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CREDIT OPINION

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Albuquerque (City of) NM

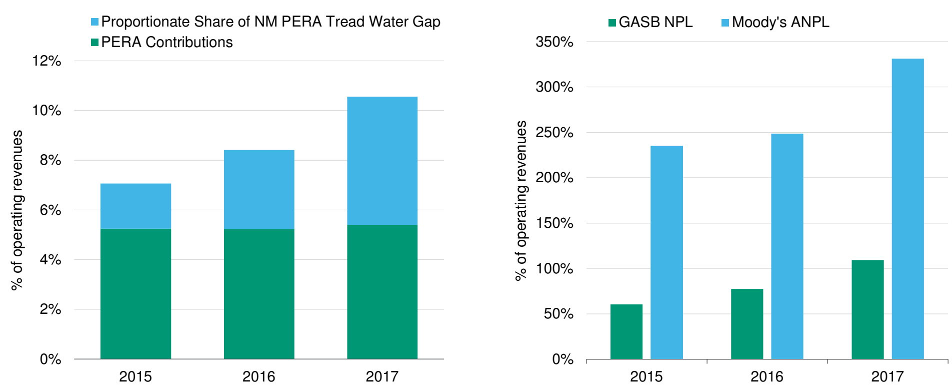
Update following downgrade of GO to Aa2; outlook negative

Summary

Albuquerque, NM (Aa2) has a narrow financial position, which is compounded by an elevated fixed cost burden and widening pension contribution tread water gap. City Council enacted a new gross receipts tax, which will partially ease near-term operational pressure; however, it will not address the consistent pension underfunding. As a participant in the state-wide cost sharing plan (PERA), the city makes its statutorily-required annual contribution, which is not sufficient to prevent the unfunded liability from increasing. Albuquerque does have a manageable direct debt burden and serves as the regional economic hub of the state, with a large tax base anchored by military installations and institutions of higher learning.

Exhibit 1

The city's ANPL is increasing on an annual basis, and contributions remain well below tread water; consistent underfunding has potential to pressure city's operations in the future



Source: Moody's Investors Service

THIS REPORT WAS REPUBLISHED ON 14 MARCH 2018 TO UPDATE TEXT AND CORRECT FORMATTING.

Credit strengths

» Large and diverse tax base that serves as the economic engine for the state of New Mexico

» Favorable direct debt profile with rapid principal amortization

Credit challenges

» Tepid economic recovery; reliance on economically sensitive gross receipts tax (GRT) revenues, the growth of which is muted due to the hold harmless phase out

» Limited financial position in comparison to similarly rated entities

» Steadily increasing pension burden and tread water gap

Rating outlook

The negative outlook is reflective of the city's already narrow operating position, which provides limited flexibility in managing increasing near-term and long-term costs. While implementation of a new sales tax will address rising public safety costs, the additional revenues are not sufficient to combat the widening gap between the city's statutorily-required pension contributions and treadwater payment. In event that contributions increase, an assumption that is not unreasonable given the Plan's underfunded nature, the city may face severe financial pressure.

Factors that could lead to an upgrade

» Trend of operating surpluses that increase reserves

» Material decline in the city's pension burden and/or measures taken to address future pension and fixed cost pressures

» Significant increases in state shared GRT collections, absent additional debt leveraging

» Significant economic expansion and diversification

Factors that could lead to a downgrade

» Trend of imbalanced operations resulting in deterioration of financial reserves

» Tax base contraction or economic stagnation; weak growth or declines in GRT collections

» Further increases in the city's pension burden, tread water gap or fixed cost burden

