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# MEMORANDUM

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Date: January 31, 2007

To: Chair, Vice Chair and Members  
Pima County Bond Advisory Committee

From: C.H. Huckelberry  
County Administrator

A handwritten signature in black ink, appearing to be "CHH", is written over the printed name "C.H. Huckelberry".

Re: Recent Bond Sales and County Debt Financing Credit Rating

Enclosed please find a memorandum I recently transmitted to the Board of Supervisors regarding our recent sale of \$166 million of bonds. In summary, these bonds, including General Obligation, Highway User Revenue and Sewer Revenue, were sold at interest rates that continue to be very favorable to the County. In addition, our debt financing credit rating continues to improve as the County received a credit rating upgrade for this most recent sale of bonds.

It is important to note that there has been very little movement in the net effective interest rate in County General Obligation Bond sales with the net effective interest rate remaining at approximately 4 percent. In addition, it is also important to understand that our bond life remains relatively short. In the case of the most recent sale, over 75 percent of the issued bonds will be retired within ten years, and all within 15 years. This aggressive debt repayment schedule is what allows the County to continue to seek voter authorization for other public facilities or projects to be constructed with bonds. Continuing improvement in our credit rating also contributes to our low borrowing interest rates.

CHH/jj

Attachment

c: The Honorable Chairman and Members, Pima County Board of Supervisors  
Nicole Fyffe, Executive Assistant to the County Administrator



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# MEMORANDUM

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Date: January 25, 2007

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

From: C.H. Huckelberry,  
County Administrator *CHH*

Re: Pima County Bond Rating

Attached please find a memorandum from our Finance and Risk Management Director, indicating our credit rating has been improved through a number of sound financial management actions taken by the Board. These are outlined in Mr. Burke's memorandum. As the Board recalls, we recently sold and closed, as of today, \$166 million in bonds, including General Obligation, Sewer Revenue, and Highway User Revenue Bonds. These bonds were sold at interest rates very favorable to the County. These favorable interest rates were achieved through our increasing creditworthiness as rated by national financial rating agencies.

Given the large number of outstanding bonds the County still has, it is important that we continue to improve our financial standing by continuing to increase our unrestricted General Fund balance. We must also continue to eliminate and not incur additional deficits in special revenue funds. In the past we have eliminated all special revenue fund deficits, and it is important that we not incur future deficits in special revenue funds.

Finally, it is important that the management of Kino Community Hospital remain with University Physicians Healthcare. It is important that hospital services at University Physicians Hospital not only serve the community, but also be financially successful for University Physicians Healthcare.

CHH/jj

Attachment



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# MEMORANDUM

## DEPARTMENT OF FINANCE & RISK MANAGEMENT

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Date: January 25, 2007

To: Chuck Huckelberry  
County Administrator

From: Tom Burke  
Director

A handwritten signature in black ink, appearing to read "T. Burke", is written over the printed name "Tom Burke".

Re: **Pima County Upgraded by Rating Agencies**

Pima County recently received an upgrade to Aa3 (a "double-A" rating) in its credit rating from Moody's Investors Service and continued to have AA- rating from Standard & Poor's Rating Services for the County's General Obligation bonds, reflecting sound fiscal management steps taken by Pima County over the past few years. These double-A ratings indicate Pima County has a financial condition characterized as "high quality" with a strong ability to pay its debts. The upgrade is based upon many factors including both the stability of the local economy and the actions taken by the Board of Supervisors in recent years to tackle difficult financial issues that have faced the County.

### **Increasing Tax Base and Sound Debt Management:**

While the County has had a tax base that has increased substantially due to growth and development, the County has continued to maintain relatively level debt, enabling the Board of Supervisors to lower tax rates for the debt service payments. The County has maintained this manageable level of debt even though the voters have authorized significant amounts of debt not yet issued. The County has done this by electing to issue only reasonable amounts of debt spaced over a period of years with relatively short debt schedules. This has enabled the County to maintain a debt repayment schedule less than the average for communities of our size, with more than 75% of our debt regularly paid off within 10 years.

