




MEMORANDUM

Date: November 13, 2009

To: The Honorable Chairman and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator 

Re: County Bonded Indebtedness and Debt Management

I. Introduction.

In a previous Board meeting, a request was made for information regarding the County's bonded indebtedness for general obligation bonds, highway user revenue fund (HURF) bonds, sewer revenue bonds, sewer loans with the Water Infrastructure & Finance Authority (WIFA), and Certificates of Participation. This memorandum provides the requested information; a qualitative discussion of the County's bonded indebtedness and our debt management principles and practices; and independent evaluation commentary on our debt and debt management.

II. County Bonded Indebtedness Continuously Disclosed in our Financial Management Documents.

The County's bonded indebtedness is disclosed annually in our Adopted Budget, as well as in the Comprehensive Annual Financial Report (CAFR).

Each year our long-term debt obligations are disclosed as of that fiscal year. This information is shown in Attachment 1 and also within the Adopted Budget, beginning on Page 16-49 and continuing to Page 16-56 in the Fiscal Year 2010 Adopted Budget. This information covers the County's long-term debt from a variety of sources and is a snapshot of the County's debt position at the time of budget adoption. These numbers will change during the course of the fiscal year as debt is retired and new debt may be issued to support ongoing voter-authorized bond programs. The annual budget also contains a detailed description of the County's debt policies and practices. This information is Attachment 2 and begins on Page 16-38 of the Adopted Budget and continues through Page 16-41.

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Our debt is also reported in our CAFR (Attachment 3). The information for Fiscal Year 2008 is shown in Note 7 of the Notes to Financial Statements and can be found on Pages 60 through 68 of the CAFR. This information is disclosed in the form identified each year upon budget adoption and in each CAFR. County budgets and CAFRs are published online at <http://www.pima.gov/finance/HTML/Reports.html>. Budget information is posted for Fiscal Years 2004/05 through 2009/10, and CAFRs are posted for Fiscal Years 1997/98 through 2007/08.

III. Detailed Schedule of County Long-term Debt Published Annually and Updated Each Year in the Pima County Debt Manual.

The Pima County Debt Manual (Attachment 4) includes all information with regard to the County's long-term debt. The manual is to manage various bond authorizations and bond issuance sales by date and to cross-tie to the Adopted Budget. Appropriate repayment schedules of the County then must be budgeted each year in the Adopted Budget. It is essential that our debt be actively monitored and managed. This active management and monitoring occurs through Finance staff as well as County Administration. To assist the Board in reviewing the long-term debt manual, I am enclosing as Attachment 5 a memorandum from the Finance and Risk Management Director explaining the details of the debt manual. The manual is current to its last update and will be updated again with the bond sales that occurred on April 22, May 6, June 10, and October 7, 2009. These updates are included as Attachment 6. Please note that further updates to the debt manual will occur with the issuance of general obligation and HURF bonds by the sale scheduled for November 17, 2009.

IV. Opinion of County Debt and Debt Management.

At the time of issuance of any bonded indebtedness, the County is required to receive credit ratings following evaluation by national credit rating services. These rating services include Moody's, Standard & Poor's, and Fitch Ratings. The most recent ratings for County debt issuance were received from Standard & Poor's and Fitch. Our debt rating remains the same: AA-/Stable, which is the same rating the County has received for the last several years. I am including as Attachments 7a and 7b the ratings associated with the proposed debt issuance and sales scheduled for November 17, 2009. However, key statements with regard to the County's debt are instructive and important to highlight. Fitch Ratings writes, in part:

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"County overall debt ratios are moderate at about \$1,500 per capita and 1.9% of fiscal 2010 market value. Payout of GO debt is rapid with more than 80% repaid in 10 years."

Standard & Poor's states:

"Overall net debt levels are, in our view, low at \$1,282 per capita and 1.6% of market value. Amortization of the county's direct GO and COP debt is what we consider rapid, with approximately 75% of principal maturing in 10 years and all retired in 20 years."

Further, with regard to County management and budget monitoring, Fitch Ratings stated:

"Given the ongoing recessionary pressures in Arizona, Fitch believes the close monitoring and prompt action displayed by County administrators during fiscal 2009 will be critical over the next several years to preserving adequate reserves and maintaining the current rating."

They also state:

"The County recorded a string of positive general fund results from fiscal 2005 to fiscal 2008 and the unreserved fund balance nearly doubled from \$33 million to \$65 million during that period..."

Standard & Poor's states:

"In our opinion, the county has performed well financially in recent years due to its strong property tax growth and strong financial practices, including a demonstrated willingness to adjust spending midyear to reflect decreasing state revenues."

