Moody's Investors Services

Global Credit Research
Rating Update
30 APR 2009

Rating Update: Maricopa (County of) AZ

MOODY'S AFFIRMS MARICOPA COUNTY, ARIZONA, ISSUER RATING OF Aa1 WITH STABLE OUTLOOK

COP RATINGS ALSO AFFIRMED

County
AZ

Opinion

NEW YORK, Apr 30, 2009 -- Moody's Investors Service has affirmed the Aa2 lease revenue bond rating and Aa1 issuer rating with a stable outlook for Maricopa County, Arizona. The Aa3 rating on the county's certificates of participation, Series 2000, was also affirmed. The rating affirmations recognize the severe economic stress currently experienced in the state and region, but also reflect the County's strong financial position resulting from conservative management practices, a favorable direct debt profile, and one of the largest tax bases for a large, urban county in the U.S. These credit factors help position the county as it faces significant challenges in the next few years including a difficult operating revenue environment, potential expenditure shifts from the state and potentially large declines in assessed value that could have a direct impact on operations.

ECONOMY OF THE 4TH LARGEST COUNTY IN THE U.S. EXPERIENCES STRESS FOLLOWING PERIOD OF RAPID EXPANSION

Maricopa County is the fourth largest county in the U.S. with nearly 4.0 million residents, or roughly 62% of Arizona's (issuer rating Aa3 stable outlook) total population. In 2006, Arizona was the fastest growing state in the nation and the county directly benefited from the strong in-migration with nearly 76% of the state's population growth from 1996 to 2006 occurring in the Phoenix metropolitan area. Correspondingly, tax base growth has been very strong, averaging 18.0% over the last five years with an extraordinary 43.2% increase in 2008 alone, pushing the total value to $516.7 billion in 2009. Wealth indices for the county remained fairly stable relative to the state and U.S. in the mid-decade census. As of the 2005-2007 census, per capita and median family incomes measured 101.3% and 105.1% of the U.S., respectively, which is consistent with other peer-rated, large, urban counties.

The housing driven recession prompted a rapid contraction in the local economy with rising unemployment and corresponding declines in consumer spending. As of February 2009, unemployment rates for the county continued to rise, but were still below the state and the nation at 6.7% compared to 7.4% and 8.9%, respectively. The local housing market remains weak with foreclosure sales contributing to already high home inventories. Due to state statutes that result in a two year timing lag, the impact of the current housing market correction will not become evident in assessed and full market values until the 2010 and 2011 property valuations. Forecasts prepared by the county indicate a worst case 16.2% cumulative decline in secondary assessed value from FY09 to FY11, significantly greater than historical trends. Only during the fiscal years 1992 to 1994 did the county experience decreases in its AV averaging 2.9% annually, due to a statewide methodology change. While the county's taxable values will likely decline somewhat over the next few years, the county's current base is amongst the largest for an Aa1-rated county in the U.S. having more than doubled in size since 2005 and, as such, can withstand moderate levels of declines. It is expected that the region will emerge from the recession in a good position for growth over the long term given its strong research base and with the recession restoring the area's affordable housing and low business costs.

As property tax revenues comprise nearly 40% of the county's operating revenues, the decline in assessed values could have budgetary implications for the county beginning in FY11. According to the state constitution, operating or primary tax levy dollars for counties, cities and community college districts are limited by an amount that grows by 2% each year plus new construction from a base year of FY2005-06. The levy limit increases each year regardless of use, so there is no loss of future capacity if the jurisdiction does not levy to its limit. Historically, the county's board has approved budgets that have allowed the county to fully capture the maximum allowed levy growth. However, in a declining assessed value environment, this would require increasing the primary tax levy rate which may be politically difficult. While the board's policy decision on this matter is unknown at this time, county management has prudently developed budgets that consider different revenue assumptions.