### **Increase In Unrestricted General Fund Balance:**

Another significant factor in the County's healthy credit rating arises out of the actions of the Board of Supervisors over the past five years to gradually increase the fund balance of the General Fund to a level appropriate for the size of County's operations. In the late 1990s, the County's General Fund fund balance had become very low. Since that time, the Board has regularly limited budgeted expenditures in a manner to increase the unrestricted fund balance each year. For the current Fiscal Year 2006-07, the County budgeted for an ending fund balance of \$23,000,000, about 5% of the General Fund revenues expected. The Governmental Finance Officers Association, which sets the standards for governmental budgeting, recommends a General Fund balance between 5% and 15% of projected revenues. The continued increase of an unrestricted General Fund balance enhances the County's credit rating by providing for a reserve that ensures sound fiscal management in the face of unexpected swings in revenues or

expenses. To that end, the County established and maintains a Budget Stabilization Fund within the General Fund to control expenditures centrally for many of the non-routine costs encountered each year.

**Elimination of Deficits in Special Revenue Funds:**

In addition to increasing the stability of the General Fund, the Board of Supervisors took action to eliminate the fund deficits in several special revenue funds including Graphic Services, Grants relating to Juvenile Courts, and the Stadium District. The most significant of such actions was the elimination of the \$6.2 million deficit in the County's Stadium District which had accumulated during the late 1990s. Future deficits are not expected given the current operation of the Stadium. The elimination of deficits in the Special Revenue Funds strengthens the overall credit of the County by protecting the General Fund from having to subsidize such funds.

**Transfer of the Hospital to UPH:**

The Board's actions in structuring the transfer of the former Kino Hospital to University Physicians Healthcare (UPH) put a cap to the future costs facing Pima County for Kino. This played a major role in enabling the County to stabilize the General Fund. The fact that the arrangement has been successful in limiting the County's costs in this area was considered critical by the rating agencies in analyzing Pima County as a high quality credit entity. The rating agencies have placed significant focus on the success of the transfer of the hospital to UPH and indicated that the continued ability of this arrangement to reduce the risks and costs to Pima County will be a continuing factor in the County's credit ratings. If UPH is unable to operate the hospital without additional County subsidy, and the County increases the subsidy beyond its current commitment, then there would be a substantial likelihood that the County's credit rating would be downgraded.

**Attachments**

# PUBLIC FINANCE

## Pima County, Arizona

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standardandpoors.com

**Secondary Credit Analysts:**

Patty Young

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Description		
US\$95. mil GO bnds ser 2007 dtd 01/01/2007 due 07/01/2021		
<i>Long Term Rating</i>	AA-/Stable	New
Pima Cnty GO bnds ser 2007 dtd 01/01/2007 due 07/01/2021		
<i>Long Term Rating</i>	AA-/Stable	New Rating
Pima Cnty GO (MBIA)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

### Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to Pima County, Ariz.'s GO bonds, series 2007, and affirmed its 'AA-' underlying rating (SPUR) on the county's outstanding GO bonds.

The 'AA-' rating reflects the county's:

- Ongoing economic growth and diversification, anchored by Tucson's role as a regional employment and service center for southern Arizona;
- Average wealth and income indicators;
- Large and expanding tax base;
- Sound financial management, with improving reserve levels; and
- Moderately low debt burden, with manageable capital needs.

The county's full faith, credit, and unlimited ad valorem taxing authority secures the bonds.

Pima County encompasses 9,240 square miles in southern Arizona, with 960,000 inhabitants, more than 55% of whom reside in Tucson. The county's population has grown by more than 10% since 2000, with immigration resulting from favorable weather, attractive scenery, and affordable housing. Services, government, and trade are the primary employment sectors. Raytheon Missile Systems has surpassed The University of Arizona (UA) as the leading employer (with 10,756 employees), followed by the UA (10,282), state government (9,742), and Davis-Monthan Air Force Base (8,233).

**RatingsDirect**

**Publication Date**

January 5, 2007

Employment in the county has increased for seven consecutive years, while the unemployment rate, 4.3% in 2006, has been consistently below state and national averages.

Income indicators are average. Median household effective buying income is 90% of state and national averages; per capita income is slightly higher at 98% of state and 95% of U.S. averages, respectively. The county's large student and military presence somewhat depresses income levels.

Steady new construction activity, particularly in the residential sector, has bolstered property tax base growth. Secondary assessed valuation (SAV) has increased by an average of 8.4% annually in the past five years to \$6.869 billion. Full property valuation totals \$59.89 billion, or a moderate \$62,539 per capita. The tax base is diverse, with the 10 largest taxpayers accounting for 6.6% of SAV. Growth within the county continues to increase more rapidly than growth within Tucson.

Pima County's management practices are considered 'strong' under Standard & Poor's Financial Management Assessment (FMA). An FMA of strong indicates that practices are strong, well embedded, and likely sustainable. Sound budgeting practices coupled with well-defined investment, financial, and debt management policies provide the county with the tools needed to maintain sound fiscal operation despite the high growth pressures it is under. The county also maintains a strong planning effort with emphasis on capital and financial planning.