They further state:

"Pima County's management practices are considered "strong" under Standard & Poor's Financial Management Assessment (FMA). In our framework, an FMA of strong indicates that practices are strong, well embedded, and likely sustainable."

Clearly, the national credit rating firms who rate thousands of debt issuances for cities, towns and counties believe the County's debt levels are moderate, with rapid debt repayment and that active budget monitoring and management has resulted in general

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County fiscal stability, even with the current context of uncertain recessionary conditions throughout Arizona and an unbalanced State budget.

V. Why does Pima County rank first in bonded indebtedness among Arizona counties?

Several parties have commented with regard to the level of debt in Pima County among all other Arizona counties. At first glance, this might seem to be a matter of concern; however, it does not in and of itself articulate Pima County's governmental obligations philosophy of having growth proportionately pay for County capital improvements. As of June 30, 2008, the date from which comparable statewide information is available, the County's outstanding general obligation debt of \$348,335,000, our HURF revenue bond debt and sewer revenue debt of \$380,211,667, and \$29,075,000 of Certificates of Participation (total debt of \$757,621,667) has been reported by some as "alarming." This is inaccurate and unfounded. Our debt must be considered within the context of the County's governmental responsibilities, which may differ from other counties in Arizona.

Pima County is the only county in Arizona that operates a regional wastewater system serving a population of now over one million. The outstanding sewer revenue bond and other bond indebtedness of the Regional Wastewater Reclamation Department is not unusual and will grow given the once every 50 years capital obligations the department is under. The Board is fully aware and briefed on the capital expenditure implications of the Regional Optimization Management Plan (ROMP). ROMP will require significant capital financing in the next few years. It will increase the agency's debt substantially; however, that debt is related to replacing the more than 60 years old regional wastewater treatment facility and meeting environmental compliance requirements imposed by the Arizona Department of Environmental Quality. The current debt of our wastewater agency should be compared to similar wastewater agencies in the Maricopa metropolitan area, such as the City of Phoenix, which operates a regional wastewater system serving 400,000 connections, which has today an outstanding wastewater revenue debt of \$835 million. By comparison, the combined debt of wastewater (serving 260,000 connections) in Pima County was \$236 million. When comparing total County indebtedness throughout Arizona, wastewater debt clearly should not be included as a valid comparator.

Pima County is also the only county in Arizona to have issued highway revenue debt, with \$137 million currently outstanding. The issuance of this debt is well documented and incurred when the County received additional HURF funding as a result of statewide legislation to more equitably distribute these gas taxes among counties. The significantly increased revenues due Pima County, which were won through legislative reform and frankly had been due Pima County for the previous 20 years, enabled the County to issue

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bonds to catch up with much of the backlog of highway transportation capacity improvements in the unincorporated area, requiring the County, in November 1997, to go to the voters for authorization of a revenue bond issue. This authorization was originally planned for only improvements in the unincorporated area. The City of Tucson at the time threatened to oppose the bond issue unless they received County HURF bonds: something to which they were not legally entitled. The County agreed and allocated a significant portion of the \$350 million voter authorization to transportation improvements within the City of Tucson.

The issuance of these bonds in the future will be severely limited due to declines that have been well documented in HURF revenues statewide. Given the national and state recession, the issuance of new bonded indebtedness for HURF bonds will occur less frequently and in lower amounts than previously scheduled, with project implementation emphasizing the primary legal obligations of the County with regard to transportation in the unincorporated area. Given the unusually unique circumstances of Pima County being the only county in Arizona to issue HURF bonds and the fact Pima County is the only county in Arizona to allow County HURF bonds to be used for improvements inside cities and towns, the amount of bonded indebtedness is unique and, again, should not be a comparator to other counties.

The amount of general obligation bond issuance of Pima County as compared to others is a fair comparator, with one exception, that being Maricopa County. Maricopa County has historically had the fiscal capacity to finance their capital improvements through a pay-as-you-go philosophy, which is simply to utilize levied and collected primary property taxes within Maricopa County, accumulated over many years, to pay for capital improvements. The latest project to receive pay-as-you-go financing is the Superior Court Complex in Maricopa County, costing approximately \$340 million.

Pima County has philosophically chosen general obligation bonding to provide needed capital improvements and to provide some form of future user pay and benefit equity, simply meaning that long-term capital improvements constructed by the County with voter-authorized bonds will be utilized by future residents and property taxpayers in Pima County. A portion of the cost of providing these capital facilities can be transferred to these future residents by bonding the improvements over the next ten to 15 years.

