S&P Global
Ratings

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Summary:

Gilbert, Arizona; General Obligation; General Obligation Equivalent Security

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Summary:

Gilbert, Arizona; General Obligation; General Obligation Equivalent Security

Credit Profile		
Gilbert GO		
Long Term Rating	AAA/Stable	Upgraded
Gilbert Imp Dist No. 19		
Long Term Rating	AA-/Stable	Upgraded
Gilbert Twn Imp Dist No. 20, Arizona		
Gilbert, Arizona		
Gilbert Twn Imp Dist No. 20 (Gilbert) GOEQUIV		
Long Term Rating	AA-/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on Gilbert, Ariz.'s general obligation bonds (GO) outstanding. At the same time, S&P Global Ratings raised its long-term rating to 'AA-' from 'A+' on the town's improvement district bonds. The outlook is stable.

The raised ratings reflects our view of the town's robust economic development, which has improved wealth and income indicators to strong levels. The continuous growth has driven stable increases in ongoing revenue, supporting our view of the town's strong budgetary performance, which is further reinforced by what we consider very strong financial management policies and practices. Despite a planned modest use of reserves in the most recent audited fiscal year, the town's fund balance position remains very strong, demonstrating its strategy to utilize its excess fund balances to fund capital needs, pay down debt, and make additional contributions toward its pension liability, alleviating the budgetary pressure from long-term liabilities. While we expect the town's economic growth will continue at more moderate rates in coming years, we expect these credit factors will remain consistent overall throughout the foreseeable future.

Security

The town's unlimited ad valorem property tax pledge secures the GO bonds.

The improvement bonds are secured by a special assessment levied against property in the district. In the event of a deficiency in the funds collected from the special assessments to make timely debt service payments, the town shall, to the extent permitted by law, make a temporary loan from other available funds to the special assessment debt service fund. We rate the improvement district bonds three notches below the town's GO in accordance with our "Issue Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" criteria, published Jan. 22, 2018, on RatingsDirect. The rating reflects the town's contingent liability to loan money to the special assessment revenue fund if special assessments are insufficient to cover debt service. Although the town is contingent guarantor for the special assessment debt, we note that we do not currently believe the obligations pose a significant liquidity risk, given adequate annual coverage from special assessment collections.

Credit fundamentals

The ratings further reflects our opinion of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 67% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.0x total governmental fund expenditures and 11.0x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 18.7% of expenditures and net direct debt at 104.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 71.0% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Gilbert's GO bonds are eligible to be rated above the sovereign because we believe the town 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, U.S. local governments are considered to have moderate sensitivity to country risk. In a potential sovereign default scenario, U.S. local governments should maintain financial flexibility through the ability to continue collecting locally derived revenue, and U.S. local governments have independent treasury management.

Very strong economy

We consider Gilbert's economy very strong. The town, with an estimated population of 254,982, is located in southeastern Maricopa County, roughly 35 miles southeast of downtown Phoenix, within the Phoenix-Mesa-Scottsdale, Ariz., MSA, which we consider to be broad and diverse. Formerly centered on agriculture, the town's local economy has experienced vast expansion over the last several years in the commercial, industrial, and residential sectors. The town's economic development strategy focuses on life sciences, aerospace, technology, and advanced business services, and has attracted several large employers within the industries. The town's major employers are diverse and include Gilbert Unified School District, Banner Health, Wal-Mart, the town itself, and Go Daddy Software, with additional growth in the aerospace and health care sectors. The town has a projected per capita effective buying income of 114% of the national level and per capita market value of $109,837. The county unemployment rate was 4.1% in 2018.

Since 2014, the town's property values have grown at strong rates, exemplifying the rapid economic development within the town and a recovery from the Great Recession. The town's market value (net full cash value) grew by 8.3% in 2019 to $25.4 billion, surpassing its prerecession peak. Preliminary estimates show continued growth to $28.0 billion in 2020. The town's tax base deteriorated substantially during the recession, with the net full cash value declining by a cumulative 48.4% between 2009 and 2014. The town's net limited assessed value (AV), which is now used for setting the tax rate, has grown consistently in recent years, mirroring the net full cash value trend, and totaled $2.1 billion in 2018, a 6.4% increase from the prior year. Net limited AV is expected to grow by 7.1% and 8.2% in 2019 and 2020, respectively. We expect continued growth in property values in coming years as the ongoing development within the town persists, including new hotel, residential, and commercial development. The taxpayer base is very diverse, in our view, with the 10 largest property taxpayers accounting for 3.1% of net limited AV in 2018.