Following a period of financial weakness in the late 1990s, characterized by health care system losses and consequent transfers-out and declining reserve levels, the county has taken steps to enhance revenues, manage expenditures, and stabilize fund balances. The county's recent financial performance has also been buoyed by healthy economic conditions. The county ended fiscal 2006 (unaudited) with a general fund balance of about \$51.5 million, or 13% of operating expenditures—well above the 1%-2% balances posted between 1997 and 1999. The county targets a minimum unreserved general fund balance level of 5%, and has achieved this level in unaudited fiscal 2006.

The county entered into a 25-year lease, effective June 2004, with University Physicians Inc. (UPI), a nonprofit organization affiliated with the University of Arizona School of Medicine. Under this agreement, UPI assumes full responsibility for the operations of Kino Community Hospital, while the county pays UPI an annual service fee, if operating costs exceed revenue generated by UPI at the hospital. The county's annual service fees are capped and reduced annually from \$25.8 million in year one (fiscal 2005) to \$7.7 million in year 10, with no payments due in years 11 through 25.

With this issuance, the county's outstanding GO debt totals \$326.3 million. Amortization of GO bonds is rapid, with more than 75% of principal maturing in 10 years and final maturity in 2021. Overall net debt levels remain moderate at \$1,306 per capita, and low at 2.2% of property market value. Series 2007 bond proceeds will be used to finance a variety of capital projects. After this issuance, the county will have in excess of \$478.66 million in authorized but unissued GO bonds available to assist funding the capital plan.

## Outlook

The stable outlook reflects our expectation that the county will continue to post balanced financial operations and improving reserve levels. Continued healthy economic and tax base trends are also anticipated.

## Strong Economic Growth

Pima County, estimated population of 960,000, is located in southern Arizona along the boarder with Mexico. The county's largest city is Tucson, where more than 55% of county residents live. The county has seen strong growth over the last four years in its employment base, with more than 31,700 new jobs created. Employment in

the county has increased for seven consecutive years, while the unemployment rate, 4.3% in 2006, has been consistently below state and national averages. Davis-Monthan AFB has seen an increase in its missions from the last Base Realignment and Closure Commission report. Wealth and income levels within the county are average to slightly below average, depending on which indicators are used. Overall, median household effective buying income is 90% of state and national averages; per capita income is slightly higher at 98% of state and 95% of U.S. averages. The county's large student and military presence somewhat depresses income levels. Steady new construction activity bolstered property tax base growth, especially within the residential sector (until recently). SAV has increased by an average of 8.4% annually in the past five years to \$6.869 billion. Full property valuation totals \$9.89 billion, or a moderate \$62,539 per capita. The tax base is diverse, with the 10 largest taxpayers accounting for 6.6% of SAV. Growth within the county continues to increase more rapidly than growth within Tucson.

**Financial Management Assessment: Strong**

Pima County's management practices are considered strong under Standard & Poor's Financial Management Assessment (FMA). An FMA of 'strong' indicates that practices are strong, well embedded, and likely sustainable. Sound budgeting practices coupled with well-defined investment, financial, and debt management policies provide the county with the tools needed to maintain sound fiscal operation despite the high growth pressures it is under. The county also maintains a strong planning effort with emphasis on capital and financial planning. The county maintains as part of its public works department a separate capital improvements unit that is responsible for developing a list of major capital projects, maintaining the list of such, and following those projects that are under construction.

Rating: Baa1/Aa3/SPUR/Stable		
<b>Pima Cnty GO (FGIC)</b>		
<i>Unenhanced Rating</i>	<b>AA-(SPUR)/Stable</b>	<b>Affirmed</b>
<b>Pima Cnty GO (FSA)</b>		
<i>Unenhanced Rating</i>	<b>AA-(SPUR)/Stable</b>	<b>Affirmed</b>
Many issues are enhanced by bond insurance.		