Given the County's general obligation debt of \$348 million and the estimated annual principal repayment now approaching \$40 million as indicated in a memorandum to the Bond Advisory Committee dated October 8, 2009 (Attachment 8), it can be seen that the County's existing debt is relatively low and our repayment schedule surprisingly short-lived (as identified by both Standard & Poor's and Fitch Ratings, compared to other entities they

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rate). This is most appropriate given that the County will face continuing capital obligations as a result of population expansion. While the current recession has tempered growth and development, it is likely by 2011 that population expansion and development will return to the average that has been experienced over the last three decades.

VI. Pima County Debt as Compared to Other Arizona Counties

Pima County is also unique from all other Arizona counties in that a large percentage of our total county population resides in the unincorporated area – approximately 36 percent (as compared to Maricopa County, which has only six percent of its population in the unincorporated area).

If Pima County were a city, based on unincorporated population, we would be the fourth largest city in Arizona. The significant percentage of our population living in the unincorporated area places additional service and capital demands on the County, particularly in the area of public works development and public health. Based on the annual Arizona debt report prepared by the Arizona Department of Revenue for the year ending June 30, 2008, municipalities in Arizona with an even lesser population have a debt load significantly higher than that of Pima County. For example, the City of Glendale, with a population of 248,000, has a total outstanding indebtedness of \$926 million. During the same year, Pima County's indebtedness was reported at \$757 million. The City of Mesa, with a population of 460,000, has a total outstanding debt of \$1,154,000,000; the City of Tucson, with a population of 544,000, has outstanding debt of \$1,009,000,000. The City of Phoenix, whose population is 1,561,000, has outstanding indebtedness of \$6,310,000,000. The City of Scottsdale, with a population of 242,000 has outstanding debt of \$1,114,000,000. We have not examined the length of the debt periods or repayment timeframes for these municipalities; however, it is likely that their debt repayment schedule is not nearly as rapid as Pima County's. Most County general obligation debt is repaid within ten years and all within 15 years of issuance.

VII. Certificate of Participation Debt

Recently, there has been a great deal of discussion about our issuance of Certificates of Participation (COPs). This debt issuance requires discussion within this report as the County's purpose in issuing COPs has not been well understood or been misinterpreted. In the past, the County has used COPs to finance the construction of the baseball stadium, the acquisition of the Public Works Building and the Legal Services Building, the acquisition of the Bank of America Building, and the construction of the Jackson Employment Center.

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These COPs were issued for 15-year terms, and the COPs for the Public Works and Legal Services buildings were paid off in 2005. More recently, the issuance of COPs has been for debt of a shorter duration as defined as a two to four year period as bridge financing to sustain capital programs primarily in the departments of Transportation and Regional Wastewater Reclamation.

The County receives considerable revenues in the form of transportation impact fees and sewer connection fees. These revenues can be tens of millions of dollars annually, particularly in times of population expansion and growth. As these are local revenues of the County, they count against the County's constitutional expenditure limitation unless they are offset by debt issuance. Pima County has issued COPs to finance transportation and wastewater reclamation capital improvements with offsetting revenues for COP repayment directly from impact fee and sewer connection fee revenues collected by each department. There is no cost to the taxpayers for this financing methodology, as the COPs are completely repaid by non-tax revenues that exist within cash accounts of the County. These COPs are entirely retired within three years.

At its October 20, 2009 meeting, the Board authorized the issuance of COPs to finance the County's financial management, human resource, and procurement systems replacement. As much as \$20 million in COPs will be issued for this purpose. Professional proposals are being reviewed for the replacement of our systems with one system costing as much as \$19 million, and the other \$12 million. Pursuant to Board discussions regarding this matter, we will endeavor to pay off a significant portion of the cost of replacing the County's financial management system through savings created by consolidation and improved financial and business practices that will result from the new system. This repayment will occur within six to ten years.

VIII. Benefits of Bonding.

There are a number of benefits that can be achieved with regard to public bonding or debt issuance. These are classified as a) public improvements; b) countercyclical economic benefits, such as employment and economic activity; c) historic low cost of borrowing, which benefits the taxpayers; and d) debt, a method of having growth pay for itself. These benefits are explained in more detail below.

- A. Public Improvements. Bonding for capital public improvements allows the improvements to be constructed much sooner than would normally occur if the method of financing such public improvements were either pay-as-you-go or some other form. Public improvements financed with general obligation bonds

or any other debt instrument can be constructed years earlier than other options and may, in fact, be the only viable method of delivering public benefit.

