FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Pima County Community College District, AZ's IDR at 'AA' and Rev Bonds at 'AA-'

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Fitch Ratings - Austin - 12 Jan 2022: Fitch Ratings has affirmed the following ratings of Pima County Community College District (the district), AZ:

--Issuer Default Rating (IDR) at 'AA';

--Approximately $51 million in outstanding revenue bonds, series 2019 at 'AA-'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Pima County Community College District (AZ)	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Pima County Community College District (AZ) /Combined Fee	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

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Pima County Community College District (AZ) /Issuer Default Rating/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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 revenues, interest earnings, and other certain operating revenues.

ANALYTICAL CONCLUSION

IDR ANALYTICAL CONCLUSION

The 'AA' IDR reflects Fitch's expectation of the highest level of operating flexibility and anticipated financial resilience to be maintained by the district through future economic cycles. This expectation is based on the district's solid expenditure flexibility, satisfactory revenue-raising ability and a high reserve cushion, balanced against Fitch's expectation of weak long-term revenue growth prospects. Fitch expects the long-term liability burden to remain low as regional capital and debt needs should remain balanced against further population and income gains.

DEDICATED TAX ANALYTICAL CONCLUSION

Fitch maintains the 'AA-' pledged revenue bond rating and Stable Outlook despite significant, one-year revenue loss given the robust resiliency cushion of the debt structure that is expected to be preserved. Fitch expects stagnant post-pandemic growth prospects for pledged revenues, absent policy action. Underpinning the lower 'AA-' rating is the narrower base and largely downward volatility of pledged revenues in recent years. However, Fitch recognizes the district's ability and mandate to increase or add new pledged revenues if needed; management expects to internally maintain debt service coverage at a threshold well above the 2.0x ABT. Residual revenues, net of debt service, fund general operations, therefore, the rating is capped at the district's 'AA' IDR.

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taxpayers represent retail, healthcare, utility and mining sectors and comprise a modest 7% of total fiscal 2021 taxable value.

KEY RATING DRIVERS

Revenue Framework: 'a'

Fitch believes the district's revenue growth prospects remain largely flat and below inflation, improving from a historical downward trajectory. This is based on Fitch's expectation of further moderate tax base expansion (property taxes provide at least half of the district's total operating revenue) and some enrollment traction post-pandemic due to the future expansion of workforce programs tied to local employers. The district's ability to independently increase operating revenues is satisfactory.

Expenditure Framework: 'aa'

The natural pace of spending will likely exceed the flat revenue growth projected over time. The district retains solid expenditure flexibility, even after right-sizing in recent years to a declining enrollment trend, due to its ability to further adjust academic programs and labor costs. Expenditure flexibility is also bolstered by modest fixed carrying costs.

Long-Term Liability Burden: 'aaa'

The long-term liability burden is estimated at a low 3% of 2020 resident personal income. Further growth in county population and income levels should remain largely aligned with potential increases in overlapping local government debt, which is the predominant driver of the liability burden.

Operating Performance: 'aaa'

Fitch anticipates the district will maintain the highest level of operating flexibility due to its satisfactory revenue-raising ability, substantial reserve cushion and solid expenditure flexibility. Fitch believes the district is well positioned to address challenges posed by future cyclical downturns.

RATING SENSITIVITIES

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--For the IDR and pledged revenue bonds: A material and sustained improvement in the district's revenue growth prospects, particularly from a stabilized to modestly growing enrollment trend.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

For the pledged revenue bonds:

--Further, unaddressed pledged revenues declines that materially diminish the current 'aaa' debt service resilience cushion.

For the IDR:

--Material and sustained district tax base declines that would further weaken the district's revenue growth prospects;

--A material and sustained change to its currently solid expenditure flexibility that diminishes the district's high inherent budget flexibility;

--Material erosion of the district's currently high level of financial resilience. This could come in the form of large draws on the district's unrestricted cash and investments to levels inconsistent with the 'aaa' reserve safety margin.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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After modest enrollment decline in fiscal 2020, Pima County Community College saw fiscal 2021 full-time equivalent students (FTEs) enrollment fall sharply by an atypical 17% to 11,488, largely induced by the pandemic. This outcome was despite the district's shift to provide mostly virtual or otherwise hybrid (a mix of virtual and in-person education) classes over much of the fiscal year as did many other community colleges. Fitch believes this rapid loss of enrollment is likely a one-time occurrence as it is an outlier to the district's flat to modestly declining enrollment trend in recent years that generally runs counter-cyclical to local economic conditions.

Net tuition/fee revenue has historically comprised about 14%-16% of total revenues, but the actual tuition/fee revenue loss of $6.2 million in fiscal 2021 yoy saw that trimmed to 11%. To counter the year's revenue loss, the district eliminated or delayed budgetary spending (total spending declined about 4% yoy in fiscal 2021) and utilized a portion (about $9 million) of its federal stimulus dollars received as revenue replacement. Moderate growth in local property taxes and state funding also buffered general operating performance. In total, these measures generated a strong 11.7% operating margin and preserved a robust $180.5 million unrestricted cash and investments position, equal to approximately 97% of spending at audited fiscal 2021 YE (June 30), well above Fitch's 'aaa' reserve safety margin. Overall, the district's revenue decline in fiscal 2021 was lower than the revenue losses suggested in the baseline and downside scenarios by the Fitch Analytical Stress Test (FAST) model, which was adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions.

