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Ratings

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Summary:

Albuquerque, New Mexico; General Obligation

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Credit Profile		
US$84.225 mil gen purp bnds ser 2018A due 07/31/2031		
Long Term Rating	AAA/Stable	New
US$6.975 mil storm swr bnds ser 2018B due 07/01/2018		
Long Term Rating	AAA/Stable	New
Albuquerque GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Albuquerque, N.M.'s series 2018 A and B general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the city's existing GO bonds. The outlook is stable.

The bonds constitute valid obligations of the city, and our rating reflects the city's pledge of unlimited ad valorem property taxes levied on all taxable property in Albuquerque. We understand that the series A bonds will be used to finance certain city projects related to public safety, public transportation, and other public facilities, and that the series B bonds will be used to finance certain storm and sewer improvements.

The city's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above the Sovereign--Corporate and Government Ratings: Methodology and Assumptions," U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived revenues are the source of security for the bonds, and the institutional framework in the U.S. is predictable with significant U.S. local government autonomy. In a potential sovereign default scenario, U.S. local governments would maintain financial flexibility through the ability to continue collecting locally derived revenues and U.S. local governments have independent treasury management.

The GO rating reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level in fiscal 2017, that we believe will be supported by the city council's recent vote to increase its local gross receipts tax (GRT) rate;
- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 11.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 58.6% of total governmental fund expenditures and

5.5x governmental debt service, and access to external liquidity we consider strong;

- Weak debt and contingent liability position, with debt service carrying charges at 10.7% of expenditures and net direct debt that is 109.9% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation, but rapid amortization, with 74.3% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Strong economy

Albuquerque is located in Bernalillo County, and its estimated population of 565,000 represents nearly one-third of the state's total population. The city is the economic and cultural hub of the state, and we consider the eponymous MSA to be broad and diverse. The city's projected per capita effective buying income for 2021 is 94.3% of the national level, and its market value per capita increased to above $80,000 in fiscal 2018. As a result, we have revised our assessment of the local economy to strong from adequate.

The city's economic base is diverse and includes manufacturing (Intel, Honeywell Aerospace, General Mills), technology (Raytheon), federal and military institutions (Sandia National Labs, Kirtland Air Force Base, the Air Force Research Laboratory), higher education, healthcare, and back-office centers for major multi-national corporations. The tourism and leisure sector, in particular, has seen rapid growth in the past three years and is becoming a major component of the local economy. This diverse base, as well as the city's central role in the statewide economy, helped stabilize employment during the Great Recession: The county unemployment rate peaked at 7.7% in 2010, and has decreased to 5.7% for the year ended November 2017 (below the statewide rate, but higher than the national rate). At the MSA level, nonfarm payrolls grew by 1.7% in fiscal 2017--led by construction, education and health services, and leisure and hospitality--and the University of New Mexico Bureau of Business and Economic Research projects overall job growth of 1.1% annually for the next five years.

The city's main tax bases were relatively stable during the recession, further reflecting the city's centrality to the state economy. Taxable gross receipts (the base for its gross receipts tax, or GRT) declined by 9.1% from fiscal 2008 to fiscal 2010, and have since grown by 2.3% annually (through fiscal 2017). The city's total assessed value (which is defined as one-third of market value less any exempted property) declined by 3.4% from fiscal 2010 to fiscal 2013, and has since grown by 2.2% annually (through fiscal 2018). Looking ahead, we expect the city's economy and tax base to remain stable.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights of the FMA include the city's:

- Utilization of internal trend analysis and external information to make revenue and expenditure assumptions, and assessment of current trends that may affect future results;
- At least quarterly budget-to-actual reporting to the council;
- Five-year general fund projections that are updated annually;
- 10-year capital improvement plan that is updated every two years (when voters provide new GO authorization);

- Investment management policy with quarterly investment reporting to the council;
- Debt management policy that discusses projects that may be funded with debt, maturities, debt structures, credit enhancements and derivatives, and refunding guidelines; and
- Formal fund balance policy requiring a minimum 1/12 general fund balance for cash flow purposes, to which the city has historically adhered.

Adequate budgetary performance

Albuquerque's budgetary performance is adequate in our opinion. The city had slight deficit operating results in the general fund of 0.5% of expenditures, and deficit results across all governmental funds of 2.6% in fiscal 2017. General fund operating results of the city have been stable over the last three years, with a result of negative 0.7% in 2016 and a result of 0.0% in 2015. We note that we have adjusted general fund and total governmental funds budgetary figures for recurring transfers in and out, a decrease in reported debt service expenditures due to an accounting change, and bond-financed expenditures.

Our forward-looking view of the city's budgetary performance has been bolstered by the council's March 5 decision to increase the local GRT rate by 3/8 of a percentage point (as of the writing of this article, the mayor had not yet signed the tax increase, but we expect that he will do so). We expect that this tax increase will counteract budgetary pressure the city has been facing due to the state's phase-out of "hold harmless" payments to cities. These payments originated in 2004, when the state exempted food and medical expenses from the GRT (including local GRT levies), which made the tax less regressive but also reduced local GRT revenues. In order to limit the negative fiscal effects of this policy change on local governments, the state made annual hold harmless payments to cities and counties equal to their lost GRT revenue from the exempted food and medical expenses. In 2015, however, the state began phasing out these hold harmless payments over a 15-year period, but also gave local governments the option to increase their local GRT rate by 3/8 of a percentage point in order to recoup the lost revenue. Until March 5, Albuquerque was one of the few cities in New Mexico that had not exercised this option.