The Mountain region of the U.S. continues to lead the country in net migration from other states, and we expect most of these new residents to find work, with nonfarm employment growth expanding through 2021. As many of these new residents come with coastal-level buying power, we anticipate that median home price growth will proceed at more than two times the national Consumer Price Index and give developers incentive to build in a region with plenty of land. On the flip side, the forecast also points to a major slowdown in housing starts in 2019 before a rebound in 2020 and 2021. Further, we see the region's diverse portfolio of leading industries--professional services, natural resources and mining, and leisure and hospitality--and attractiveness to interstate migrants for its quality of life as helping it capture a portion of the growth that would otherwise flow to high-paying but even higher-costing metropolitan areas in the Pacific states. For more information, please see our report "Summer Should Be Smooth Sailing For U.S. State And Local Governments, But There Could Be Waves Ahead," published April 30, 2019.

Very strong management

We view the town's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights of policies and practices include the town's conservative budgeting practices based on internal analysis of extensive historical trends and economic conditions. The town maintains an annually updated five-year financial forecast, which is based on detailed scenario modeling, as well as an annually updated capital improvement plan covering fiscal years 2020 through 2029. Management actively reviews its forecasts and provides budget-to-actual reports to the governing body on a quarterly basis. The governing body has formally adopted comprehensive investment and debt policies, and investment performance is reported to the council at least quarterly, with monthly updates provided to the investment committee. The town also adheres to a formal unrestricted fund balance policy requiring a fund balance of at least 25% of expenditures, which equates to 90 days of expenditures, and one year of debt service, with additional reserve policies for other funds.

Strong budgetary performance

Gilbert's budgetary performance is strong, in our opinion, and operating performance has been better than budgeted in each of the last three fiscal years. In fiscal 2018, the town had surplus operating results in the general fund of 5.2% of expenditures, and balanced results across all governmental funds of 0.5%. Our assessment accounts for various adjustments to exclude one-time revenues and expenditures, including certain capital outlay, economic development incentives, and a payout to employees as the result of a lawsuit pertaining to the Public Safety Personnel Retirement System (PSPRS), as well as the inclusion of recurring transfers out of the general fund to the debt service funds as ongoing expenditures.

We note that Gilbert relies heavily on volatile revenue such as sales and other cyclical tax revenue, as the town does not levy primary property taxes for operations. We believe that potential correlated budgetary pressures are somewhat alleviated by the town's maintenance of its very strong fund balance position and very strong financial management. The town's sales taxes have increased by an annual average rate of 8% over the last five years to $89.5 million in fiscal 2018.

Looking ahead, the town has conservatively budgeted for a general fund deficit in fiscal 2019 of about 21% of budgeted expenditures, although management expects to the end year near balanced, as it has historically, due to unspent contingencies and to higher-than-budgeted sales and use tax revenue. While the town anticipates a deficit of about $2 million at year-end, the fiscal 2019 budget includes various one-time expenditures. Gilbert's fiscal 2020 budget projects an additional deficit of about 19% of budgeted expenditures, reflecting conservative revenue and expenditure assumptions and including various one-time capital outlay expenditures and a one-time $9.5 million excess contribution to its PSPRS liability. While we expect the town will maintain its strong financial position in the near term after accounting for these one-time items, our assessment accounts for our expectation that budgetary results could deteriorate somewhat from 2018 results.

Very strong budgetary flexibility

Gilbert's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 67% of operating expenditures, or $113.8 million. The town's available fund balance position has remained very strong historically, in our opinion, with reserves equating to upwards of 50% of expenditures since fiscal 2012. In fiscal 2017, the town reclassified its vehicle license tax and streets capital replacement funds to report as part of its general fund, resulting in an increase in both the available fund balance and general fund expenditures, which in turn reduced the budgetary flexibility ratio. Although the town maintains a practice of intentionally utilizing its reserves for various one-time items as needed, we expect the available fund balance to remain well above the town's formal reserve policy and above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Additionally, the town maintains a reserve within its outside sources fund, which is funded by developer reimbursements for capital projects. Management indicated that, while these funds are assigned for capital projects, they are not restricted and are legally available for operations, if necessary. In fiscal 2018, the outside sources fund maintained an available fund balance of $15.9 million, which would increase the available fund balance to 76.3% of general fund expenditures.