CONSERVATIVE FISCAL MANAGEMENT ENSURES FISCAL STABILITY

Maricopa County's financial operations can be characterized by prudent, long-term financial planning, with regular and frequent re-assessments. Such practices combined with prudent contingency policies supports Moody's expectation that the County will continue to maintain sound and stable operations that can withstand transitions in both economic conditions and management. Over the last five years, the County has maintained an average general fund balance equal to 41.2% of revenues, the bulk of which has remained unreserved and undesignated. Audited FY08 results were consistent with this trend at $533.6 million (45.2% of revenues), with $512.1 million unreserved. In FY07, the county did reduce the ending balance by $95 million with a notably larger than historical increase to expenditures, reflecting a larger than typical transfer out of $410 million (twice the size of historical transfers) to the capital projects fund for the court tower project as well as increased costs related to employee compensation ($60 million), ALTCS ($20 million) and mental health ($11 million). Expenses were moderated the following year as a result of a freeze on hiring and capital spending. Including the county's detention operations fund, the county's total available operating balance for FY08 is significant in size and amongst the largest compared to other Aa1-rated urban counties in the U.S. at $689.2 million (50.6% of revenues).

BUDGET CHALLENGES AHEAD WITH WEAKER REVENUE FORECASTS AND POTENTIAL EXPENDITURE SHIFTS FROM THE STATE

Going forward, the county faces a number of difficult budget challenges in the near and medium-term including declines in both local and state shared revenues, potential expenditure shifts from the state as it addresses its own budget pressures, and declining assessed valuations. Mitigating these challenges are the county's strong fiscal management including sound fiscal policies, multi-year financial forecasting with conservative revenue projections, and a demonstrated willingness and ability to make expenditure reductions as necessary. Furthermore, the sizeable FY08 ending reserves leave the county well positioned to address these difficult challenges.

The county's revenue structure relies heavily on state shared sales taxes (39% of FY09 Revised GF and Detention Fund Revenues), a local sales tax for jail operations (37%), property taxes (39%), and state shared vehicle license taxes (12%). As of February 28, 2009, state shared sales tax collections were $26.5 million below FY09 budget (8.6%) and 10.5% below FY08 levels. Jail excise tax revenues were also $9.4 million below budget (10%) or 12% below FY08 levels. Nevertheless, officials project balanced operations for FY09 reflection over $115 million in expenditure cuts including elimination of 446 FTE or 3% of the workforce, followed by an additional elimination of 47 positions in October 2008 and a continued freeze on hiring and capital spending. It is noted that $177 million of reserves were appropriated for capital projects, $144 million of which has been transferred year to date. Officials do not expect to utilize the full appropriation given the freeze on capital spending and cash flow timing of projects. The county also maintains a designated general fund and detention fund reserve balance equal to 15% and 20%, respectively, to provide for budget stabilization. County management has and is expected to continue to maintain reserve levels in excess of this amount including additional reserves for liquidity management, self funded benefits, and pay-as-you-go capital projects. Management also budgets in the both the general and detention fund an extra reserve of roughly $35 and $29 million respectively. Ten and five year forecasts are prepared externally and internally, respectively, and, in fiscal 2003, management revised its procedures to base budget revenues on the most pessimistic scenario. As a result, the County's operating surpluses were quite significant in the last two years. As the County's economy and corresponding revenue streams, transitions to through the current economic recession, management has actively revised budget forecasts and associated expenditures.

COUNTY REMOVES ITSELF FROM HOSPITAL OPERATIONS AND ROLE AS HEALTH PLAN PROVIDER; EXPENDITURE MANDATES STILL REMAIN, BUT APPEAR MANAGEABLE

Since 2003, the County has achieved several key milestones which have and will continue to contribute to its long-term financial health. In November 2003, voters approved the creation of the Maricopa County Special Health Care District. Since that time, the District has and is currently levying up to the maximum $40 million annually in property tax revenues to fund its operations and all assets and liabilities with the hospital have been transferred to the District. The County made a modest one time financial assistance loan to the District in 2005 to assist in the transition. However, officials report that the County has no other financial or operating responsibility for the Special Health Care District. Additionally, the County has discontinued acting as a health care plan provider for all three of its plans: Senior Select (which was closed on

12/31/2004), Arizona Long-Term Care System or ALTCS (closed on 9/30/2005), and AHCCCS (which was transferred to the Health Care District on 8/29/2005). The removal of the hospital and health plans as financial and operating responsibilities of the County are key factors contributing to Moody's expectation that operations will remain sound. The operating challenges and complexity associated with these health care expenditures were multifaceted and required the County to make significant operating subsidies, which plagued the County's general fund during the early and mid-1990s when the general fund balance reached deficit levels.

