

Fitch Rates El Paso, Texas GOs and COs 'AA'; Outlook Stable

Written by Australian Business

AUSTIN, Texas--([BUSINESS WIRE](#))--Fitch Ratings assigns an 'AA' rating to the following El Paso, Texas obligations:

--\$110.4 million GO refunding and improvement bonds, series 2014;

--\$43.3 million combination tax and airport revenue certificates of obligation (COs), taxable series 2014.

Both series are scheduled to sell via negotiation the week of April 7. A portion of the bond proceeds will be used to refund certain outstanding obligations for savings. The new money portion will fund parks and recreation projects approved in the 2012 bond referendum. The COs will fund improvements to the city's airport, including the construction of a consolidated rental car facility.

In addition, Fitch affirms the following El Paso, TX debt:

--\$583.9 million general obligation (GO) bonds at 'AA' (pre-refunding);

--\$400.5 million COs at 'AA';

--\$60.8 million El Paso Downtown Development Corporation (DDC) special revenue bonds at 'A+'.

The Rating Outlook is Stable.

SECURITY

The GOs and COs are secured by an ad valorem tax levied on all taxable property within the city, limited to \$2.50 per \$100 taxable assessed valuation (TAV). The COs are also secured by a de minimis pledge of surplus revenues from certain city's enterprises (limited to \$1,000 from the waterworks and sewer system, or the airport system).

The DDC special revenue bonds are secured by annually appropriated lease payments made by the city to the DDC from lawfully available revenue, which includes most city operating revenue except property taxes.

KEY RATING DRIVERS

ADEQUATE FINANCIAL RESERVES: The city's reserves remain adequate despite a moderate draw on reserves in fiscal 2013. Fitch recognizes that management's response to revenue fluctuations during the recession was timely but also notes that budget balance was slightly dependent on temporary solutions.

ECONOMIC EXPANSION AND DIVERSIFICATION: Much of the city's economic activity has come from its position in a key NAFTA trade corridor near Mexico's maquiladora assembly plants, as well as the presence of Fort Bliss. Recent expansion at Fort Bliss and an emerging healthcare sector serve as catalysts for further economic diversification.

HIGH OVERALL DEBT BURDEN; GROWING FIXED COSTS: Overall debt levels are high relative to market values. The pace of principal amortization is average. Fitch expresses concern over the city's underfunding of annual required contributions (ARC) and growing unfunded liability for the police and fire pension plans.

LARGE CAPITAL PLAN: The city's capital improvement plan (CIP) and debt issuance plans continue to increase to support the city's ongoing growth-related needs and voter-approved quality of life projects. Balancing an increasing debt load with tax base growth and capital needs is essential to the rating given the already above-average debt service tax rate.

RATING SENSITIVITIES

ESCALATING PENSION LIABILITY: Continued underfunding of the city's pension programs--particularly the public safety plan--will increase the liability of the city and would not be consistent with the current rating.

DETERIORATION OF RESERVES: Further reduction in the city's reserves or use of non-recurring means to achieve budget balance also could apply downward pressure to the rating.

CREDIT PROFILE

SATISFACTORY FINANCIAL PROFILE

The city's financial position was affected by modest revenue contraction during the recession and ongoing growth-related operating and capital pressures. Through fiscal 2012, the city was able to make timely adjustments resulting in balanced operations amidst growing pressures. However, Fitch notes that one of these adjustments was underfunding of pension obligations, which has resulted in growing liabilities.

In fiscal 2013, the city drew down \$5 million in reserves, slightly above the \$4 million previously projected. The shortfall was due to a \$3 million tax appeal payment to its largest taxpayer, Western Refining Company LP, and relocation costs of city hall offices. The resulting unrestricted general fund balance of \$33.7 million (including a \$16 million charter required reserve), or 10.1% of fiscal 2013 spending is considered adequate.

The fiscal 2014 budget is balanced and incorporates the reduced taxable value of Western Refining. General fund spending is up 5.3% from the adopted fiscal 2013 budget and includes funding for police and fire collective bargaining agreements, police academy classes, public safety vehicles, and non-departmental increases. Sales tax revenues were

projected to increase by 4.4% over the prior year budget, which Fitch believes may be optimistic. The budget also includes a two cent increase to the property tax rate to \$0.68 per \$100 of TAV.

Interim results point to a moderate \$7 million projected revenue shortfall in sales taxes, franchise fees, and fines and forfeitures. City officials report that mid-year departmental budget cuts, a hard hiring freeze, and deferral of budgeted cash capital outlays are expected to eliminate or significantly reduce the shortfall. Fitch cautions that further reduction in the city's reserves may apply downward pressure to the rating, given the city's growth pressures and large long term liabilities.

MODEST TAX BASE GROWTH

Increases in the city's TAV slowed after double-digit annual percentage growth between fiscals 2005 and 2008. Slower growth beginning in fiscal 2009 was in line with weaker economic conditions nationwide, but gains resumed at 3% and 4% in fiscal years 2012 and 2013, respectively as economic conditions improved.