Very strong liquidity

In our opinion, Gilbert's liquidity is very strong, with total government available cash at 2.0x total governmental fund expenditures and 11.0x governmental debt service in 2018. In our view, the town has strong access to external liquidity if necessary. Gilbert has issued various forms of long-term debt frequently over the last 15 years, including GO bonds, street and highway user bonds, and several types of enterprise debt, and we have no reason to believe that the town's access to markets has diminished. We expect that liquidity levels will not materially change in the next few years. Management reports that it has no exposure to direct purchase debt or instrument provisions that might increase liquidity risk. Additionally, as the majority of investments are in government investments, we do not consider the portfolio to pose a liquidity risk.

Adequate debt and contingent liability profile

In our view, Gilbert's debt and contingent liability profile is adequate. As of fiscal 2019, the town has approximately $365 million in direct debt outstanding. Total governmental fund debt service is 18.7% of total governmental fund expenditures, and net direct debt is 104.8% of total governmental fund revenue. Overall net debt is low at 1.9% of market value, and approximately 71.0% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors. We understand that the town intends to issue $65.4 million in GO debt in May 2020 and is currently evaluating the need for an additional GO authorization within the next three years.

The town participates in three defined-benefit pension plans for its personnel: the Arizona State Retirement System (ASRS), the PSPRS, and the Elected Officials Retirement System. ASRS, the largest plan, maintained a plan fiduciary net position as a percentage of total pension liability of 69.9% as of June 30, 2018, and the proportionate share of the net pension liability was $76.8 million. Public safety employees participate in the PSPRS, which is an agent multiple-employer retirement system, maintained a funded ratio of 64.4% for the police plan and 77.1% for the fire plan, and the town's proportionate share of the combined net pension liability is $41.2 million. Gilbert's combined required pension and actual other postemployment benefit contributions totaled 6.8% of total governmental fund expenditures in 2018, which we consider moderate. In an effort to reduce its PSPRS unfunded pension liability, the town has implemented a policy to make contributions of $2 million annually above its annual required contribution, as well as additional contributions from excess revenue at year-end, until fiscal 2021, when it estimates the plan will be 90% funded, assuming current rates remain level. In fiscal 2018, the town made an additional payment toward PSPRS of $2.5 million and, as a result, the town made 110% of its annual required pension contribution in 2018.

Strong institutional framework

The institutional framework score for all Arizona municipalities with a single audit requirement is strong.

Outlook

The stable outlook reflects our view of the town's local economy, which has exhibited strong growth in recent years, strengthening its wealth and income indicators to a sustainably strong level. Although we expect growth rates will moderate somewhat in coming years, we expect the town's strong operating performance and very strong financial position will remain stable throughout our two-year outlook horizon. The town's efforts to proactively address its long-term liabilities further supports our view of the overall creditworthiness, as we believe the mitigation of potential budgetary pressure provides additional stability in the financial position. Therefore, we do not expect to change the ratings in the next two years.

Downside scenario

Should the town experience a sustained operational imbalance, resulting in a significant reduction in its reserves to a level we no longer consider very strong, we could lower the ratings.

Related Research

2018 Update Of Institutional Framework For U.S. Local Governments

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Ratings

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Summary:

Gilbert, Arizona; Miscellaneous Tax

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Summary:

Gilbert, Arizona; Miscellaneous Tax

Credit Profile		
Gilbert MISCTAX		
Long Term Rating	AAA/Stable	Upgraded
Gilbert Pub Facs Mun Prop Corp, Arizona		
Gilbert, Arizona		
Gilbert Pub Facs Mun Prop Corp (Gilbert) MISCTAX		
Long Term Rating	AAA/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on Gilbert Public Facilities Municipal Property Corp., Ariz.'s existing senior-lien excise tax revenue bonds, issued on behalf of the town of Gilbert. At the same time, S&P Global Ratings raised its long-term rating to 'AAA' from 'AA+' on the town's existing subordinate-lien excise tax bonds. The outlook is stable.

The raised rating reflects the application of our "Priority-Lien Tax Revenue Debt" criteria, published Oct. 22, 2018, on RatingsDirect, which factors in both the strength and stability of the pledged revenue, as well as the general credit quality of the town, where taxes are distributed and collected (the obligor's creditworthiness, or OC). The priority-lien rating on all excise tax revenue obligations is equivalent to the OC and is therefore not constrained by our view of the town's underlying creditworthiness.

