

FITCH RATES ALBUQUERQUE, NM'S GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-Austin-28 March 2019: Fitch Ratings has assigned a 'AA+' rating to the following Albuquerque, NM general obligation (GO) bonds:

- \$14.3 million GO general purpose bonds series 2019A;
- \$12.3 million GO storm sewer bonds series 2019B.

Fitch has also affirmed the 'AA+' on the following city ratings:

- Issuer Default Rating (IDR);
- \$389 million outstanding GO bonds;
- \$250 million outstanding gross receipts tax (GRT) revenue bonds.

The Rating Outlook is Stable.

Proceeds of the GO general purpose bonds and GO storm sewer bonds will finance various public improvements and storm sewer improvements, respectively. The bonds are scheduled to sell competitively on April 3.

SECURITY

The GO bonds are payable from an annual unlimited property tax levy.

The GRT revenue bonds are payable from the 1.225% state-shared GRT levied on all transactions within the city. Certain GRT revenue bonds are also payable from 50% of the city's 5% lodgers' tax.

IDR ANALYTICAL CONCLUSION

The city's 'AA+' IDR and GO bond ratings reflect ample revenue-raising flexibility, demonstrated spending control, a moderate long-term liability burden, and superior gap-closing capacity including established reserve levels.

DEDICATED TAX ANALYTICAL CONCLUSION

The 'AA+' GRT bond rating reflects ample resilience to revenue declines and limited future leveraging plans balanced against sluggish revenue growth prospects.

(SEE BELOW FOR DEDICATED TAX ANALYSIS)

Economic Summary

Albuquerque is the largest city in New Mexico, accounting for about one-quarter of the state's population. The city's population grew rapidly from 2000-2010 although recent growth trends have been very modest, resulting in an estimated population of nearly 559,000 in 2017.

IDR KEY RATING DRIVERS

Revenue Framework: 'aa'

Fitch expects that the long-term pace of revenue growth will likely approximate the rate of inflation as the city continues its prolonged recovery from the previous downturn. Property and gross receipts tax revenue-raising flexibility is ample.

Expenditure Framework: 'aa'

Fitch expects the pace of expenditure growth to be in line or marginally above natural revenue growth. Solid expenditure flexibility is aided by moderate carrying costs for debt service and retiree benefits plus rapid principal amortization.

Long-Term Liability Burden: 'aa'

The combined overall debt and unfunded pension liability burden is at the low end of moderate relative to the city's resource base. Modest direct debt plans and overlapping debt issuances may increase the overall liability burden, but Fitch expects it to remain moderate.

Operating Performance: 'aaa'

Operational flexibility during economic downturns is derived from the city's ample independent revenue-raising ability and solid spending control, supplemented by state-required reserve levels. Fitch expects recent revenue policy actions will allow the city to address its growing public safety needs and maintain superior operating results.

RATING SENSITIVITIES

Shift in Fundamentals: The IDR is sensitive to material changes in the city's strong revenue-raising and expenditure flexibility and superior financial position, which Fitch expects the city to maintain through economic cycles.

Pledged Revenue Declines: Large and sustained gross receipts tax (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 leverage

ECONOMIC RESOURCE BASE

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 about 5% of the MSA's employment base. SNL has helped attract a highly educated workforce to the area but is vulnerable to federal budget restrictions and shifts in defense spending priorities. Fitch expects the magnitude of any potential cuts to the military installations would be tempered due to 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 Honeywell Aerospace), although some contraction is apparent. Intel's workforce in nearby Rio Rancho (IDR rated AA/Stable) has declined to 1,900 from 3,300 since 2013. The film industry in the area has grown to four major studios, one of which was recently purchased by Netflix

The area's recovery from the last economic downturn has been tepid. Employment gains have been modest and the unemployment rate has exceeded the U.S. average. Median home values rose by over 4% to \$201,600 in February 2019 from a year prior according to Zillow.com, but remain below their peak in 2007, as do building permits. IHS Insights anticipates population growth will accelerate in the future along with payroll gains. A growing retiree population is expected to make health care a leading employment sector in the medium-to-long term.

