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Summary:

Albuquerque Metropolitan Arroyo Flood Control Authority, New Mexico; General Obligation

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Credit Profile		
US$12.5 mil GO bnds ser 2020 dtd 07/28/2020 due 08/01/2029		
Long Term Rating	AAA/Stable	New
Albuquerque Metro Arroyo Fld Cntl Auth GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to the Albuquerque Metropolitan Arroyo Flood Control Authority (AMAFCA), N.M.'s series 2020 general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the authority's GO debt outstanding. The outlook is stable.

Revenue from unlimited-ad valorem taxes secures the bonds. Bond proceeds will be used to finance the extension, improvement, and maintenance of the authority's flood control system.

Credit Overview

As a result of the broad and diverse Albuquerque metropolitan statistical area (MSA) economy, the authority's tax base has exhibited exceptional stability. Officials state that property tax collections, due in May, have reached historical levels, around 97.5%, with a final payment due on June 20. New developments include Amazon, Kairos Power, and a growing film industry with NBC Universal planning on spending $1.5 billion in the region on original content. The stable tax base has contributed to the authority's predictable financial performance, with a very strong reserve position and a low overall net debt burden as a percentage of market value. While the authority's debt service carrying charges are elevated as a percentage of expenditures, we believe this indicates the authority's special and limited purpose and do not view this as a negative credit factor. Although the authority plans to issue additional debt, the rapid amortization should allow the authority to layer on issuances without weakening its debt profile. Our outlook period is generally two years, but we see significant risks related to the COVID-19 pandemic and U.S. recession over the next six-to-12 months.

The authority's GO bonds are eligible to be rated above the sovereign because we believe the authority 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," published Nov. 19, 2013 on RatingsDirect. U.S. local governments are considered moderately sensitive to country risk. The authority's locally derived revenue is 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 their ability to continue collecting locally derived revenue, and U.S. local governments have independent treasury management.

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

- Extremely strong available fund balances, bolstered by a multilayered reserve policy that effectively requires minimum reserves of about 100% of operating expenditures;
- Broad and diverse tax base with access to the Albuquerque MSA;
- Diverse employment base that includes the government, defense-related research, health care, and high-tech sectors;
- Low-to-moderate overall net debt burden with very rapid amortization; and
- Strong and consistent financial management policies and practices.

Party offsetting the above strengths, in our opinion, is the adequate but below-average effective buying income (EBI).

Environmental, Social and Governance Factors

We analyzed the authority's social, risks relative to its economy, management, budgetary outcomes, and debt and liability profile and determined that all are in line with our view of the sector standard. We consider the authority's environmental risks slightly higher than the sector standard due to a higher incidence of flooding events. However, we consider district's governance a credit positive, given the investments the authority has made into flood control systems and the extensive capital planning used to address potential infrastructure issues.

Stable Outlook

Downside scenario

We could lower the rating should the authority experience sustained operational imbalance, causing it to draw on reserves, reducing them to a level below its policy minimum or to levels we no longer consider commensurate with those of similarly rated peers.

Growing economy, although not immune to COVID-19

AMAFCA provides flood control services to an area that includes all of the City of Albuquerque and about 95% of Bernalillo County's assessed valuation (AV). We consider the Albuquerque MSA broad and diverse, and Bernalillo County's population has grown by approximately 2.4% cumulatively since 2010, to about 679,000. Albuquerque is the cultural, commercial, and financial hub for the state, and as a result we consider the local economy strong. The authority's median household EBI is 89% of the national level, and its per capita EBI is 91% of the national level--both of which we consider good. We view the authority's market value per capita as strong at about $70,454.

The local employment base is relatively broad, including manufacturing (Intel, Honeywell Aerospace), federal and military institutions (Sandia National Labs, Kirtland Air Force Base, the Air Force Research Laboratory), higher education, health care, and back-office centers for major multinational 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. Officials expect NBC Universal to renovate and redevelop an existing downtown warehouse into a state-of-the art TV and Film Studios with an expected total spend on new original content of $500 million. In addition management also mentioned a new Amazon distribution facility in the area and state that Netflix is investing $1.0 billion into the region in the form of original programming.". The county unemployment rate peaked at 7.7% in 2010, and decreased to 4.4% for 2018 (below the statewide rate, but higher than the national rate). COVID-19 has increased unemployment to 12.4%, but this figure is lower than the U.S. average of 14.7% in May. Officials state that they have not heard of any significant layoffs at any the large employers in the city and state that the real estate market continues to thrive.

Following declines experienced during the Great Recession, the authority's market value has grown, increasing at an average annual rate of 2.7% since fiscal 2013, to $47.8 billion. While the growth in AV (which is defined as one-third of market value less any exempted property) has been modest, it has been consistent and stable. Despite the slow growth, the underlying AV stability is due partly to the breadth of the regional economy that includes a very diverse array of taxpayers, as the top 10 taxpayers account for only 2.7% of fiscal 2019 total AV.

