the county to maintain throughout economic cycles.

Pledged Revenue Declines: Large and sustained GRT revenue declines, beyond the range of historical experience and Fitch's expectations, could pressure the GRT revenue bond rating.

CREDIT PROFILE

The broad-based economy is led by the government, healthcare/education, and trade/transportation/utilities sectors. Key federal installations include Kirtland Air Force Base and Sandia National Laboratories (SNL) in which troop strength and direct jobs account for a manageable 5% of the MSA's employment base. SNL has attracted a highly educated workforce to the area but it's vulnerable to budget restrictions and shifts in defense spending priorities. The magnitude of any potential cuts to the military installations may be tempered by their unique role in maintaining the country's nuclear assets.

The area's high-tech hub includes firms engaged in microelectronics (Intel, Raytheon) and aerospace (Boeing and Eclipse Aerospace). Intel's workforce in nearby Rio Rancho (IDR of 'AA') has declined to 1,900 from 3,300 since 2013. Plans are underway for a $600 million replacement of the University of New Mexico Hospital, located in the county, which is scheduled to start construction in 2017.

The area's recovery from the last economic downturn has been tepid. Employment gains have been stagnant, but the unemployment rate remains in line with the U.S. average. Median home values - $184,200 in 2017 - continue to rise moderately but remain below their peak in 2007, as are building permits.

Revenue Framework

Property taxes and gross receipts taxes account for nearly equal proportions of total general fund revenues in fiscal 2016, comprising 48% and 44% of revenues, respectively. In fiscal 2016, the county imposed a net 1/16% GRT for general purposes, equal to about 3.4% of general fund revenues.

Total general fund revenues grew by a CAGR of 3.8% for the 10-year period ending fiscal 2015, a rate in excess of US GDP growth, including the impact of tax policy changes. Fitch expects the county's revenue growth to remain modestly above U.S. GDP due to continued but uneven economic expansion.

The county retains ample revenue flexibility in the form of two local-option municipal GRTs, which it can impose without a voter referendum. The aggregate additional revenue from the unutilized 1/8% and 1/16% GRTs totals $31 million or 12% of fiscal 2016 revenues.

In fiscal 2016, the state began a 15-year phase-out of its hold-harmless payments to municipalities for the exemption of food and medicine from the GRT. The hold-harmless reduction totaled $514,000 (0.2% of spending) for the county in fiscal 2016, growing to a projected $10 million by fiscal 2031. To offset these reductions, the state authorized municipalities to impose additional GRTs up to 3/8th of 1%. The hold-harmless GRTs, in 1/8% increments, can be imposed through ordinance only and are not subject to referendum.

In fiscal 2016, the county imposed a 1/8% hold-harmless GRT for general purposes and a 1/8% hold-harmless GRT for behavioral health services. Concurrently, the county repealed a 1/16% GRT for general purposes. The net revenue increase to the general fund in the fiscal 2016 totaled $10 million (3.9% of general fund revenues), substantially greater than that year's hold-harmless reduction.

Expenditure Framework
Public safety comprised 57% of general fund expenditures in fiscal 2016. General government, public works, and culture and recreation are the other major areas of expenditures.

The pace of spending growth absent policy actions is likely to be generally in line with revenue growth, aided by the recent county jail reforms that have reduced overcrowding and stabilized operational costs.

Expenditure flexibility is derived from the county's moderate carrying costs for debt service, pension, and OPEB which totaled 13.9% in fiscal 2016. Additional flexibility is provided by the county's annual pay-go capital spending, averaging 2% of spending per year, which can be reduced, deferred, or eliminated. A high 60% of the county's workforce is represented by seven labor unions. Management maintains a large degree of control over headcount, but wages and benefits are negotiated through labor contracts. Management can ultimately impose its terms after following a structured framework in the event of an impasse. The terms of the labor contracts are typically one to two years.

Long-Term Liability Burden
The county's long-term liability burden, comprised of overall debt and net pension liability, is modest at approximately 6% of personal income. The large majority of the overall burden is comprised of overlapping debt. The 10-year amortization rate for the county's GO and GRT revenue bonds is rapid at 83% given the county's long-term goal to structure its debt with level principal payments.

The direct debt burden is $234 million. Future direct debt issuance plans are manageable. The county's practice is to hold biennial GO bond elections for about $36 million - $40 million. The county also plans to issue up to $23 million in GRT revenue bonds to reimburse the county for the planned purchase of a new office building; this will allow the consolidation of its 1,100 administrative employees from various locations.

Full-time county employees participate in the Public Employees Retirement Association (PERA) of New Mexico, a cost-sharing multiple employer defined benefit pension plan. PERA reforms effective in 2013 increased contribution rates and established a new tier of benefits for new hires. The county funds its actuarially-determined pension contribution, and the unfunded pension liability is moderate at approximately $289 million (adjusted to reflect a 7% rate of return assumption) or 1% of personal income.

Operating Performance

The county's strong financial resilience is derived from a combination of revenue and expenditure flexibility and ample reserve levels. Prudent budgeting has allowed the county to maintain a reserve safety margin well above the 25% of spending required by the state.

Financial reserves remained large despite sizable drawdowns in fiscal 2013 - 2015 for one-time capital outlays and elevated public safety spending related to the county's overcrowded detention center. Enhanced revenues and stabilized detention center spending allowed the county to restore structural balance in fiscal 2016 as evidenced by a $4.9 million (1.9% of spending) net operating surplus. The resulting financial cushion, comprised of the unrestricted fund balance and the state-required 25% restricted reserve, totaled a large $128 million or 51% of spending. The 2017 budget is balanced and expected to further add to reserves due to greater than budgeted GRT revenues and continued cost controls.

GRT Bonds

Debt service on the GRT revenue bonds is paid from the county's first 1/8% GRT for general purposes and the county's second 1/8% GRT for general purposes, excepting $1 million annually for indigent care. Effective fiscal 2016, the county enhanced the basket of pledged revenues with the addition of the first hold-harmless 1/8% GRT ($16.5 million or a 37.5% increase).

Pledged revenues exhibited compounded annual growth of a modest 1.2% for the 10-year period through 2016 due to uneven performance within the county's employment sectors. However, Fitch expects the long-term trajectory of pledged revenues to trend closer to the five-year CAGR of 2.4%, a rate below US GDP but above inflation, due to its position as a Sun Belt economy that is projected to experience accelerated population growth and economic expansion.

Legal provisions provide strong bondholder protections in the form of a 2x MADS ABT based on historical revenues. After debt service payments on the bonds, GRT revenues are used by the county for general operations.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both the revenue sensitivity results (using the same 1% decline in national GDP scenario that supports assessments in the IDR framework) and the largest decline in revenue over the period covered by the sensitivity analysis. Based on the county's 10-year revenue history, Fitch's analytical sensitivity tool (FAST) generates a 3.7% scenario decline in revenue. The largest actual cumulative decline in historical revenue is a 9.9% decline in fiscal years 2009-2010.

Fiscal 2016 pledged revenues of $60.6 million cover MADS of $15.1 million by a high 4x. Although the county plans to issue up to $23 million of GRT bonds in 2017, MADS is not expected to climb materially higher as management's goal is to wrap any new debt around existing debt. Fitch estimates that the structure could tolerate a large 75% drop in AV before MADS coverage reaches 1.0x. The 75% decline is equivalent to a high 20x the scenario results and 7.6x the largest actual revenue decline in the review period.

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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 and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478