IDR CREDIT PROFILE

Revenue Framework

The city's operating revenues are heavily dependent on municipal and state-shared GRTs which comprise 65% of fiscal 2018 general fund revenues, followed by property taxes (16%). A trend of sluggish GRT revenue growth is likely to continue as recent private investments and associated

job gains are partially offset by the uneven performance of the city's employment sectors such as manufacturing.

Adjusted for property and GRT policy changes, total general fund revenues grew by a CAGR of 1.6% for the 10-year period ending fiscal 2018, a rate equal to CPI, although numerous one-time revenue losses make a clear view of historical trends difficult. Fitch expects the city's long-term revenue growth to approximate the level of inflation (CPI) as the city continues its recovery from the last economic downturn.

The city retains ample revenue flexibility in the form of a 1/2% local-option general purpose municipal GRT (\$76 million or 15% of fiscal 2018 general fund revenues) which it can impose without a voter referendum. The city also has remaining 1.1 mill of operational mill levy underneath its cap which would generate \$15 million (2.8% of revenues) assuming a 97% collection rate.

In fiscal 2016, the state began a 15-year phase-out of its hold-harmless payments to municipalities and counties for the exemption of food and medicine from the GRT. The hold-harmless reduction totaled \$4.6 million (0.9% of fiscal 2017 general fund revenues) for the city in fiscal 2017, and is projected to grow to \$34.5 million (6.8% of revenues) by fiscal 2030. To offset these reductions, the state authorized municipalities and counties 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. The city imposed the entire 3/8th GRT in the fiscal 2019 budget.

Recessionary pressures on the city's revenues were exacerbated by reductions in the local option GRT rate and lapses in GRT levy authority. The city reduced its GRT by 1/8% in fiscal 2008 upon its cancellation of the contract to share the operational costs of the county detention center; reduced its GRT by 1/8% in fiscal 2009 for the purpose of providing tax relief, and authority for a 1/4% GRT lapsed for five months in fiscal 2010.

Expenditure Framework

General fund expenditures are led by public safety which comprised 52% of spending in fiscal 2018.

The city's pace of spending is expected to be in line or modestly above projected sluggish revenue gains as it addresses its growing public safety spending and the service pressures of a population base with a moderately elevated poverty rate.

The city's fixed-cost burden for debt, pension and other post-employment benefits is moderate. Assuming a more conservative, 20-year amortization of the city's net pension liability would require more than doubling actuarial contributions under Fitch's benchmark pension contribution methodology. Flexibility is aided by a very rapid 10-year GO and GRT bond principal amortization rate of 77%. Additional flexibility is provided by the city's annual transfers for capital projects which can be reduced, deferred, or eliminated.

A high percentage of the city's workforce is represented by 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 city's long-term liability burden (comprised of ULT bonds, GRT bonds, overlapping debt, and the net pension liability) is at the low end of moderate at about 11% of personal income. The Fitch-adjusted net pension liability accounts for nearly 43% of the total liability. Future direct debt issuance plans are manageable. The city's plan is to hold biennial GO bond elections for about

\$126-\$185 million which management expects to supplement with additional GRT debt issuances. Despite new issuance plans, debt levels ought to remain moderate since the city's existing debt amortizes rapidly due to the city's policy to structure its GO debt with level principal payments and a maximum maturity of 13 years.

Full-time city 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 city funds its actuarially-determined pension contribution and the unfunded pension liability is \$1.1 billion (adjusted to reflect a 6% rate of return assumption) or 4.6% of personal income. Fitch's supplemental pension metric, which estimates annual pension contributions based on a more conservative level dollar payment for 20 years with a 5% interest rate, indicates that contributions at the actuarial level would likely be insufficient to reduce pension liabilities over time.

