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

Fitch Ratings-Austin-11 February 2016: Fitch Ratings assigns an 'AAA' rating to the following Bernalillo County, NM (the county) bonds:

--$10.3 million general obligation (GO) bonds, series 2016;
--$14.9 million GO refunding bonds, series 2016A.

The bonds are expected to sell competitively on Feb. 16. GO bond proceeds will be used for various public improvements. GO refunding bond proceeds will refund outstanding debt for interest cost savings.

In addition, Fitch affirms the following county ratings:

--$100.5 million in outstanding GO bonds at 'AAA';
--$119.9 million in outstanding gross receipts tax (GRT) revenue bonds at 'AA+'.

The Rating Outlook is Stable.

SECURITY:

The GO bonds are payable from an unlimited property tax levy on all taxable property within the county. The GRT bonds are secured by 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 (at the rate of $83,333 per month) for indigent care. The 2010A GRT bonds are additionally secured by the county's second hold-harmless 1/8 GRT.

KEY RATING DRIVERS

FINANCES PRESSURED BUT STILL SOUND: The county's financial position has been affected by spending pressures, particularly in public safety, but remains solid. Financial reserves remain large despite three consecutive years of sizable draw downs. Enhanced revenues and stabilized detention center spending should allow the county to restore structural balance in fiscal 2016 as planned.

SOLID GRT COVERAGE: Debt service coverage of the county's GRT revenue bonds remains solid, and legal and practical limitations on further leverage are strong.

FAVORABLE DEBT PROFILE: The county's debt profile remains positive, as evidenced by moderate debt levels, a rapid GO and GRT bond principal payout rate, moderate carrying costs, and modest capital plans.

BROAD ECONOMY: The county's economic base is broad but has been slow to recover from recessionary employment losses. The unemployment rate remains moderate. The county's recent development as a technology hub may aid its recovery while further enhancing economic diversity.

RATING SENSITIVITIES

CONTINUED DRAWS ON FUND BALANCE: Failure to maintain ample reserves due to unabated spending pressure or revenue declines could lead to negative rating pressure.

LARGE DEFENSE INSTALLATIONS POSE VULNERABILITY: The large presence of military and defense installations exposes the county's economic base to potential future military downsizing. Any resulting financial impact on the county's revenue base without offsetting actions could lead to downward rating pressure.

CREDIT PROFILE

As the state's largest county, population grew a notable 19% from 2000-2010 and currently exceeds 675,000; the increase was spurred in part by the area's recent development as a technology hub. The city of Albuquerque comprises about 80% of the county's population.

LARGE RESERVES WEATHER SPENDING PRESSURES

The county's financial profile remain solid, characterized by large reserves that typically exceed the state-required three-month (25%) minimum fund balance. Although spending pressure is evident, substantial reserves ranging from 49% - 87% of spending have allowed the county to accommodate sizeable hikes in public safety spending (the county's largest expenditure category) and capital outlays.

Due also to other one-time expenditures, the county posted its third consecutive large drawdown in fiscal 2015. Improved prisoner processing at the metropolitan detention center (MDC) and resulting increased capacity and stabilization of related expenditures is expected to allow a return to balanced operations in fiscal 2016. A continued trend in large drawdowns would generate negative rating pressure.

The fiscal 2015 audit posted a general fund net deficit of $10.5 million (4.1% of spending), well below the projected $41 million draw down for one-time expenditures. The year-end financial cushion (comprised of its unrestricted fund balance and the state-required three-month reserve), totaled a still strong $125.6 million or 49% of spending. Liquidity remained ample at over $128 million, covering current liabilities by an ample 6.4x.

FISCAL 2016 BUDGET INCLUDES ADDITIONAL GRTS

The fiscal 2016 budget, adopted as part of the fiscal 2015-2016 biennial budget, includes a modest $3 million (1% of spending) drawdown due to almost $8 million in pay-go capital outlays. The county's five-year forecast projects annual balanced operations, assumes no new revenue sources, and GRT collection growth of 1.7% - 3% annually, which Fitch considers reasonable.

In fiscal 2016, the state will begin 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 is estimated at $514,000 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 3/8 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 mental 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 budget is projected at $8.3 million (3.4% of general fund revenues), substantially greater than the projected hold-harmless payment reduction. GRT revenues account for 44% of general fund revenues, exposing the county to economically volatile taxes; this risk is mitigated by the county's healthy fund balances.

AMPLE REVENUE FLEXIBILITY

Fitch notes that the county retains significant revenue flexibility. An estimated $14.2 million (5.6% of fiscal 2015 spending) in additional property tax revenue is available under the non-residential mill cap. Remaining authority in four different local option GRTs would generate $137 million (53% of spending), although only $30 million (12% of spending) could be imposed without an election.

