FitchRatings

Fitch Rates $43MM Bernalillo County, NM GRT Bonds 'AA+'; Outlook Stable

Fitch Ratings-Austin-12 October 2017: Fitch Ratings has assigned an 'AA+' rating to the following Bernalillo County, NM bonds:

--$31.7 million gross receipts tax (GRT) revenue bonds, series 2017A;
--$11.4 million GRT revenue bonds, series 2017B.

Fitch also has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AAA';
--$122.7 million general obligation (GO) bonds at 'AAA';
--$102.1 million GRT revenue bonds at 'AA+'.

The Rating Outlook is Stable.

The bonds are scheduled to sell competitively on Oct. 24. Proceeds of the 2017A bonds will finance the purchase and renovation of a county administration building. Proceeds of the 2017B bonds will finance the energy efficiency improvements of the county detention center.

SECURITY
The GRT bonds are payable from the county's first and second 1/8% GRT for general purposes, excepting $1 million annually for indigent care ($83,333 per month), and the county's 1/4% hold-harmless GRT. The GO bonds are payable from an annual unlimited property tax levy.

ANALYTICAL CONCLUSION

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

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.

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 2000-2010, 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.

KEY RATING DRIVERS

Revenue Framework: 'aaa'
The pace of revenue growth will likely modestly exceed U.S. GDP due to ongoing albeit uneven economic expansion. Property tax revenue-raising flexibility is ample.

Expenditure Framework: 'aa'
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'
The combined overall debt and unfunded pension liability burden is modest at about 7% 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'
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 'AAA' IDR is sensitive to material changes in the county's strong revenue growth prospects, solid expenditure flexibility, and superior financial operations, 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 as could substantially higher than expected leveraging.

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 helped attract a highly educated workforce to the area but is vulnerable to budget restrictions and shifts in defense spending priorities. Fitch expects the magnitude of any potential cuts to the military installations to 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 - $186,300 in September 2017 - continue to rise moderately but remain below their peak in 2007, as are building permits.

Revenue Framework
Property taxes and GRTs account for nearly equal proportions of total general fund revenues in fiscal 2016, comprising 48% and 44% of revenues, respectively. In fiscal 2018, the proportion of GRTs will increase to 49% of budgeted revenues due to the adoption of additional GRT increments.

Total general fund revenues grew by a compound annual growth rate (CAGR) of 3.4% for the 10-year period ending fiscal 2016, a rate in excess of U.S. 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 1.10 mills in remaining property tax margin which it can impose without a voter referendum. The additional revenue from the unutilized property tax mills totals $17.6 million or 6.8% 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 $575,000 (0.2% of spending) for the county in fiscal 2016, and is projected to grow to $12.6 million by fiscal 2030. 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.

After imposing two 1/8% hold-harmless GRT increments through fiscal 2017, the fiscal 2018 budget imposed the last remaining 1/8% hold-harmless increment, effective Sept. 1, 2017. Concurrently, the county imposed the last remaining 1/16% GRT increment for general purposes. The aggregate revenue increase to the general fund in the fiscal 2018 budget totals $25 million (8.9% of general fund revenues).

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 other post-employment benefits (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 7% of personal income. The large majority of the overall burden is comprised of overlapping debt.

Aggregate direct GO and GRT debt totals $269 million and the 10-year amortization rate is rapid at 74%. 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 2017A GRT bonds will finance the purchase and renovation of an office building that will allow the county to consolidate 1,100 administrative employees from various locations. The county currently does not have plans to further leverage the GRT with additional bonds.

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 $451 million (adjusted to reflect a 6% rate of return assumption) or 1.7% of personal income.

Operating Performance

The county's high gap closing capacity 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, which is well above the 2% reserve safety margin needed to achieve 'aaa' financial resilience.

Financial reserves remained ample relative to expected revenue volatility 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. Management projects another operating surplus in fiscal 2017. The fiscal 2018 budget is balanced and includes $25 million in additional revenue from the adoption of the last remaining 1/8% hold-harmless GRT and 1/16% operating GRT ($18 million of which has been ear-marked for public safety).

Revenue Stream Analytical Conclusion

Debt service on the GRT revenue bonds is paid from the county's first and second 1/8% GRT for general purposes, excepting $1 million annually for indigent care, and the county's first and second 1/8% hold-harmless GRT. The 1/8% hold-harmless GRTs were added to the bonds' pledged revenues in fiscal years 2016 and 2018. The most recent expansion is projected to increase pledged revenues by $16.5 million or 37.5%.

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 compound annual growth rate (CAGR) of 2.4%, a rate below U.S. GDP but above inflation, due to its position as a Sun Belt economy that is projected to experience above average population growth and economic expansion.

Legal provisions provide strong bondholder protections in the form of a 2x maximum annual debt service (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 $16.8 million by a high 3.6x. Limited leveraging plans and the county's reliance on excess GRTs for operations leads Fitch to expect coverage well above the ABT of 2x. Fitch estimates that the structure could tolerate a large 72% drop in pledged revenues before MADS coverage reaches 1.0x. The 72% decline is equivalent to a high 20x the scenario results and 7.3x the largest actual revenue decline in the review period.

Issuing Entity Exposure

Fitch does not view the pledged sales taxes 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. As a result, the rating on the GRT revenue bonds is capped at the county's IDR.

Contact:

Primary Analyst
Jose Acosta

Senior Director
+1-512-215-3726
Fitch Ratings, Inc.
111 Congress Avenue
Austin, TX 78701

Secondary Analyst
Nancy Rocha
Director
+1-512-215-3741

Committee Chairperson
Karen Ribble
Senior Director
+1-415-732-5611

Media Relations: Benjamin Rippey, New York, Tel: +1 646 582 4588, Email: benjamin.rippey@fitchratings.com.

Additional information is available on www.fitchratings.com

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. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1030592)
Solicitation Status (https://www.fitchratings.com/site/pr/1030592#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.