Fiscal 2014 TAV grew modestly by 1.3% to \$32.5 billion, with new construction offsetting a substantial \$460 million or 59% reduction in Western Refining's taxable value. For purposes of capital planning and budgeting, the city has assumed a 1.5% annual growth rate through fiscal 2017, followed by 2% annual growth through fiscal 2020. Fitch believes these growth assumptions over the next five years are reasonable given recent performance.

HIGH DEBT BURDEN AND LARGE CAPITAL PLAN

Overall debt levels are high relative to market value at nearly 7%, but are more moderate on a per capita basis at roughly \$3,700. Principal amortization is average. Given the city's plans to issue additional debt for recently voter-approved quality of life projects, as well as COs for transportation and public infrastructure projects, debt levels are projected to remain elevated for the near-to medium-term. The city's fiscal 2014 - 2018 debt funded CIP, which includes some of the voter-approved projects, totals \$400 million. The city plans to issue approximately \$77 million GO bonds in the fall of 2014.

In November 2012 voters passed two GO propositions totaling \$473 million for quality of life projects (i.e. parks and recreation, zoo, open space, libraries, museum, and performing arts). The bond plan had a healthy 70% voter approval rate. The city projects the debt impact from issuance of the bonds will not exceed \$0.05 per \$100 of TAV assuming issuance over a 10-year period and the aforementioned 1.5% - 2% annual tax base growth.

Fitch believes the city will be challenged to balance ongoing capital needs against an already above-average debt service tax rate, slower tax base growth in the near term, and the area's below-average socio-economic characteristics.

ADEQUATE PENSION FUNDING LEVELS DESPITE UNDERFUNDING

The city maintains two single-employer pension plans: a city employee pension fund (CEPF) and a fire and police pension fund (FPPF).

The city issued \$212 million in voter-authorized pension obligation bonds to address underfunding in the FPPF. The funded position for the combined plans is estimated at an adequate 71% as of fiscal 2013, adjusted for a 7% return on investment.

The city has contributed between 97% and 99% of its annual pension cost (APC) over the past three fiscal years for the CEPF. However, contributions to the fire and police divisions of the FPPF were about 10% and 25% below the APC respectively, in both fiscal years 2011 and 2012. For fiscal 2013 this gap increased; contributions for the fire and police divisions of the FPPF were 16% and 32% below the APC respectively. The actual funding contribution was relatively static, reflective of the city's rapidly growing pension costs. Pension payments totaled about 7.4% of audited fiscal 2013 governmental spending, compared to 9% had the city paid the required amount. The city's underfunding is a credit concern, and continuation of this practice would not be consistent with the current 'AA' rating.

Public safety employees recently agreed to a less generous, second-tier of pension

benefits for new employees that should reduce growth in the overall liability over time. A similarly structured program was also implemented for general city employees beginning in fiscal 2012. Carrying costs for debt service, retiree healthcare and required pension payments were moderately high in fiscal 2013 at 22% of governmental spending.

BALLPARK PROJECT NOT ESSENTIAL TO CORE OPERATIONS

The DDC special revenue bonds are secured by annually appropriated lease payments made by the city to the DDC from lawfully available revenue, which includes most city revenue except property taxes. Fitch does not consider the leased asset (ballpark) to be essential to the city's core governmental operations, leading to a two-notch distinction between the DDC special revenue bonds and the city's limited tax bonds. However, the statutory requirement that ballpark costs are the sole eligible use of receipts of the recent voter-approved 2% increase in hotel occupancy tax lessens Fitch's concerns about the city's incentive to make full and timely annual appropriations.

ECONOMIC DIVERSITY

El Paso is the sixth largest city in Texas. Its current population estimate of more than 685,000 reflects ongoing growth at an average annual rate of nearly 1.5% since the 2000 census, slightly below the state's population growth rate of roughly 2% for the same period. City income levels as measured by median household income are below average, but continue to grow at a faster clip than state and national levels.

Much of the city's economic activity has historically come from its position in a key NAFTA trade corridor near Mexico's maquiladora assembly plants as well as the presence of Fort Bliss, the Army's second largest installation. Recent investment in the medical sector and the opening of the Texas Tech University Health Sciences Center further helps to diversify the city's economic base.

The Pentagon's 2005 base realignment and closure recommendations led to the expansion of troops at Fort Bliss with corresponding relocation of military family members. The ongoing expansion of Fort Bliss' troop strength and military facilities has boosted residential and commercial construction citywide, although the full economic impact of the

expansion is still unfolding.

Government and educational entities comprise most of the top 10 civilian employers, which provide roughly 25% of the area's employment. Major additions to the city's retail, commercial and healthcare sectors brought unemployment rates down to record lows in 2007 and 2008, although they rose notably during the last recession along with the national unemployment rate. At 7.2% in December 2013, the city's unemployment rate improved from the prior year but remained above the state's 5.6% and the U.S. average of 6.5%.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, and LoanPerformance, Inc.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria'(Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria'(Aug. 14, 2012).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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