Nonetheless, the slimmer revenue stream that underpins the district's outstanding pledged revenue bonds is largely comprised of net tuition/fee revenues at about 80%, and this revenue stream took a significant hit in fiscal 2021 from the year's enrollment loss. Pledged revenues dropped by nearly 30% YoY to total approximately $23 million in fiscal 2021. This revenue loss exceeded Fitch's prior expectations and the 20% assumed stress modeled. However, the strong resiliency of the bonds' debt service cushion, due in part to management's prior decision to keep relatively modest leverage levels, allowed the district to withstand the significant loss and retain ample debt service coverage.

For fiscal 2022, the district's roughly $411 million, all-funds budget reflects a sizable yoy increase, primarily from a larger capital (plant fund) budget that focuses on completing certain priority projects. These capital projects, inclusive of planned 2019 bond

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2020 semester, but initial numbers for the current spring 2022 semester reflect some modest yoy stabilization. Operations are running largely in line with budget, and management indicates plans to pull-back some pay-go capital funding and utilize about $6 million in federal stimulus funds to offset any budgeted revenue loss.

Fitch believes the district is well prepared to withstand a period of stress due to its history of maintaining high levels of unrestricted cash/investments (net of bond proceeds and other restricted funds). While recognizing local governments may utilize a portion of their reserve cushion in a period of fiscal stress, Fitch expects the district will continue to maintain the highest level of financial resilience and prudently manage its spending to preserve a financial cushion consistent with the current 'aaa' resilience assessment.

CREDIT PROFILE

The district serves the residents of Pima County, Arizona (IDR AA+). The district operates multiple comprehensive campuses throughout its taxing jurisdiction of the county. County population has expanded by roughly 6% since 2010, comparable with the U.S, but below the state's rate of growth.

District revenues are 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 enrollment decline has persisted.

Countywide assessed valuations (AV) have continued to grow at a steady, moderate pace post-recession beginning in fiscal 2015, and continuing that trend, AV grew further by nearly 5% in fiscal 2021 to roughly $9 billion. District management expects additional near-term tax base growth based on current residential construction activity and appreciation of existing properties.

Major southern Arizona employers include the University of Arizona, Raytheon Missile Systems, Davis-Monthan Air Force Base, state and local government, Wal-Mart Stores Inc., Tucson Unified School District, U.S. Customs & Border Protection/U.S. Border Patrol, Freeport-McMoRan Copper and UA Healthcare. Economic recovery is evident from the peak of job losses during the pandemic in a reduced yoy county unemployment rate of 3.2%

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Flat Growth Prospects for Pledged Revenues: Fitch anticipates essentially flat future pledged revenue growth post-pandemic, aided by expected enrollment stability from the expansion of the district's workforce, vocational, and technical programs.

Sound Resilience: Pledged revenues are highly resilient and provide a strong debt service cushion even after the significant fiscal 2021 revenue loss. Fitch recognizes the district's ability and mandate to increase or add new pledged revenues if needed; management expects to internally maintain debt service coverage at a threshold well above the 2.0x ABT. District management currently has no plans to further leverage the pledged revenues.

PLEDGED REVENUE GROWTH PROSPECTS

Although a more modest portion of the district's overall operating revenues, tuition and fees provide the majority of pledged revenues at roughly 80%. Steady enrollment loss since counter-cyclically peaking during the Great Recession has led to a trend of modest to moderate annual declines in pledged revenues. The sharp 17% FTE student enrollment loss that occurred in fiscal 2021 appears to Fitch to be an outlier; the 10-year revenue CAGR hovered under -1% in the two preceding fiscal years. Also, the estimated $29.3 million in fiscal 2022 pledged revenues at year-end reflects a respectable one-year rebound with a roughly 4.5% yoy gain.

Given the district's enrollment history and despite some modest pledged revenue growth over fiscals 2019-2020, Fitch believes natural pledged revenue growth prospects (absent management action to periodically increase tuition and fees) remain stagnant. This is underpinned by Fitch' expectation of potential for stability and perhaps some strengthening in enrollment given the district's expanding technical and skill training workforce contracts with local employers in a growing local economy.

RESILIENCY OF PLEDGED REVENUES

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 revenues over the period covered by the revenue sensitivity analysis. Fiscal 2021 pledged revenues that totaled approximately $28 million reflect a 30% yoy decline, although Fitch believes this significant decline due to the rapid loss of enrollment over the pandemic is not likely to be

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million in 2022). This cushion is 2.8x the now largest historical cumulative revenue decline of 30% realized in fiscal 2021.

Enhancing the 'aaa' resilience assessment is Fitch's recognition of the district's ability and mandate to increase or add new pledged revenues if needed. Management expects to internally keep a higher debt service coverage cushion at a 4.0x threshold, well above the 2.0x ABT, which aligns with the support residual revenues provide to operations and management's lack of further leverage plans currently.

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

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria - Effective from May 4, 2021 to April 2, 2024 (pub. 04 May 2021) (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, v3.0.0 (1)

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