Maricopa County, Arizona

Certificates of Participation

New Issue Report

Ratings

New Issue

Certificates of Participation, Series 2015	AA+

Rating Outlook

Stable

Related Research

Fitch Affirms Maricopa County (AZ) GOs & Lease Revs; Outlook Stable (March 2015)

Analysts

Rebecca C.Moses
+1 512 215-3739
rebecca.moses@fitchratings.com

Yueping Liu
+1 415 732-5629
yueping.liu@fitchratings.com

New Issue Details

Sale Information: $200,000,000 Certificates of Participation, Series 2015, scheduled to sell via negotiation on June 9.

Security: Lease payments from Maricopa County (the county) to the trustee, subject to annual appropriation by the county.

Purpose: To fund various prioritized capital projects and to pay related costs of issuance.

Final Maturity: July 1, 2018.

Key Rating Drivers

Positive Tax Base, Trends: Further modest strengthening of the local economy is marked by continued improvement in employment, development activity and sales tax metrics. Assessed valuation (AV) has begun to realize modest, positive traction after a period of sizable recessionary declines. Fitch Ratings anticipates a similar pace of economic recovery over the near term and believes long-term prospects are positive given the area's history of attracting businesses and residents.

Solid Overall Reserves: General fund reserves and liquidity have declined from pre-recessionary highs due to sizable annual pay-as-you-go capital spending, but remain healthy. Available balances outside the general fund provide added financial flexibility, which Fitch would expect at this high rating level. Management's historically conservative and proactive fiscal practices give Fitch comfort that general fund reserves will be restored as planned, despite pressure from a high level of constitutionally mandated spending.

One-Notch Rating Distinction: The one-notch distinction between Fitch's implied unlimited tax general obligation rating of 'AAA' and the certificates of participation (COPs) is a function of the COP lease structure, the payments for which are subject to annual appropriation. Fitch believes the incentive to appropriate is enhanced by the essentiality of the leased assets that would be forfeited under rights to a 20-year ground lease in the event of non-appropriation.

Moderate Liabilities: The overall debt burden is slightly above average. Carrying costs are expected to remain low due to the county's practice of financing capital needs largely on a pay-as-you-go basis; this practice should offset expected increases in contributions to the weakly funded public safety pension program.

Rating Sensitivities

Deterioration of Financial Cushion: Material deterioration of reserve levels that provide substantial financial flexibility or evidence of structural budgetary imbalance could signal a fundamental shift in the county's credit profile. The Stable Rating Outlook reflects Fitch's expectation this is unlikely over the coming review cycle.

Rating History — Lease Revenue and COPs

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	6/1/15
AA+	Affirmed	Stable	3/24/15
AA+	Affirmed	Stable	3/27/13
AA+	Affirmed	Stable	4/1/11
AA+	Assigned	Stable	4/25/07

Credit Profile

Maricopa County is the economic and population center of Arizona, encompassing Phoenix and surrounding suburbs within its large, roughly 9,000-square-mile boundary. Phoenix was the nation's fastest-growing major U.S. city from 1990–2000, with a 34% population increase. County population totals about 4 million residents currently, making it the fourth-most populated county in the U.S. Local income/wealth levels exceed the state by about 10% and are generally comparable with the nation. Educational attainment is also in line with the national rate.

Moderately Paced Economic Recovery Ongoing

The large and fairly diverse economy continues to recover since the low point of the Great Recession, which saw one of the most severe housing market collapses in the U.S. Unemployment edged down to 4.7% in March 2015 from 6.1% the year prior, balanced against nearly 2.5% labor force growth over the same time period. Education/healthcare, professional/business and leisure/hospitality service sectors have led much of the county's recent employment growth. The county is also poised to realize further growth in the near term from a number of high-profile business expansions either under way or anticipated (Apple, State Farm, Northern Trust and Microsoft).

Further improvement in home values (median home value in the Phoenix metro area rose to $195,000 in fiscal 2015, or about 15% year over year) and an active multifamily construction market in downtown Phoenix also contribute to Fitch's expectations of continued modest economic expansion over the near term.

