FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Pima County Community College District, AZ's IDR to 'AA+'; Removed From UCO

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Fitch Ratings - Austin - 21 Aug 2024: Fitch Ratings has upgraded Pima County Community College District, AZ's IDR to 'AA+' from 'AA'. Fitch has also affirmed the rating on approximately $44 million outstanding combined fee revenue bonds series 2019 at 'AA-'.

The Rating Outlook is Stable. The ratings have been removed from Under Criteria Observation.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Pima County Community College District (AZ)	LT IDR	AA+ Rating Outlook Stable Upgrade	AA Rating Outlook Stable
Pima County Community College District (AZ) /Combined Fee Revenues/1 LT	LT	AA- Rating Outlook Stable Affirmed	AA- Rating Outlook Stable
Pima County Community College District (AZ) /Issuer Default Rating/1 LT	LT	AA+ Rating Outlook Stable Upgrade	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The upgrade of the IDR to 'AA+' from 'AA' reflects implementation of Fitch's new "U.S. Public Finance Local Government Rating Criteria." The 'AA+' rating incorporates the district's 'aaa' financial resilience assessment, based on a 'high midrange' level of budgetary flexibility and Fitch's expectation that the district will continue to maintain net working capital above 10% of total expenses (less depreciation and non-cash items).

The rating also reflects the district's mixed demographic and economic strength metrics given a 'weak' population trend and 'midrange' demographic and economic level metrics, as well as a population and economy of sufficient size and diversification. The rating further accounts for 'strongest' long-term liability burden metrics and no current debt plans.

The 'AA-' combined fee revenue bond ratings reflect Fitch's expectation for below inflation pledged revenue growth, absent management action. The ratings also reflect ample resilience to pledged revenue declines and 8x coverage at assumed leverage of current MADS. The combined fee revenue bond rating is capped at the district's IDR, although the cap is not currently an active constraint.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the IDR:

--A material increase in long-term liabilities due to additional debt and/or growth in net pension liabilities;

--A decline in net working capital to a level below 10% of total expenses (less depreciation and non-cash items), which would lower Fitch's assessment of financial resilience;

-- A weakening of demographic and economic performance, including but not limited to declines in population or resident income, and/or an increase in the unemployment rate as compared to the national average.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the Combined Fee Revenue Bonds:

--Future large declines in pledged revenue or additional leveraging resulting in debt service coverage levels sustained closer to 2.0x MADS could alter Fitch's view of the structure's resilience and the rating on the bonds;

--A downgrade in the IDR below 'AA-' given that the revenue bonds are capped at the IDR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

For the IDR:

--A sustained improvement in local area economic fundamentals including population, unemployment, median household income and educational attainment;

--A sustained approximately 25% decrease in long-term liabilities and carrying costs assuming current levels of personal income and governmental resources.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

For the Combined Fee Revenue Bonds:

--A sustained increase in the growth prospects of pledged revenue.

SECURITY

The outstanding series 2019 revenue bonds are payable from a gross revenue pledge of and first lien on the district's tuition and fees, rental and contract revenue, interest earnings, and other certain operating revenue.

FITCH’S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model (LGRM) generates Model Implied Ratings (MIR) which communicate the issuer's credit quality relative to Fitch's local government rating portfolio (the MIR will be the IDR except in certain circumstances explained in the applicable criteria). The MIR is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher (AAA), 9.0 (AA+), 8.0 (AA), and so forth down to 1.0 (BBB- and below).

MIR reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile (MP), and a structured framework to account for Additional Analytical Factors (AAFs) not captured in the MP that can either mitigate or exacerbate credit risks. AAFs are reflected in notching from the MP and are capped at +/-3 notches.

RATINGS HEADROOM & POSITIONING

Pima County Community College District MIR: 'AA+' (Numerical Value: 9.94)

-- MP: 'AA+' (Numerical Value: 9.94)

-- Net AAF Notching: 0.0

Pima County Community College District's MIR is 'AA+'. The associated numerical value of 9.94 is at the upper end of the 9.0 to 10.0 range for its current 'AA+' rating.

KEY RATING DRIVERS

FINANCIAL PROFILE

Financial Resilience - 'aaa'

Pima County Community College District's financial resilience is driven by the combination of its 'Midrange' revenue control assessment and 'High' expenditure control assessment, culminating in a 'High Midrange' budgetary flexibility assessment.

-- Revenue control assessment: Midrange

-- Expenditure control assessment: High

-- Budgetary flexibility assessment: High Midrange

-- Minimum net working capital for current financial resilience assessment: >=10.0%

-- Current year net working capital to expenditure ratio: 27.4% (2023)

-- Five-year net working capital to expenditure ratio: 27.4% (2023)

Revenue Volatility - 'Weak'

Pima County Community College District's weakest historic three-year revenue performance has a modest negative impact on the MIR.

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenue dating back to 2005): 11.5% decrease for the three-year period ending fiscal 2014

-- Median issuer decline: -4.5% (2023)

DEMOGRAPHIC AND ECONOMIC STRENGTH

Population Trend - 'Weak'

Based on the median of 10-year annual percentage change in population, Pima County Community College District's population trend is assessed as 'Weak'.

Population trend: 0.7% 2022 median of 10-year annual percentage change in population (40th percentile)

Unemployment, Educational Attainment and MHI Level - 'Midrange'

The overall strength of Pima County Community College District's demographic and economic level indicators (unemployment rate, educational attainment and median household income [MHI]) in 2023 are assessed as 'Midrange' on a composite basis, performing at the 46th percentile of Fitch's local government rating portfolio. This is due to high education attainment levels offsetting low median-issuer indexed adjusted MHI and midrange unemployment rate.

