Fitch Affirms Maricopa County (AZ) GOs & Lease Revs; Outlook Stable Ratings Endorsement Policy

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Fitch Ratings-Austin-24 March 2015: Fitch Ratings affirms the ratings on Maricopa County, Arizona's outstanding debt as follows:

--$108.9 million outstanding Public Finance Corporation lease revenue bonds at 'AA+';
--Unlimited tax general obligation (ULTGO) bond rating (implied) at 'AAA'.

The Rating Outlook is Stable.

SECURITY:
The lease revenue bonds are secured by lease payments from the county to the corporation, subject to annual appropriation by the county. The bonds are further secured by a cash-funded debt service reserve fund.

KEY RATING DRIVERS

POSITIVE TAX BASE, ECONOMIC 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 sizeable recessionary declines. Fitch 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 sizeable annual pay-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.

STANDARD SECURITY PROVISIONS: Although lease payments are subject to annual appropriation, Fitch believes the incentive to appropriate is enhanced by the essentiality of the leased assets that would be forfeited in the event of non-appropriation. The cash-funded debt service reserve fund provides protection against any temporary disruption in payment.

MODERATE LIABILITIES; FIXED BURDEN LOW: 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-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 Outlook reflects Fitch's expectation this is unlikely over the coming review cycle.

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 to the nation. Educational attainment is also in line with the U.S.

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 5.7% in January 2015 from 6.2% the year prior, balanced against nearly 3.5% labor force growth over the same time period. Education/health care, 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 underway or anticipated (Apple, State Farm, Northern Trust, 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 multi-family 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 sizeable tax base decline (fiscals 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.

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 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 REMAINS 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 multi-year 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 county-wide 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 2014 and 2015 have subsequently restored about 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 $259 million or 24% of spending at fiscal 2013 year-end. However, Fitch takes comfort in the sizeable capital reserves outside but available to the general fund that preserve the county's flexibility (despite planned use over time). About half of the large, annual drawdowns on reserves since fiscal 2011 were directed to fund non-recurring capital spending as the county continues its practice of funding sizeable 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 $0.05 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. Non-recurring spending was addressed with the budgeted use of fund balance, which must be included in the next year's spending according to state statute.

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 $85 million or about 7.4% of general operational spending. This modest level of reserves is bolstered by another $315 million in reserves 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 $20 million or 2% 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. Fitch will also monitor the success of the board's recent decision to rebuild general fund reserves to two months or 17% of spending over the next five fiscal years.

MODERATE LONG-TERM LIABILITIES
The overall debt burden remains above-average at approximately $4,550 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 (fiscals 2015-2019) totals approximately $616 million with transportation and technology as the largest components. Management expects to issue about $266 million in the near term primarily for technology needs, which should allow the county to preserve some of its capital reserves.

The county has no GO debt outstanding. Amortization of the county's outstanding lease revenue bonds is somewhat above average at 60%. The lease structure that governs the outstanding lease revenue bonds has characteristics that Fitch considers standard, including essential leased assets, which the trustee can repossess 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 (CSME). Contributions for all four plans are statutory, but also based on actuarial assumptions. The county consistently contributes 100% of the annual pension/OPEB 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 (AME) 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.

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In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, Case-Shiller Index, and IHS Global Insight.

Applicable Criteria and Related Research:
'Tax-Supported Rating Criteria', Aug. 14, 2012

'U.S. Local Government Tax-Supported Rating Criteria', Aug. 14, 2012

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Additional Disclosure
Solicitation Status