Key indicators

Exhibit 2

Albuquerque (City of) NM	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$35,664,833	$35,937,076	$36,658,762	$37,194,226	$38,368,255
Population	549,812	553,576	556,092	559,277	559,277
Full Value Per Capita	$64,867	$64,918	$65,922	$66,504	$68,603
Median Family Income (% of US Median)	93.0%	92.1%	90.2%	90.2%	90.2%
Finances					
Operating Revenue ($000)	$530,879	$535,395	$549,905	$561,591	$574,082
Fund Balance ($000)	$71,550	$69,627	$78,746	$81,934	$141,872
Cash Balance ($000)	$123,345	$132,334	$139,315	$148,385	$116,468
Fund Balance as a % of Revenues	13.5%	13.0%	14.3%	14.6%	24.7%
Cash Balance as a % of Revenues	23.2%	24.7%	25.3%	26.4%	20.3%
Debt/Pensions					
Net Direct Debt ($000)	$412,111	$414,339	$624,147	$676,821	$663,604
3-Year Average of Moody's ANPL ($000)	$1,338,169	$1,304,094	$1,132,895	$1,206,366	$1,530,067
Net Direct Debt / Operating Revenues (x)	0.8x	0.8x	1.1x	1.2x	1.2x
Net Direct Debt / Full Value (%)	1.2%	1.2%	1.7%	1.8%	1.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.5x	2.4x	2.1x	2.1x	2.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.8%	3.6%	3.1%	3.2%	4.0%

Source: city's CAFRs; Moody's Investors Service

Profile

Albuquerque is the largest city in the State of New Mexico (GO rated Aa1 negative), accounting for roughly one-quarter of the State's population. Located at the center of the State in Bernalillo County (Aaa stable) at the intersection of two major interstate highways and served by both rail and air, Albuquerque is the major trade, commercial and financial center of the State.

Detailed credit considerations

Economy and tax base: Albuquerque continues to serve as the economic hub of the state

The city's economy and tax base will remain stable and sizeable over the mid-term given regional importance and institutional presence. Located in north central New Mexico (Aa1 negative), the City of Albuquerque is home to approximately 25% of the state's population. The tax base is sizeable at $38.4 billion, and five year average annual growth is modest at 1.3%. Recent development includes expansion of the engineering firm, Raytheon, as well as construction of retail and grocery chains. The housing market remains steady, with new listings up 7.7% year-over-year (November). Per the November 2017 Moody's Economy report, the Albuquerque MSA is in “recovery”, and we expect that over the next couple of years, the city will have steady employment growth. Over the long-term, Albuquerque may be challenged to attract private sector industries, especially in tech, resulting in job growth that tracks in line with the US.

Major employers in the Albuquerque MSA include the University of New Mexico, Kirtland Air Force Base (AFB), and Sandia National Laboratories. The institutional presence provided by these entities is an anchor for the local economy. Healthcare and high-tech industries also have significant presence in the employment base. The city's October 2017 unemployment rate of 5.3% was below the state (5.9%) but above the nation (3.9%). Resident wealth levels are average with median family income of approximating 90.2% of the US (2015 ACS).

Financial operations and reserves: narrowing General Fund balance

The city's financial position is limited, which is compounded by the increasing pension burden, and widening pension contribution tread water gap. Even with an additional $51 million per year in revenues after city council has voted to enact the 3/8th hold harmless sales tax, the city's future financial performance is still pressured when including the pension contribution tread water gap. These pressure are reflected in downgrade to Aa2.

Albuquerque's financial position has weakened in recent years, a consequence of three consecutive deficits. Fiscal 2017 ended with a deficit of $2.8 million, reducing General Fund balance to $57.2 million, or a narrow 11.2% of revenues. While the city has historically operated within narrow margins, the trends are negative. Furthermore, the operations do not directly capture the city's heavy pension burden and consistent annual underfunding. For instance, in fiscal 2017, the city contributed $31 million to PERA; however, in order to ensure the liability did not increase (under reported assumptions), contributions would have been $60.6 million, creating a tread water gap of $29.6 million (5.2% of operating revenues). That is, the city effectively ran over a $30 million deficit.

Based on performance through December, in fiscal 2018, the city is reporting a $18.1 million General Fund deficit; net of $57 million in fund balance, which is incorporated into the projections, the gap lessens to $6 million. Recurring revenues increased by 1.7% rather than the 3.2% that was budgeted, and both recurring and nonrecurring (capital investment) expenditures are up $7 million compared to projections. Officials explain that the current variance is conservative, and assumes departments spend their budgets in full, which is unlikely to happen.