Security

The senior bonds are secured by a first lien on the town's excise taxes and state-shared revenue. Excise taxes are composed of unrestricted transaction privilege (sales) tax, business license and franchise fees, parks and recreation permits and fees, and fines and forfeitures that Gilbert imposes. State-shared revenue includes transaction privilege (sales) taxes and income taxes collected by the state and allocated to Gilbert. The senior bonds are special limited obligations of the Gilbert Public Facilities Municipal Property Corp. payable from rent payments due from Gilbert to the corporation pursuant to the triple-net town lease. Under the lease, the town pledges its excise tax revenue and the state-shared revenue first to the lease rental payments for the bonds and parity bonds and before any other purpose. In addition, the lease is not subject to abatement or appropriation. While not legally pledged to the bonds, certain of the town's developer fee revenue has been allocated toward its excise tax obligations, which have historically paid about 75% of the annual debt service on both liens.

The subordinate-lien bonds are secured by a second lien on the town's excise taxes and state-shared revenue.

Credit fundamentals

Key credit considerations include:

- A large and diverse tax base located within the Phoenix-Scottsdale-Mesa metropolitan statistical area (MSA), with coupled with strong per capita income levels;
- Our view that nationwide sales taxes have historically demonstrated low volatility, in addition to our view of low volatility at the local level; and
- The town's maintenance of very strong coverage on the both liens, with 10.1x maximum annual debt service coverage (MADS) on the senior lien and 8.9x coverage on the subordinate lien, based on actual fiscal 2018 pledged revenue.

Gilbert's excise tax bonds are eligible to be rated above the sovereign because we believe the town 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, U.S. local governments are considered to have moderate sensitivity to country risk. In a potential sovereign default scenario, U.S. local governments should maintain financial flexibility through the ability to continue collecting locally derived revenue, and U.S. local governments have independent treasury management.

Economic fundamentals: Strong to very strong

Gilbert, with an estimated population of 254,982, is located in southeastern Maricopa County, roughly 35 miles southeast of downtown Phoenix, within the Phoenix-Mesa-Scottsdale, Ariz., MSA, which we consider to be broad and diverse. Formerly centered on agriculture, the town's local economy has experienced vast expansion over the past several years in the commercial, industrial, and residential sectors. The town's economic development strategy focuses on life sciences, aerospace, technology, and advanced business services, and has attracted several large employers within the industries. The town's major employers are diverse and include Gilbert Unified School District, Banner Health, Wal-Mart, the town itself, and Go Daddy Software, with additional growth in the aerospace and health care sectors. The town has a per capita effective buying income of 113% of the national level and per capita market value of $109,837. The county unemployment rate was 4.1% in 2018.

Since 2014, the town's property values have grown at strong rates, exemplifying the rapid economic development within the town and a recovery from the Great Recession. The town's market value (net full cash value) grew by 8.3% in 2019 to $25.4 billion, surpassing its prerecession peak. Preliminary estimates show continued growth to $28.0 billion in 2020. The town's net limited assessed value (AV), which is now used for setting the tax rate, has grown consistently in recent years, mirroring the net full cash value trend, and totaled $2.1 billion in 2018, a 6.4% increase from the prior year. Net limited AV is expected to grow by 7.1% and 8.2% in 2019 and 2020, respectively. We expect continued growth in property values in coming years as the ongoing development within the town persists, including new hotel, residential, and commercial development. Reflective of the ongoing development, we anticipate continued growth in the pledged revenue driven by construction-related and ongoing sales tax revenue. Sales tax collections are primarily concentrated in retail sales, representing 60% of total collections. While specific information on the town's sales tax contributors is privileged, we believe the taxpayer base to be diverse, with the 50 largest transaction privilege tax contributors accounting for 51% of total collections.

The Mountain region of the U.S. continues to lead the country in net migration from other states, and we expect most of these new residents to find work, with nonfarm employment growth expanding through 2021. As many of these new residents come with coastal-level buying power, we anticipate that median home price growth will proceed at more than two times the national Consumer Price Index and give developers incentive to build in a region with plenty of land. On the flip side, the forecast also points to a major slowdown in housing starts in 2019 before a rebound in 2020 and 2021. Further, we see the region's diverse portfolio of leading industries--professional services, natural resources and mining, and leisure and hospitality--and attractiveness to interstate migrants for its quality of life as helping it capture a portion of the growth that would otherwise flow to high-paying but even higher-costing metropolitan areas in the Pacific states. For more information, please see our report "Summer Should Be Smooth Sailing For U.S. State And Local Governments, But There Could Be Waves Ahead," published April 30, 2019.

Volatility: Low

We assess the volatility of revenue in order to determine the likelihood of the availability of revenue during different economic cycles. We have two levels of volatility assessment: macro and micro.

