

CREDIT OPINION

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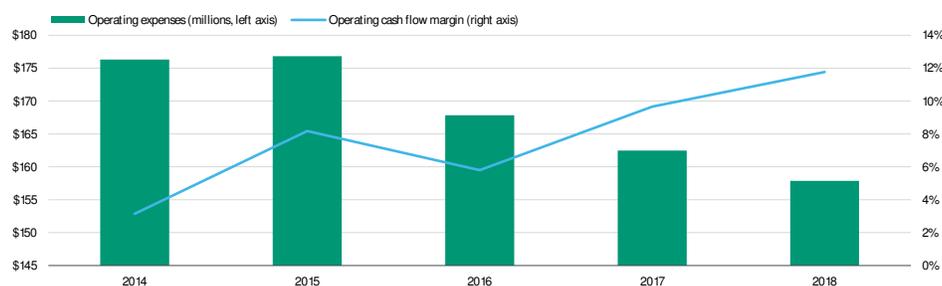
Pima County Community College District, AZ

New issuer

Summary

[Pima County Community College District's](#) (PCC or the district, Aa3 stable) credit profile reflects its excellent strategic positioning given its prominent role as a low-cost provider of higher education and vocational training in the [Tucson, Arizona](#) (Aa3 stable GO) metropolitan area. PCC benefits from its large operating scale and robust property tax support from its [Pima County](#) (Aa2 stable) tax base. Financial reserve levels and unrestricted liquidity are strong relative to community college peers providing a sound cushion for expenses and for a growing, yet manageable debt burden. Operating performance has improved driven by a state mandated expenditure limitation and continued growth of tax revenue, the district's primary revenue source. However, PCC's enrollment prospects remain challenged due to an improving regional economy. Other offsetting credit factors include a lack of state operating appropriations, very high age of plant and an elevated pension burden relative to peers.

Exhibit 1

Expense reductions improving operating cash flow generation


Source: Moody's Investors Service

Credit strengths

- » Moderately large operating scale for a community college, with over \$178 million in fiscal 2019 operating revenue, provides for economies of scale
- » Growing financial reserves with spendable cash and investments up nearly 28% since fiscal 2015
- » Large tax base and significant property taxing flexibility inherent to Arizona community college districts

- » Low financial leverage inclusive of planned 2019 issuance resulting in very good debt affordability

Credit challenges

- » Challenged enrollment environment reflecting the improving regional economy
- » Very high age of plant of 23 years indicates need for increased capital investment
- » Elevated pension liabilities represented by total adjusted debt to operating revenues in fiscal 2018 of 2.0x

Rating outlook

The stable outlook reflects expectations of stabilizing enrollment, steady operating performance, and of limited material near-term debt issuance.

Factors that could lead to an upgrade

- » Sustained improvement in operating performance
- » Greater revenue diversity through state operating appropriations, higher tuition revenue or gift support

Factors that could lead to a downgrade

- » Sustained deterioration of operating performance or of pledged revenues available for debt service
- » Significant reduction of unrestricted liquidity
- » Prolonged contraction of tax base or deterioration of resident wealth levels

Key indicators

Exhibit 2

PIMA COUNTY COMMUNITY COLLEGE DISTRICT, AZ

	2014	2015	2016	2017	2018	Pro forma 2018
Total FTE Enrollment	28,070	26,880	24,956	24,347	22,870	22,870
Operating Revenue (\$000)	173,462	183,160	170,394	172,636	178,702	178,702
Annual Change in Operating Revenue (%)	1.8	5.6	-7.0	1.3	3.5	3.5
Total Cash & Investments (\$000)	105,152	104,138	109,203	119,398	131,627	131,627
Total Debt (\$000)					1,329	58,929
Spendable Cash & Investments to Total Debt (x)					94.9	2.1
Spendable Cash & Investments to Operating Expenses (x)	0.6	0.6	0.6	0.7	0.8	0.8
Monthly Days Cash on Hand (x)	210	203	221	252	275	275
Operating Cash Flow Margin (%)	3.1	8.2	5.8	9.7	11.8	11.8
Total Debt to Cash Flow (x)	0.0	0.0	0.0	0.0	0.1	2.8
Annual Debt Service Coverage (x)	3.8				153.2	4.7

Pro forma 2018 reflects fiscal 2018 financial information with planned Series 2019 issuance. Annual debt service coverage incorporates fiscal 2019 debt service (maximum annual debt service or MADs).

FTE enrollment is fall unduplicated headcount as reported to IPEDS

Source: Moody's Investors Service

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Profile

Pima County Community College District (PCC or the district) is the main provider of two-year education and vocational training across six campuses in Pima County, Arizona. The district served a fall 2018 enrollment of nearly 23,000 students and had operating revenue of over \$178 million in fiscal 2018.

Detailed credit considerations

Market profile: emphasis on workforce development programs to improve demand

The district's location in increasingly economically vibrant Tucson, AZ and management's actions to expand workforce development programs in high demand areas such as automotive and autonomous vehicle technology, robotics, and mining technology, will improve enrollment over the medium to long term. Similar to peers, PCC's student demand has suffered during the recovery from the Great Recession, and from fall 2011 through fall 2018, enrollment declined roughly 38%.