Consistent Finances with extremely strong reserves

The authority's extremely strong available fund balances, along with our expectation that it will maintain compliance with its reserve policy of around 100% of operating expenditures, is essential to our view of the authority's credit quality. We consider the authority's financial profile extremely strong, despite a record of small general fund deficits in fiscal years 2014 to 2017. We understand that the authority was deliberately drawing down its available fund balances to keep its mill levy stable. However, these drawdowns were small relative to the authority's available fund balance, and fiscal 2018 and fiscal 2019 results reversed the trend with a $69,000 and $137,000 general fund surplus respectively. The authority's already sizable reserve position increased to $8.8 million, or 236.5% of fiscal 2019 expenditures. Officials attribute the fiscal 2019 surplus results to conservative budgeting assumptions, and effectively managing costs. For fiscal 2020, as usual, the authority is planning on a deficit of 797,000, and plans on drawing down approximately $150,000 to $200,000 in order to keep its mill levy stable. For fiscal 2021, the authority is budgeting for another $750,000 deficit, but expecting a smaller-than-expected deficit.

The authority's multifaceted fund balance policy reflects a layered reserve requirement that mirrors the board's historical practice of maintaining nominally high fund balance reserves. The policy is built on a 25% general fund minimum requirement that can mitigate potential service disruptions in a period of stress. Next, the policy articulates a series of contingency reserves that include a board contingency reserve of $500,000, an infrastructure reserve that requires at least 1.5% of total infrastructure cost, an executive engineer contingency reserve of $400,000 for emergency outlays, and an insurance reserve of $200,000 for unplanned expenditures. In addition to the reserve policy, the board adopted the New Mexico three-12ths reserve requirement that is required for all New Mexico counties but is optional for the authority. Taken altogether, the strong reserve policy adds stability to the 'AAA' long-term GO rating, as it provides a minimum fund balance requirement that is well in excess of one year's operating costs.

As of the most recent, fiscal 2019 audit, more than 96% of the authority's general fund revenue derives from local property taxes. The authority's general fund revenue is closely linked to its operating mill levy: 0.172 mills for residential properties and 0.477 mills for nonresidential properties. Management states that the priority regulating the mill levy rate is stability and consistency for local property taxpayers, although it does have the ability to raise its levy to a maximum of 0.5 mills, subject to the state yield control formula, which is managed by the state finance department.

Manageable Debt Burden with Rapid Amortization

We consider the authority's overall net debt low-to-moderate at 2.6% of market value and $1,818 per capita. Amortization remains very rapid, with 100% of the authority's direct debt scheduled to be retired within 10 years. We note that the authority's track record of annual GO debt issuance, coupled with shortened maturities, leaves us to expect continued rapid amortization. Debt service carrying charges are typically very high, measuring about 78.5% of total noncapital governmental fund expenditures in fiscal 2018, but we note that high carrying charges are typical of single-purpose, capital-intensive districts, and we do not view this carrying charge as a significant credit weakness.

The district recently received board approval to proceed with $90 million to $95 million of capital projects in its 2020 project schedule, and expects to issue similar amounts of debt ($12.5 million) in the next few years. These issuances are dependent on voter approval in 2020, 2022, and 2024, and management believes that local voters will continue to provide support to the authority's projects. The projects are for drainage, flood control, and storm water quality projects. Projects currently underway include various miscellaneous projects such as walkways and ramps for better access, the Valle de Oro outlet project, and the Black Mesa 3-Dam outlet project. In the future the authority has plans to continue work on Black Mesa, partner with Central New Mexico Community College on Arroyo grade stabilization for both flood control and educational purposes, various storm water projects, and to continue their partnership with Kirtland Air Force Base on projects related to downstream erosion.

Minimal Pension and OPEB contributions despite likely increases in the future

We do not consider the authority's pension or OPEB obligations as a credit pressure given the authority's capital intensive expenditures and small number of employees. We believe OPEB expenditures will likely increase or fluctuate given inherent volatility in health care claims. In fiscal 2019, the authority's combined pension and other postemployment benefit (OPEB) contributions are, what we consider, low, representing just 0.6% of total government fund expenditures.

The authority participates in the following plans:

- Public Employee Retirement Assn. (PERA) funded at 70.5% with a proportional net pension liability of $11.7 million; and
- New Mexico Retiree Health Care Fund's defined health care plan, funded at 18.92% with a proportional net OPEB liability of $973,000.

We consider PERA's funded ratio low at 70.5% in fiscal 2018, and some of its actuarial assumptions to be imprudent (particularly its statutory contribution rates, which lead to an extremely long amortization period). The authority is making its actuarially required contribution; however, our actual minimum funding progress and actual static funding calculations are well below 100%, indicating that the pension plan is not making progress towards funding. Ultimately, pension obligations are a minor part of the authority's budget and even with an expected increase in contributions, this likely will not pressure the authority's budget.

Related Research

- Credit FAQ: Financial Management Assessment In U.S. Public Finance, June 27, 2006
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020