Operating Performance

The city's superior gap closing capacity is derived from a combination of revenue and expenditure flexibility and ample reserve levels which have allowed the city to maintain a reserve safety margin above the state-required fund balance of 1/12th or 8.3% of spending. The state-required reserve is higher than the reserve safety margin needed to achieve a 'aaa' financial resilience assessment given expected moderate revenue volatility.

Aggressive budget cuts in the wake of the Great Recession allowed the city's finances to maintain fairly stable reserves as a percentage of spending, despite an ongoing sluggish recovery. If adjusted for capital outlays, balanced operations or net surpluses were recorded in every year since fiscal 2011. The fiscal 2018 audit posted a modest \$2.5 million (0.5% of spending) drawdown due to one-time spending and GRT revenue trends that came in modestly under budget. The resulting unrestricted fund balance totaled \$54.6 million or 10.4% of spending, exceeding the state-required reserve level of one-month (8.3%).

To address growing public safety needs, the city's fiscal 2019 budget imposed the local-option hold-harmless 3/8% GRT which is projected to add almost \$50 million (8.5% of budgeted fiscal 2019 revenues). Aided by a state-wide tax package recently approved by the governor, along with budgeted GRT growth of 2.3%, the revised fiscal 2019 budget projects balanced operations.

DEDICATED TAX KEY RATING DRIVERS

Pledged Revenue Growth Prospects: Fitch expects pledged revenues will expand in the long run at approximately the rate of inflation as population and economic growth resumes.

Ample Pledged Revenue Resiliency: The structure provides ample resilience to large declines in pledged revenues based on strong legal provisions. Outstanding GRT bonds mature rapidly and the additional bonds test (ABT) provides significant protection against considerable leveraging of pledged revenues.

DEDICATED TAX CREDIT PROFILE

The pledged 1.225% state-shared GRT is imposed by the state on persons selling goods or services, including legal services and certain medical services, but is subject to various exemptions. Local businesses remit the total 5.225% GRT to the state which remits the 1.225% portion back to municipalities.

Fitch expects pledged revenue growth will approximate the rate of inflation as the city continues its recovery from the last downturn during which recent private investments and modest population growth have been offset by uneven performance within the city's employment sectors. State-shared GRTs have grown by a compound average annual growth rate of 0.7% for the 10-year period ending fiscal 2018 but have approximated inflation in recent years. Year-to-date natural growth of

state-shared GRTs for the first seven months of fiscal 2019 totals 2.6% and exceeds the 2018 rate of inflation.

Legal provisions provide strong bondholder protections in the form of a 2.25x ABT based on historical revenues. After debt service payments on the bonds, GRT revenues are used by the city for general operations.

The GRT is broader than a typical sales tax as it is levied on goods and services, including legal services and certain medical services although various exemptions have been approved by the state. Businesses remit the 5.225% GRT to the state which remits the 1.225% portion back to municipalities based on the point of sale.

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 revenues over the period covered by the revenue sensitivity analysis. Based on the city's 15-year pledged revenue history, Fitch's analytical sensitivity tool (FAST) generates a 2.9% scenario decline in pledged revenues. The largest actual cumulative decline in historical revenues is an 11.2% decline in fiscal years 2008-2010.

Assuming issuance up to the 2.25x ABT, well below actual current coverage, the structure could tolerate a 56% drop in pledged revenues, over 19x the scenario results and 5x the largest actual revenue decline in the review period. These results, when combined with the slow revenue growth prospects are consistent with the 'AA+' rating.

Fiscal 2018 pledged revenues of \$201 million are up for the eighth consecutive year and cover MADS (2021) by 8.8x. Based on current MADS of \$22.9 million, the sales tax revenue bonds could tolerate a 89% drop in revenues, over 30x the scenario results and nearly 8x the largest actual revenue decline in the review period.

EXPOSURE TO ISSUER OPERATIONS

Despite the very strong debt service coverage, the rating on the GRT revenue bonds is capped at the city's IDR. 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.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

<https://www.fitchratings.com/site/re/10024656>

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