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McGraw-Hill



Moody's Investors Service

Global Credit Research

New Issue

8 JAN 2007

New Issue: Pima (County of) AZ

MOODY'S UPGRADES TO Aa3 FROM A1, PIMA COUNTY, AZ, G.O. BONDS

APPROXIMATELY \$326.3 MILLION IN PARITY DEBT AFFECTED, INCLUDING CURRENT SALE

County  
AZ

Moody's Rating

ISSUE	RATING
General Obligation Bonds Series 2007	Aa3
Sale Amount	\$95,000,000
Expected Sale Date	01/16/07
Rating Description	General Obligation Bonds

Moody's Outlook Stable

Opinion

NEW YORK, Jan 8, 2007 -- Moody's Investors Service has assigned an Aa3 rating to the Pima County, Arizona, General Obligation Bonds Series 2007 in the approximate amount of \$95 million. At this time, Moody's has also upgraded the County's general obligation bond rating to Aa3 from A1, affecting \$231.3 million in debt. The County's Certificates of Participation Series 2003, in the outstanding amount of \$24.3 million, have also been upgraded to A1 from A2. The upgrade and G.O. rating assignment of Aa3 reflect the County's sizeable tax base, importance as the second largest economic hub in the state, maintenance of relatively stable reserves for the last six years, and average debt profile. The County's rating incorporates the assumption that it will continue to maintain a manageable level of debt, consistent with levels of tax base growth, despite significant outstanding authorization. The stable outlook reflects the expectation that the County will continue to maintain sound reserves despite challenges with hospital operations and a recent reduction in the County's operating tax rate. The current offering is secured by the County's unlimited property tax pledge. Bond proceeds will finance a variety of projects including new construction and improvements to county facilities, parks, flood and solid waste systems, and historical sites, as well as the purchase of open space.

STATE'S SECOND LARGEST ECONOMY, ANCHORED BY TUCSON; HOUSING SLOW DOWN EXPECTED FOLLOWING PERIOD OF RAPID EXPANSION

Moody's believes that the County, anchored by the City of Tucson (GO rated Aa3 with a stable outlook), will continue to benefit from a stable employment base despite softening in the local housing market. The County is the second largest economy in the state and the regional hub for southern Arizona with major public sector and military/defense employers. The Davis-Monthan Air Force Base and related military and defense employers are major economic drivers in the area. Raytheon Missile Systems, the largest employer in the County, reported a sizeable backlog on its contract orders which will continue to support manufacturing demand in the near term. The University of Arizona and the significant presence of state and local governmental agencies provide economic stability as evidenced by relatively stable unemployment rates for Pima County over the last five years. As of the 2000 census, per capita and median family incomes roughly mirror the state and results from the mid-decade census show no change in that relationship. These wealth indices for Pima County, including a full value per capita of \$64,761, are consistent with the median for other Aa3-rated counties across the nation.

Tax base growth in 2007 was unusually strong with a 24.8% increase compared to the moderate five year average annual pace of 11.9%. This growth is attributed primarily to very strong housing permit activity and appreciation in home values as well as new commercial construction, including resort properties, coming on-line. As a result, Pima County's full value is sizeable for its rating level at \$59.9 billion. Following the recent peak in housing construction, permit activity for the current fiscal year has softened considerably by a rough

estimate of 20 to 30 percent from the prior year. Although construction represented 7% of 2006 total employment, some of the slack in housing construction should be picked up by commercial and large public sector projects, such as the Rio Nuevo redevelopment, as well as growth in other employment sectors. While tax base growth may be slow over the near term, Moody's believes the County's economic fundamentals will continue to support moderate growth over the longer term.

#### STABLE GENERAL FUND RESERVE; DRAW DOWN FOR ONE TIME PURPOSES EXPECTED IN 2007 BUT SOUND LEVELS TO BE MAINTAINED

Over the last five years, the County has retained a relatively stable general fund reserve averaging 9.1% of revenues, in stark contrast to the late 1990s when reserves as a percentage of revenues hovered in the low-single digits. Results in 2005 exceeded expectations as reported during the County's prior credit review in April 2005 and un-audited but nearly finalized FY06 financials indicate a sizeable operating surplus of \$14.3 million. As a result, the County's total general fund balance is expected to grow to \$51.8 million (12% of revenues), with \$46.4 million (10.8%) in unreserved balance. The operating surplus is attributed to solid growth in key revenue streams including property taxes and state shared revenues, as well as reductions in the County's subsidy to the hospital. Property taxes comprise roughly 58% of operating revenues, followed by state shared sales taxes (25%). The County also restored fund balances to positive levels in several of its special revenue funds, including the Stadium District, which had a deficit position in 2004.