The gradual loss of the hold harmless revenues, along with the new mayoral administration's plans to increase spending on public safety (in response to a shortage of police officers and an associated increase in the crime rate), has led to a projected general fund deficit of 3.2% of expenditures for fiscal 2018. Although the increased GRT rate will not go into effect until the beginning of fiscal 2019 and therefore will not affect fiscal 2018 performance, we expect that it will significantly increase the city's ongoing revenues and allow it to achieve stable general fund and total governmental funds results beginning in fiscal 2019. (As context, the GRT accounted for about 25% of general fund revenues in fiscal 2017, compared to 16% for property taxes.)

Strong budgetary flexibility

Albuquerque's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 11.4% of operating expenditures, or $58.4 million. While we expect that the city's projected budgetary deficit for fiscal 2018 will lead to a drawdown of available fund balance--possibly to slightly below our threshold for adequate budgetary flexibility--we view this as a largely one-time event due to the city council's decision to raise the GRT rate. The city estimates that the GRT increase will generate an additional $52 million in revenue on an ongoing basis, which is much more than the city's projected fiscal 2018 general fund balance drawdown of $17.5 million. Given the city's historical practice of maintaining available balances above both its policy minimum and the threshold for levels we consider strong, we expect that it will use a portion of the additional GRT revenues to rebuild its available balance should it fall below our threshold.

Very strong liquidity

In our opinion, Albuquerque's liquidity is very strong, with total government available cash at 58.6% of total governmental fund expenditures and 5.5x governmental debt service in 2017. We believe the city has strong access to external liquidity, given its issuances of GO bonds in the past 20 years. We believe that the city's available cash is unlikely to fall below our thresholds in the coming years. The city's investments are held in high-grade securities as regulated by the city's investment policy, and we do not consider its investment exposure aggressive. Additionally, we note that the city issued $25.1 million in private placement debt in July 2017; we have reviewed the documentation for this debt and found that the events of default and payment provisions are standard, so we do not believe that it represents a significant liquidity risk.

Weak debt and contingent liability profile

In our view, Albuquerque's debt and contingent liability profile is weak. Total governmental fund debt service is 10.7% of total governmental fund expenditures, and net direct debt is 109.9% of total governmental fund revenue. Approximately 74.3% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor. We have adjusted the debt service figure reported in the city's fiscal 2017 audit, which was much lower than reported in previous years due to a change in accounting practice (recognizing debt payments on a July 1 due date). We do not believe that the city's debt burden has decreased from an analytical viewpoint.

In our opinion, a credit weakness is Albuquerque's large pension and OPEB obligation. Albuquerque's combined required pension and actual OPEB contributions totaled 9.8% of total governmental fund expenditures in 2017. Of that amount, about 8.7% represented required contributions to pension obligations, and about 1.0% represented OPEB payments. The city made its full annual required pension contribution in 2017.

The city participates in the Public Employees Retirement Assn. (PERA), a cost-sharing, multiple-employer, defined-benefit retirement plan. PERA's funded ratio was 73.7% as of June 30, 2017, which we view as somewhat low. Additionally, we consider some of PERA's funding policies and actuarial assumptions to be risky. In particular, the plan effectively has no amortization schedule--instead, it calculates its amortization period annually based on statutory contribution rates and actuarial assumptions. As of the plan's 2017 actuarial valuation, the amortization period was 55 years, which we view as very long. Additionally, the plan projects its mortality tables out only one year, which we view as a risky mortality assumption. Nevertheless, we believe that Albuquerque's current practice of paying for a portion of its employees' pension contributions is a source of potential pension flexibility, as it could discontinue these payments if needed.

The city's OPEBs consist of a life insurance benefit plan, to which it makes annual contributions intended to amortize the unfunded liability over 30 years (the plan's funded ratio was 30.5% as of fiscal 2017), and a retiree health care plan that it funds on a pay-as-you-go basis.

Very strong institutional framework

The institutional framework score for mayor-council municipalities in New Mexico that are required to produce annual audits is very strong.

Outlook

The stable outlook reflects our expectation that Albuquerque's economy will continue to improve gradually, bolstered by its central role in the statewide economy. Additionally, we believe that its recent increase to the GRT rate will resolve its budgetary imbalance and allow it to quickly recover from any potential drawdown of its available fund balance in fiscal 2018. Accordingly, we do not expect to change the rating within the next two years.

Downside scenario

We could lower the rating if the city were to increase ongoing expenditures--potentially due to pension pressures--to the extent that the GRT increase is insufficient to maintain available fund balances at a level we consider strong over the medium term.

Related Research

2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of March 9, 2018)		
Albuquerque GO		
Long Term Rating	AAA/Stable	Affirmed
Albuquerque GO		
Long Term Rating	AAA/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.