Positive Tax Base Gains

The county has begun to realize modestly positive tax base growth after a period of sizable tax base decline (fiscal years 2011–2014) that was largely attributable to minimal new construction and significant home value declines. Primary assessed valuations (PAV), which lag market values by two years and from which the county's operating revenue is determined, fell by a cumulative 36% from the prior peak of $49.7 billion in fiscal 2010.

AVs regained modest, positive traction with a nearly 5% gain in fiscal 2015 and are projected to add another 3% in fiscal 2016; new construction and tax base appreciation contributed about equally to the respective year's gains. Top 10 taxpayer concentration remains modest at 6% of the total.

Property Value and Tax Revenue Trends

($000, Audited Fiscal Years Ending June 30)

	Primary Assessed Valuation	% Change	State-Shared Sales Taxes	% Change	Property Taxes	% Change
2010	49,675,117	10.7	386,285	(2.2)	605,041	7.1
2011	46,842,819	(5.7)	385,487	(0.2)	598,410	(1.1)
2012	38,492,098	(17.8)	400,454	3.9	580,860	(2.9)
2013	34,263,842	(11.0)	418,642	4.5	512,512	(11.8)
2014	31,996,205	(6.6)	447,542	6.9	475,803	(7.2)
2015	33,519,795	4.8	N.A.	—	N.A.	—
2016	34,623,670	3.3	N.A.	—	N.A.	—

N.A. – Not available.

Related Criteria

Tax-Supported Rating Criteria (August 2012)

U.S. Local Government Tax-Supported Rating Criteria (August 2012)

Fitch believes further tax base growth is likely given the aforementioned development and business investment trends, but will be similarly moderated in light of the recent change to the property assessment process. Proposition 117, which was approved by Arizona voters in November 2012 as a constitutional amendment, now tempers the prior years' steep tax base swings. Annual increases in existing property values are limited to 5% beginning in fiscal 2016 (2014 real property valuations), excluding the increase associated with any new construction.

Finances Remain Sound Despite Reduced General Fund Position

The county's financial profile is sound despite recent economic pressures and their impact on various revenue sources. Fitch views management's strong and historically prudent fiscal practices that include conservative revenue estimates and multiyear financial/economic forecasting as a key contributor to these results.

County operations are funded by a fairly diverse revenue stream, led by state-shared sales tax and vehicle license tax revenues (55% of fiscal 2014 general operating revenues), followed by local property taxes at 40%. The county also benefits from a countywide sales tax levy approved by voters to fund jail operations. General operating revenues totaled $1.1 billion in fiscal 2014 and have trended generally flat on a year-over-year basis since 2010.

Annual expenditures consist of a number of constitutionally mandated services, as well as periodic shifts in county funding responsibility given the state's recurring budget challenges. Management leaned heavily on spending reductions starting in fiscal 2008 through fiscal 2013 (totaling about $170 million) in order to maintain its financial position, although budgets in fiscal years 2014 and 2015 have subsequently restored about one-half of the prior years' cuts. Expenditure cuts also served to largely offset the board's decision not to utilize the full value of an increased operating tax levy allowable due to much-reduced PAV. The county is limited to a 2% levy increase year to year, excluding gains from new property.

Operating reserves have steadily declined from prior highs; the unrestricted general fund balance totaled $121.2 million, or 10% of spending at June 30, 2014, down from $258.6 million, or 24% of spending at fiscal 2013 year end. However, Fitch takes comfort in the sizable capital reserves outside but available to the general fund that preserve the county's flexibility (despite planned use over time). About one-half of the large, annual drawdowns on reserves since fiscal 2011 were directed to fund nonrecurring capital spending as the county continues its practice of funding sizable capital needs from available resources.

The $1.1 billion fiscal 2015 operating budget was adopted as structurally balanced and assumed a somewhat higher 5%–6% estimate of growth in certain economically sensitive revenues. Spending was up by roughly 4%, or $64 million from the prior-year's revised budget largely due to criminal justice needs and state mandates. Performance pay increases that averaged 2.5% for the workforce were also included to maintain competitive salaries. The moderate $0.04 per $100 AV increase to the fiscal 2015 property tax levy remained significantly below the maximum levy allowed and is expected to generate about $33 million, or 7.5% in increased property tax revenue. Nonrecurring spending was addressed with the budgeted use of fund balance, which must be included in next year's spending according to state statute.