-- Unemployment rate as a percentage of national rate: 105.6% 2023 (40th percentile), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 35.0% (2022) (64th percentile)

-- MHI as a percent of the portfolio median: 90.1% (2022) (34th percentile)

Economic Concentration and Population Size - 'Strongest'

Pima County Community College District's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the MP are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 1,057,476 (2022) (above the 15th percentile)

-- Economic concentration: 23.6% (2023) (above the 15th percentile)

LONG TERM LIABILITY BURDEN

Long-Term Liability Burden - 'Strongest'

Pima County Community College District's long-term liability metrics remain broadly strong across each of the three dimensions: liabilities to personal income, liabilities to governmental revenue and carrying costs to governmental expenditures. The long-term liability composite metric in 2023 is at the 95th percentile, indicating a low liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 0.3% Analyst Input (100th percentile) (vs. 0.3% 2023 Actual)

-- Liabilities to governmental revenue: 66.4% Analyst Input (96th percentile) (vs. 66.8% 2023 Actual)

-- Carrying costs to governmental expenditures: 7.8% (2023) (91st percentile)

Analyst Inputs to the Model

Analyst inputs to the model reflect metric adjustments to account for historical data anomalies, forward-looking performance shifts, or non-recurring events that may otherwise skew the time series.

Analyst input for the long-term liability metrics reflects an adjustment to account for scheduled amortization of outstanding principal in fiscal 2024.

DEDICATED TAX KEY RATING DRIVERS

Given the district's enrollment history, and despite some modest pledged revenue growth in recent years, Fitch believes natural pledged revenue growth prospects (absent management action to increase tuition and fees) remain largely stagnant and in line with a 'bbb' revenue growth assessment. This is underpinned by Fitch' expectation for some stabilization in the enrollment trend given the district's expanding technical and skill training workforce contracts with local employers in a growing local economy.

Although a more modest portion of the district's overall operating revenue, tuition and fees provide the majority of pledged revenue at roughly 80%. Steady enrollment loss since countercyclically peaking during the Great Recession led to a trend of modest to moderate annual declines in pledged revenue, with revenue showing growth starting in fiscal 2023. The 10-year revenue compound annual growth rate is below -1%. The $35.5 million in fiscal 2023 pledged revenue at year-end reflects a sizable one-year rebound with a roughly 40% year-over-year gain. A reversal of the historical trend of stagnant revenue, as the district expects, could lead to positive pressure on the rating.

To evaluate the sensitivity of the pledged revenue stream to cyclical decline, Fitch considers both a revenue sensitivity scenario and the largest decline in pledged revenue over the period covered by the revenue sensitivity analysis. Pledged revenue can sustain a significant level of decline and still maintain ample debt service coverage on all obligations. Based on the pledged revenue history, Fitch's Analytical Sensitivity Tool (FAST) generates a 10.2% revenue decline in a -1% U.S. GDP scenario.

The largest actual historical decline occurred from fiscal 2021 to fiscal 2022 at 36%, which Fitch believes to be overstated. Assuming leverage to current maximum annual debt service (MADS), the bond structure could tolerate an approximate 88% decline in pledged revenue before MADS ($4.4 million in 2026) coverage reaches 1x. This level of tolerance is equivalent to 8x the FAST estimate and roughly 2.3x the largest actual revenue decline. Given the overstated nature of the historical revenue decline, Fitch considers these results consistent with a 'aaa' resilience assessment.

The mandate to increase the rate at which pledged revenue is charged also positively affects the assessment. The district has covenants in its bond documents to maintain rates and charges sufficient to produce sum sufficient pledged revenue coverage of aggregate annual debt service.

The combined fee revenue pledged to the bonds does not meet the requirements set out in Fitch criteria for treatment as "pledged special revenue" under section 902(2) of the bankruptcy code and is not otherwise insulated from the operating risk of Pima County Community College District. Therefore, the rating of the debt is capped at the IDR.

PROFILE

Pima County has a population of over one million people and is home to Tucson, the second largest city in Arizona. The county's diverse economy features higher education, healthcare, government, technology, tourism and manufacturing as primary anchors. The district operates multiple comprehensive campuses throughout its taxing jurisdiction of the county. The county population has expanded by roughly 6% since 2010, comparable with the overall U.S. population, but below the state's rate of growth.

District revenue is primarily influenced by local trends, including enrollment and taxable assessed valuation (TAV). Full-time equivalent students (FTEs) peaked in fiscal 2011 during the depths of the Great Recession, but since then a trend of flat to declining enrollment persisted through fiscal 2022, with fiscal 2024 showing enrollment gains.

Countywide assessed valuations (AV) have continued to grow at a steady pace post-recession beginning in fiscal 2015, and the five-year compound annual growth rate (CAGR) through fiscal 2023 was nearly 5%. District management expects additional near-term tax base growth based on current residential construction activity and appreciation of existing properties.

Sources of Information

In addition to sources of information identified in Fitch's applicable criteria specified below, this action was informed by data from DRIVER by Solve.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Finance Local Government Rating Criteria (pub. 02 Apr 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.1.0 (1)

U.S. Local Government Rating Model, v1.2.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Pima County Community College District (AZ)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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