For fiscal 2007, county officials expect a draw down on the general fund to \$38 million in unreserved funds (8.6% of revenues), above the original budget figure of \$23 million and the County's 5% General fund balance target. The use of reserves is largely for one time purposes including open space acquisition, facility maintenance, and technology improvements. Ongoing expenditure increases included a 2.8% salary increase for all employees. It is noted that the County reduced its operating tax rate by \$0.23, representing a 5.6% decrease, for the first time since FY99 to \$3.8420 per \$100 of A.V. in part to accommodate an increase to the library district tax rate and to provide property tax relief. Despite the reduction in property tax rate, management anticipates maintaining balanced operations. Moody's notes that the County's FY07 budget is very close to its expenditure limit; officials estimate a 3% to 5% or \$15 to \$20 million buffer. At this time, there is no plan to return to voters to increase the expenditure limit and officials expect to maintain operations within those constraints at this time. Positively, the County does not have an OPEB liability as its retirees are offered no medical benefits.

#### HOSPITAL AGREEMENT HELPED REDUCE RISKS FOR COUNTY, BUT CHALLENGES REMAIN

Moody's believes that the Pima County Health Care System remains an ongoing credit factor for the County, although the County's agreement with University's Physicians Inc. (UPI), has helped reduce operational subsidies to the hospital. Under a 25-year lease beginning June 15, 2004, UPI, a nonprofit organization affiliated with the medical center of the University of Arizona, assumed full responsibility for operation of the hospital, including outpatient clinics. Under the contract, Pima County will subsidize operating costs exceeding revenues up to scheduled service fee levels beginning at \$25.8 million in fiscal 2005 (compared to \$31 million GF transfer in FY04), with subsidies declining by approximately \$5 million annually in FY06 and FY07, then stabilizing at \$10 million for another six years.

While the lease currently defines and limits the County's exposure to the risks associated with the hospital, risks remain as to whether UPI will remain in the lease beyond June 2009. Exit clauses provided under the lease agreement would allow UPI to terminate the lease and return hospital operations to the county if it loses more than a cumulative amount of \$10 million, inclusive of the service fee. However, the agreement may not be terminated earlier than the fifth anniversary of the lease. Significantly, UPI has recorded a loss of approximately \$7.5 million as of FY06, which with the already scheduled \$5 million reduction in the County's subsidy in FY07, will reach the \$10 million exit clause threshold this fiscal year. County officials report that UPI is expected to continue to operate the hospital. Should UPI decide to exit after June 2009, however, they would be required to provide the County with 18 months notice to enable the County time to plan for the transition of hospital operations or to provide more limited health care services. Future credit evaluations will closely monitor the County and UPI's ability to meet strategic operational goals, and, should the exit clause be triggered, the County's willingness and ability to retain sound operations.

#### AVERAGE DEBT PROFILE; FUTURE BORROWING PLANNED

Although the County is a regular issuer of G.O. bonds, current debt levels remain moderate compared to the national median due to tax base growth and faster than average debt payout (75.8% in ten years). Direct and overall debt burdens are 0.8% and 2.4%, respectively. Pima County retains a sizeable authorization for G.O. bonds that have not been issued at \$478.7 million including a recent \$54 million authorization approved by voters in May 2006 to construct a psychiatric facility. To finance the County's ongoing capital needs, county officials expect to issue between \$75 to \$90 million in G.O. bonds in 2008. Going forward, management also expects to regulate future G.O. bond issuances in such a manner as to maintain the debt tax rate at or below \$0.715 per \$100 of A.V. Concurrent with this debt offering, the County will also be issuing \$21 million in HURF obligations and, consistent with historical practice, will issue similarly sized debt offerings every 18 to 24 months.

**Outlook**

The stable outlook reflects the expectation that the County will continue to maintain sound reserves despite challenges with hospital operations and a recent reduction in the County's operating tax rate. Pima County's current credit rating is also based upon the assumption that the County will continue to maintain a manageable level of debt, consistent with levels of tax base growth, despite significant outstanding authorization.

**KEY STATISTICS**

2005 Population estimate: 924,786

2007 Full value: \$59.9 billion

Average annual growth in full value, 2002 -07: 11.9%

Full value per capita: \$64,761

2005 Per capita income: \$23,045 (98.6% of state)

2005 Median family income: \$49,722 (96.6% of state)

Direct debt burden: 0.6%

Overall debt burden: 2.4%

Payout of principal (all debt in 10 years): 75.8%

FY06 Unaudited General fund balance: \$51.6 million (12.0% of revenues)

FY06 Unaudited unreserved GF balance: \$46.4 million (10.8% of revenues)

Unemployment rate, September 2006: 3.9% (4.4% U.S.)

**Analysts**

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