The fiscal 2019 budget projected a $33 million deficit, driven by the softening of GRT revenues coupled with increased costs associated with medical, utilities and public safety. Positively, City Council approved the implementation of 3/8th hold harmless GRT on March 5th; the bill will go to the Mayor for review by March 9th. The new tax, once implemented (July 1), is expected generate an additional $51 million per year, with roughly 60% allocated towards public safety and the remaining to general government. Moody's notes that these additional revenues will help lessen cost pressures; however, it will not address the increasing pension burden and corresponding tread water gap.

Reviewing the city's five-year forecast (through fiscal 2021), the city is projecting recurring revenue growth of 2.4% compared to recurring expenditure growth of 3.2%. A majority of future costs are for public safety, with the city focusing on adding around 100 new policemen per year to combat crime in the region. This forecast does not reflect the addition of the new hold harmless GRT.

Future reviews will focus on the city's ability to return to structural balance, and ideally, begin to manage their increasing pension burden.

LIQUIDITY

In fiscal 2017, General Fund cash declined to $21.6 million, reflective of a sizeable $28.5 million receivable due from the Transit Fund. Officials explain that this was a timing issue, with the city waiting on the receipt of grant monies. The General Fund was reimbursed in fiscal 2018.

Debt and pensions: very elevated pension burden that could challenge operations in the future

Despite plans for additional borrowing over the mid-term, the city's direct debt burden will likely remain manageable given rapid principal retirement. The general obligation debt burden is modest at 1.1% of fiscal 2018 full value, increasing to 1.7% when GRT debt (Moody's rated Aa2) is included. Principal amortization is above average with 90.9% retired in ten years. Officials plan to approach voters again in 2019 with a $125 million bond package.

DEBT STRUCTURE

The city has $433.6 million in outstanding GO bonds. Debt service is descending, which allows for the layering in of future bond issuances. The city's debt policy only allows the issuance of bonds with 13-year maturities or less. As such, all debt retires by 2031.

DEBT-RELATED DERIVATIVES

The city has no exposure to variable rate debt or interest rate swaps.

PENSIONS AND OPEB

The city has a high employee pension burden, based on unfunded liabilities for its share of the Public Employees Retirement Association (PERA), a cost sharing plan administered by the state. Albuquerque's annual contributions into the plan have been at the statutorily required amount, which is well below the actuarially required amounts, a situation which has driven the large unfunded liability. Moody's fiscal 2017 adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $1.9 billion, or an elevated 3.31 times operating revenues and 4.96% of full value. This is outsized compared to Aa rated peers.

In addition to a steadily increasing ANPL, the city's tread water gap has widened since fiscal 2014, from 1.81% in fiscal 2015 to 5.16% in fiscal 2017. The "tread water" indicator measures the annual contributions required to prevent the reported net pension liability from increasing under the plan's assumptions. That is, it is the amount that the city would have to pay on an annual basis to ensure the liability does not increase. In fiscal 2017, pension contributions of $31 million were below the tread of $60.6 million, a credit negative. Currently, the city is able to pay the statutorily-required contribution without impairing operations. However, going forward, in order for PERA to meet its obligations, it is not unreasonable to assume that contributions will have to increase in the future, which could place pressure on the city's already-thin operating margins.

The city's fixed costs, including debt service, pension and OPEB contributions, are approximately 11.8% of operating revenues. Rather than making their July 1 principal payment in fiscal 2017, the city moved it to fiscal 2018; thus, fixed costs declined. Incorporating the principal payment into the calculation, fixed costs increase to 21.7%, which is in-line with prior year's. If the tread water payment is factored into the fixed cost calculation, it increases to 26.9%, which is high for the sector.

Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. For more information on Moody's insights on employee pensions and the related credit impact on companies, government, and other entities across the globe, please visit Moody's on Pensions at www.moodys.com.

Management and governance

The City is a home rule municipality, with its charter originally adopted in 1971, and has a Mayor-Council form of government with a salaried full-time Mayor elected every four years.

New Mexico Cities have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue sources, such as property taxes and sales taxes, are subject to statutory caps, which cannot be overriden. However, the property tax cap of $7.650 (per $1,000 AV) and the available sales tax authority (varies by type) still allows for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, New Mexico has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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