On a macro level, we consider sales and use tax revenue to have a low historical volatility assessment, based on total retail food and service sales data from the U.S. Census Bureau over the past two decades. Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Nationwide retail and food service sales have historically fluctuated moderately throughout severe economic downturns and price fluctuations, as sales of nonessential goods are relatively cyclical. However, we expect overall collections will remain relatively stable nationwide, given the relative inelasticity of demand for certain taxable goods and services.

On a micro level, local sales taxes, representing 53% of pledged revenue, has been relatively stable overall, experiencing a more modest recessionary decline relative to state peers of 18% between 2007 and 2010. Similarly, overall pledged revenue declined by a cumulative 17% during the recession. The inclusion of state-shared sales and income taxes, which together account for 37% of overall pledged revenue, provides some additional revenue diversity. The state-shared revenue is collected by the state and distributed to cities and towns monthly based on a statutory formula. The allocation of revenue to each city and town is based on their population relative to the aggregate population of all cities and towns as shown by the latest census. The town uses population estimates from a special annual census for its portion of the state-shared revenue, as opposed to the regular census conducted each decade, which has allowed the town to benefit from its growing population, as it is one of the fastest-growing municipalities in the state. Over the past five years, the total pledged revenue trend has been strong, growing by an average annual rate of 6.4% between fiscals 2014 and 2018, surpassing the prerecession peak.

Coverage and liquidity: Very strong

Based on fiscal 2018 collections, the town's pledged revenue of $169.7 million provides MADS coverage on the senior lien of 10.1x, which we consider very strong. All-in coverage on the subordinate lien is also very strong, in our view, at 8.9x using fiscal 2018 pledged revenue. The town's fiscal 2019 budget assumes 2.1% pledged revenue growth, although management anticipates actual growth to surpass the budgeted amount, supported by the ongoing development. The fiscal 2020 budget reflects conservative growth assumptions, as the town does not budget for growth in construction-related revenue and assumes flat sales tax growth. We expect coverage will remain at least very strong throughout the near-term horizon, given the expected pledged revenue growth and lack of additional debt plans.

The senior bonds' additional bonds test (ABT) requires pledged revenue for the preceding fiscal year to cover MADS for the senior debt by 3x. The senior lien does not require an initial debt service reserve, but the lease requires a buildup of a debt service reserve if debt service coverage declines to less than 3x. The lease also includes a covenant to maintain rates such that pledged revenue provides 2x annual debt service coverage.

Bond provisions for the subordinate-lien bonds include an ABT that requires pledged revenue for the preceding fiscal year to cover MADS for the senior and subordinate debt by 2x. The subordinate bonds also require a debt service reserve funded at the least of 10% of net proceeds of the original obligations, MADS, or 125% of average annual debt service at time of original delivery. We understand the district has no plans for additional senior or subordinate bonds.

With very strong coverage and a low volatility assessment based on our view of the dependability of sales and use taxes (the largest revenue stream), there is no downward adjustment to the strong coverage score that would indicate potential liquidity pressures.

Obligor linkage: Close

We believe the priority lien of pledged revenue provides some protection from operating risk; however, because taxes are collected monthly by the town, which then transfers to the trustee, we consider the flow of pledged revenue to be within the town's direct control. Under our criteria, this narrows the linkage between the priority-lien pledge and the OC, as we believe pledged revenue has some degree of exposure to operating risk. We assess the town's general operations, because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax.

Rating linkage to Gilbert

Continuous growth in the local tax base has driven stable increases in ongoing revenues, supporting our view of the town's strong budgetary performance, which is further reinforced by what we consider very strong financial management policies and practices. Despite a planned modest use of reserves in the most recent audited fiscal year, the town's fund balance position remains very strong, demonstrating its strategy to utilize its excess fund balances to fund capital needs, pay down debt, and make additional contributions toward its pension liability, alleviating the budgetary pressure from long-term liabilities. While we expect the town's economic growth will continue at more moderate rates in coming years, we expect these credit factors will remain consistent overall throughout the foreseeable future.

For more information on the OC, please see our rating report published June 28, 2019.

Outlook

The stable outlook reflects our view of the town's large and diverse local tax base, which is in the midst of ongoing expansion, supporting our expectation of continued growth in total pledged revenue. Given the town's lack of additional debt plans and growing pledged revenue, we expect coverage will remain at levels we consider very strong throughout the near term. We do not anticipate changing the rating within the two-year horizon of the outlook.

Downside scenario

If pledged revenue declines considerably, or if the town issues a significant amount of additional parity debt, causing coverage to fall to levels that we would no longer consider strong, we could lower the rating. Additionally, should the town's OC deteriorate by multiple notches, we could lower the priority-lien rating.