The County continues to face challenges on the expenditure side as the bulk of its remaining expenditures are for mandated programs for which the County's ability to constrain increases is somewhat limited. Key amongst these is public safety, which represented 61.5% of the 2008 combined GF and detention fund expenditures. Importantly, in 2002, voters approved a 20-year extension of the 1/5 of one cent sales tax for public safety beginning by June 2007 to fund operations. Nevertheless, in the last three years, public safety costs have grown at double digit rates; the court tower expansion project looks to address this concern by improving the efficiency of the court system. Public safety costs could potentially be impacted by state spending shifts in the near-term including potentially up to $60 million annually for on-going inmate expenditures. The County's second largest expenditure is state mandated payments for ALTCS and AHCCCS which together, represent 16% of G.F. expenditures in 2008. Costs for ALTCS are shared between the state and counties equally under a formula that grows based upon case load and health care costs, and as such, the County's ALTCS payments have grown rapidly and represent an area subject to potential expenditure shifts from the state. The county is actively working to reduce this exposure through negotiations with the state. AHCCCS payments are also mandated but capped at a fixed dollar amount of $24.5 million.

MAINTENANCE OF FAVORABLE DEBT PROFILE GIVEN MODEST FUTURE BORROWING

Moody's expects the County's debt profile to remain favorable given moderate future borrowing plans, expected tax base growth, and average principal payout (46.1% in ten years). Counties typically have modest debt burdens, but even in this setting Maricopa County's debt burdens are amongst the lowest in its peer group with direct and overall levels at 0.1% and 2.4%, respectively. The County's direct net debt is less than $288 million, translating into a very modest debt per capita ratio of $74. Traditionally, the County has generally funded the bulk of its capital needs on a pay-go basis and management expects this practice to continue. Officials anticipate issuing an additional $297 million in certificates of participation in 2009 to complete improvements to the court expansion project. Positively, all of the county's long-term bond obligations are fixed-rate and the county has no exposure to derivatives.

Outlook

The outlook on Maricopa County's long-term rating is stable. The outlook primarily incorporates the expectation that the Board will maintain reserves at levels as specified within its policies as it faces a number of budget challenges including reduced state shared revenues, potential expenditure shifts from the state, and declining assessed values. Future credit evaluations will continue to closely monitor revenue collections, expenditure shifts from the state and the Board's willingness and ability to maintain a balanced budget. Moody's will continue to monitor the county's tax base trends, commenting as warranted. While unlikely, a significant deterioration in assessed values, combined with a forecast of a prolonged weak economy and a trend of operating deficits, could result in downward rating pressure over time.

KEY STATISTICS

2007 Estimated population: 3.9 million

2009 Full value: $516.7 billion

2005-2007 Per capita income: $26,510 (+/-195) (101.3% of U.S.)

2005 Median family income: $63,425 (+/-650) (105.1% of U.S.)

Full value per capita: $133,158

Direct debt burden: 0.1%

Overall debt burden: 0.6%

FY08 General Fund Balance: $533.6 million (45.2% of revenues)

FY08 Balance for General and Detention Operation Funds ($689.2 million (50.6% of revenues)

County Unemployment Rate February 2009: 6.7% (7.4% Arizona, 8.9% U.S.)

The last rating action was on April 26, 2007 when the underlying rating for the County's lease revenue bonds was upgraded to Aa2 from A1.

The principal methodology used in rating the current offering was Local Government General Obligation and Related Ratings, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Rating Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

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