Favorably, the district continues to take measures to enhance its market position including increasing partnerships with local employers and bolstering online offerings. PCC's proposed Series 2019 revenue bond issuance will allow expansion of applied technology programs in addition to programs in public safety and allied health. Additionally, management expects the continued growth in the number of dually enrolled high school students to further stabilize enrollment.

Operating performance: improving cash flow driven by expense reductions and strong property tax revenue

PCC's operating performance will continue to steadily improve given continued growth of its primary revenue source, property taxes and expense containment efforts. The district is subject to a state mandated expenditure limitation which tie maximum allowable expenses to enrollment levels. Given declining enrollment, PCC has needed to reduce expenses, which have declined by nearly 11% since fiscal 2015 with additional reductions planned for fiscal 2019 and 2020. The district has reduced staffing levels, enacted hiring freezes, eliminated athletic programs, and instituted other strategic measures to ensure compliance with the expenditure limitation. Operating cash flow margins improved to nearly 12% in fiscal 2018 bolstered by the expense reductions and higher operating revenue. The district's conservative fiscal management which includes ample contingency budgeting further supports PCC's improving operating performance.

In fiscal 2018, 62% of PCC's operating revenue was derived from property taxes. Community college districts in Arizona can raise the property tax levy by 2% annually in addition to benefiting from new property growth. If a district chooses not to use the entirety of its 2% increase in a given year, it can reserve that unused capacity for future years. The district is currently at the levy maximum. Strong property tax revenue offsets the lack of state operating support as the state withdrew appropriations for the district (and Maricopa County Community College District) in fiscal 2016.

Wealth and liquidity: robust levels of flexible reserves

PCC's financial reserves will remain strong and continue to provide good financial flexibility. The district and its affiliated foundation had \$132 million in total cash and investments at fiscal end 2018, up 25% since fiscal 2014. Spendable cash and investments of \$126 million, cover pro forma debt and operations 2.1x and 0.8x, stronger than the medians for Aa-rated community colleges of 0.7x and 0.6x, respectively (2017 data). The district's foundation is in the early stages a ten year \$300 million comprehensive campaign, proceeds from the campaign will be allocated toward capital projects, programmatic support, endowed faculty chairs and scholarships.

Liquidity

Liquidity will remain strong, with fiscal end 2018 monthly liquidity of \$119 million providing a healthy 275 days cash on hand higher than the median of 149 days for Aa-rated community college peers. Consistency of property tax revenue, an increasingly flexible expense base, and an all fixed rate debt portfolio limit potential calls on liquidity.

Leverage: low direct debt burden

PCC's debt burden will continue to remain manageable even when incorporating planned debt issuance. At fiscal end 2018, the district had a low \$1.3 million in outstanding capital lease agreements and no other direct debt obligations. PCC has had no outstanding long-term debt since fiscal 2014. The district's proposed Series 2019 issuance of approximately \$58 million in revenue-backed bonds will primarily support expansion of career and technical education facilities at its Downtown campus. While PCC has no near-term plans for additional debt, a very high age of plant of 23 years reflects the need for future capital and ongoing deferred maintenance investments.

Debt structure

Favorably, PCC's proposed Series 2019 issuance is fixed rate, and regularly amortizing, allowing for budgetary predictability.

Legal security

The district's proposed revenue bond obligations will be secured by a broad gross pledge of tuition and fees, auxiliary revenue and other student charges. PCC pledges to maintain sum sufficient debt service coverage from pledged revenue and must ensure maximum annual debt service (MADs) on all revenue bonds not exceed 8% of the college's current expenditures. Estimated Series 2019 MADs of \$4.5 million is less than 3% of 2019 budgeted current expenditures. In fiscal 2018, pledged gross revenues of \$34 million, representing 19% of total operating revenue, covered MADs 7.55x.

Debt-related derivatives

There are no debt-related derivatives.

Pensions and OPEB

PCC's pension and post-retirement liabilities are elevated but manageable. The district provides defined benefit and OPEB plans through a cost-sharing, multiple-employer plan administered by the Arizona State Retirement System (ASRS) and the Public Safety Personnel Retirement System (PSPRS). In fiscal 2018, the PCC's retirement related expenses were a manageable 1.4% of operating expenses, down from 4.8% in fiscal 2017 impacted by GASB 75 related changes. Contribution rates and investment return assumptions are set by the legislature. The Moody's adjusted net pension liability (ANPL) for the district is \$273 million, and, combined with other debt, represents an elevated 2.0x operating revenue for fiscal 2018, although slightly lower than the Aa-rated community college median of 2.2x. PCC's annual pension contribution is roughly 70% of Moody's calculated tread water payment, indicating that the long-term liability of the pension obligation will rise over time.

Governance and management: solid planning and financial management

The district's effective management team views the PCC as an integral part of Tucson's economy and is continuously engaging local stakeholders to ensure programmatic offerings align with the needs of the community. PCC is currently evaluating its space requirements including the possibility of selling a smaller campus (Community campus) or leasing space at its district office to use the proceeds to re-invest in programmatic initiatives. The district is governed by a five-member elected governing board, which has discretion to raise taxes according with state limitations, as well as set tuition rates.

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