GRTS RETURN TO GROWTH
The GRT is imposed on businesses upon the sale of goods or services, subject to certain exemptions, making it broader than the typical sales tax. Recessionary pressures and the completion of major construction projects caused collections to fall by 3%-4% annually in fiscal years 2008-2011. GRT receipts remained sluggish through fiscal 2014 but increased by a solid 9.2% in fiscal 2015, due mostly to increased economic activity plus an accounting adjustment. Year-to-date GRTs are up by 7.9% for the first five months of fiscal 2016, inclusive of the additional 1/8 GRT imposed at the beginning of the fiscal year (netted against the repeal of a 1/16 GRT).

STRONG DEBT SERVICE COVERAGE OF GRT BONDS

Debt service coverage of the county's GRT revenue bonds remains solid at nearly 3 times (x) maximum annual debt service (MADS), based on audited fiscal 2015 revenues. The GRT bonds' debt service reserve requirement is standard, although its additional bonds test is strong--requiring pledged revenues to equal 2x MADS of existing and proposed GRT-secured debt.

The county does not currently plan to further leverage this revenue source, as it relies on residual revenue after debt service for operations. Effective July 1, 2015, the county imposed and pledged one of the additional 1/8 hold-harmless GRTs to its outstanding GRT bonds. The county additionally pledged the second 1/8 hold-harmless GRT, which the county has allocated for mental health services, to its 2010A GRT bonds (which funded mental health facility improvements).

MODEST FUTURE DEBT PLANS

The county maintains a formal capital improvement plan, the local portion of which has been historically financed with voter-approved GO bond authorizations every two years. County voters approved a $27.5 million authorization in November 2014 by a wide margin. The current offering will exhaust that authorization and the next bond election is anticipated in Nov. 2016 for an estimated $27.5 million.

The combined GO and GRT bonds payout rate is very rapid at 84% in 10 years. The county's revised debt policy reduces the final maturity of bonds to 15 years from 20 years as part of its long-term goal to achieve level principal payments, which Fitch views favorably. Including GO bonds and GRT obligations, overall debt levels are a moderate $2,451 per capita and 2.8% of full market value.

SLOW EMPLOYMENT RECOVERY

Recovery of the local employment base has lagged most of the U.S. in the wake of the last recession. During this period the MSA's unemployment rate remained moderate and trended down annually, although this was due partly to annual labor force contractions. The MSA's December 2015 unemployment rate increased modestly to 5.7% from 5.4% the year prior, below the state average (6.2%) but above the U.S. average (4.8%). Recent commercial projects include the new headquarters for Flagship Food Group that will add 300 jobs and an expansion of Comcast's bilingual customer service center that is projected to add 450 jobs. The film industry is surging in the MSA, providing $289 million in direct spending in 2015.

Any federal efforts to downsize the country's military operations could have a significant impact on the area's large federal installations. The combined workforce of Kirtland Air Force Base and Sandia National Labs exceeds 20,000, equal to 5% of the MSA's 2014 employment base. However, the magnitude of cuts to the military installations may be tempered given their unique role in maintaining the country's nuclear assets.

IMPROVED PENSION FUNDING

Full-time county employees participate in the Public Employee's Retirement Association (PERA) of New Mexico, a cost-sharing multiple-employer defined benefit retirement plan. The county fully funds its statutorily required contribution. PERA reforms effective in 2013 increased contribution rates and established a new tier of benefits for new hires, which Fitch considers prudent.

Under GASB 68, the county reports its share of the PERA's net pension liability (NPL) at $163.5 million, with fiduciary assets covering 81.29% of total pension liabilities at the plan's 7.75% investment rate assumption (approximately 75% based on a more conservative 7% investment rate assumption). The NPL represents less than 3/10 of 1% of the county's fiscal 2016 market value. Carrying costs for debt service, pensions and OPEB are low at 10.6% of fiscal year 2015 governmental spending.

Other post-employment benefits are provided through the New Mexico Retiree Healthcare Authority on a pay-as-you-go basis from employer and employee contributions. The carrying costs of GO and GRT debt service plus pension and OPEB contributions totaled a moderate 14% of fiscal 2015 governmental spending.

Through labor contracts, the county has elected to make additional contributions of up to 69% of its employees' pension contributions, totaling $10.9 million in fiscal 2015. Adjusting for these additional county pension contributions, which are expected to remain in place in future labor agreements, total carrying costs climb to a still moderate 17.3% of spending.

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Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include 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 in 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 Fitch's applicable criteria specified below, this action was informed by information from CreditScope, IHS Global Insight, Zillow Group and Lumesis.

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
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
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
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314