General Fund Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2010	2011	2012	2013	2014
Revenues	1,082,717	1,097,469	1,100,410	1,067,858	1,076,640
Expenditures	767,290	807,656	850,846	841,029	880,955
Operating Surplus/(Deficit)	**315,427**	**289,813**	**249,564**	**226,829**	**195,685**
Transfers In/Other Sources	3,338	1,479	1	0	2,138
Transfers Out/Other Uses	(239,837)	(371,272)	(375,566)	(251,604)	(335,307)
Net Transfers and Other Source/(Uses)	(236,499)	(369,793)	(375,565)	(251,604)	(333,169)
Net Operating Surplus/(Deficit) After Transfers	**78,928**	**(79,980)**	**(126,001)**	**(24,775)**	**(137,484)**
Total Fund Balance	509,524	429,402	302,935	277,830	140,973
As % of Expenditures and Transfers Out	50.6	36.4	24.7	25.4	11.6
Unreserved/Unrestricted Fund Balance	489,010	409,029	283,012	258,686	121,203
As % of Expenditures and Transfers Out	48.6	34.7	23.1	23.7	10.0

Notes: Numbers may not add due to rounding. GASB 54 was implemented in fiscal 2011.

Year-to-date management reports revenue trends are running slightly above budget by 1%, while expenditures are trailing budget by about 9%. Current projections are for a year-end general fund balance at approximately $83 million, or about 7% of general operational spending. This modest level of reserves is bolstered by an estimated $430 million in reserves at fiscal 2015 year end set aside for future pay-as-you-go capital projects that could support other spending priorities, as needed.

Looking ahead, management's preliminary five-year financial forecasts anticipate structural operating balance with a reasonable net growth rate of 5% in recurring revenues and spending. However, the forecast does not include likely budgetary challenges from further state mandates, which recently grew by $14 million, or 1% of general operations for fiscal 2016. The county also forecasts a widening budget gap in the detention fund from additional recurring costs.

Nonetheless, Fitch believes the projections are generally conservative and takes comfort from management's historically prudent fiscal practices, evidenced in the fiscal 2016 budget. Fitch will also monitor the success of the board's recent decision to rebuild general fund reserves to two months, or 17% of spending. This is currently projected to be accomplished by fiscal 2016 year end, well ahead of management's previously established schedule.

Moderate Long-Term Liabilities

The overall debt burden remains above average at approximately $4,530 per capita and 5.3% of market value despite recent AV gains. This is in contrast to the county's direct debt position, which is modest due to cash-funding most capital projects, including the new $85 million Maricopa County Sheriff's Headquarters that was recently completed. The county's five-year capital plan (fiscal years 2015–2019) totals approximately $900 million, with transportation and technology as the largest components. This issuance funds most of the approximately $290 million in capital projects (largely technology needs) previously identified by management to be debt financed.

The county has no GO debt outstanding. Principal amortization of this issuance and the county's outstanding lease revenue bonds is rapid at 85%. The lease structure that governs the COPs has characteristics that Fitch considers standard, including essential leased assets, which the trustee can repossess through rights to a 20-year ground lease, in the event of non-appropriation or default.

Below-Average Pension-Funded Position

The county participates in four retirement plans, the largest of which is the Arizona State Retirement System (ASRS), which includes disability, death and healthcare benefits and is a cost-sharing, multiple-employer plan. Contributions for all four plans are statutory, but also based on actuarial assumptions. The county consistently contributes 100% of the annual pension/other post-employment benefits cost for all four plans, although the pension funded positions remain below average to weak.

The overall ASRS funded position at year-end fiscal 2014 held fairly steady at about 75%, which was a below-average 68% using the Fitch-adjusted 7% discount rate. Also, the June 30, 2014 funded position for the other three agent multiple-employer plans ranged from a very low 40% to just under 60% (before adjusting for the more conservative 7% discount rate). Carrying costs are very low, totaling 6% of total governmental funds in fiscal 2014 and are expected to remain manageable even with planned increases to the employer contribution for the public safety pension program over the near term.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.