- B. Countercyclical Economic Benefits and Increased Employment. The County has a long history of bonding and has used public debt and bonding as a countercyclical tool to bolster the local and regional economy. During times of economic expansion, competition for scarce resources makes public improvements programs costly and more expensive to implement. When the economy is in a recessionary mode, the local economy benefits from public spending, and there is the added benefit of delivering public projects for public enjoyment. This countercyclical economic strategy has been used successfully by the County in prior recessions to increase employment in the local construction and related industries. Today, in the deepest economic recession since the Depression, the County has executed a thoughtful, aggressive strategy in countercyclical economic benefit. In calendar year 2009, it is likely the County will cause to be constructed or issue contracts totaling more than \$351 million in public improvements. These improvements are being constructed at costs below those expected and have resulted in increased construction employment within the local economy. Attachment 9 is a list of all projects being constructed, are contracted for construction, or will be under contract by the end of the year; the expected cost versus the engineer's or architect's estimate; and the number of local jobs created by the project.

In summary, this work is being completed at a cost of approximately \$64 million less than expected, and 2,231 jobs have been created. The counter-cyclical economic benefits of County bond programs are clear and evident.

- C. Historic Low Cost of Borrowing Benefits Taxpayers. Attachment 10 is a table indicating the historic ten-year cost of borrowing. The average net interest rate of these bond borrowings is 4.11 percent. This can be compared with bond issuances one or two decades earlier, where the typical interest rate was approximately eight percent. Given the stability of low-interest borrowing for municipal bonding, there has been no better time in the last 30 years to issue municipal bonding debt. These lower interest rates are of significant benefit to Pima County taxpayers. Given our historic issuance of between \$75 and \$100 million of general obligation debt over the last three to four years at interest rates averaging four percent, if this same debt had been issued when interest rates were averaging eight percent in the 1980s, the additional cost to County taxpayers would have been approximately \$58 million (Attachment 11).

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- D. Debt Issuance as a Method of Having Growth Pay for Itself. Pima County has taken the position for years that new growth should largely pay for itself, meaning that as population expands and new infrastructure is required, the cost of this infrastructure should be paid largely by the growth increment that resulted in its need. Bonding is one method of transferring capital improvement costs to future residents, taxpayers, and users. For example, the maximum life of County bonds has been controlled at 15 years. Fifteen years ago, the population was 723,199, and the County's net assessed value was \$3.219 billion. Today's population is approximately 1,020,000, and the net assessed value is \$9.841 billion. Bonds issued 15 years ago are now retired. Over their debt retirement period, the number of people contributing toward the retirement of that debt increased by 41 percent, and the value of property contributing increased by almost 206 percent; hence growth does, in part, pay for its future cost.

IX. Summary

As can be seen, as of June 30, 2008, total outstanding County debt was \$757 million. However, the majority of this debt relates to the County's unique position as a wastewater provider and the only county in Arizona to issue HURF bonds. Our general obligation debt, which directly relates to property taxation, was \$348 million at the same time. As has been discussed, this debt is repaid in a relatively rapid time period as compared to other local governments.

As our debt principal repayment is approximately \$40 million annually, it is a relatively simple calculation to understand how short our debt period is, given issuance of general obligation bonds. Such short debt periods have been confirmed in the recent debt issuance ratings of Standard & Poor's and Fitch Ratings. In addition, our debt relative to other debt-issuing local governments is modest and moderate, particularly when considering its short-term duration.

It should also be recognized that part of our debt is related to the unique population distribution in Pima County: the desire by a large segment of the population to live in the unincorporated area.

There are also strategic advantages to the County's debt management policies. The issuance of bonds has been used to have future taxpayers who arrive in Pima County through population growth pay for a portion of the capital infrastructure they require. Further, bonding allows the County to provide economic stimulus through countercyclical

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public investment, which is now occurring and has been documented to create or sustain 2,231 construction jobs and at the same time, provides valuable public facilities at bargains for the taxpayers. It is estimated that the prices now being seen in the construction industry likely predate 2002 levels. Finally, it is also important to understand that the cost of borrowing paid by the taxpayer is, and continues to be, at historic lows. It is likely that bonds that will be issued on November 17, 2009 are expected to carry an average interest rate of approximately 3.75 percent. This low rate has not been seen in more than 30 years.

The County's debt has been confirmed by numerous independent bond rating evaluations as moderate and well managed and has yielded substantial and significant public benefits at the least cost to taxpayers.

CHH/mjk

Attachments

c: Martin Willett, Chief Deputy County Administrator
Tom Burke, Director, Finance and Risk Management Department