

## CREDIT OPINION

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# Rio Rancho (City of) NM

Update following upgrade of GOULT to Aa2 from Aa3

### Summary

The credit profile of the [City of Rio Rancho, NM](#) (Aa2) benefits from the city's strong financial performance coupled with strengthened financial policies including the adoption of a minimum reserve policy and creation of a permanent fund. These policies help mitigate the city's reliance on economically sensitive gross receipt taxes. The rating also incorporates Rio Rancho's large and growing economy that will benefit from [Intel Corporation's](#) (A1 stable) major expansion in the area. The city's debt burden is manageable and supported by rapid principal amortization. Pension liabilities are elevated, but expected to benefit from recent legislative reform to the Public Employees Retirement Association (PERA) that mandated increased contributions by employees and participating governments.

On April 22, we upgraded the city's general obligation unlimited tax (GOULT) rating to Aa2 from Aa3.

### Credit strengths

- » Adoption of formal reserve policy and creation of Permanent Fund
- » Growing tax base with proximity to Intel expansion
- » Manageable debt burden with rapid principal amortization

### Credit challenges

- » Reliance on economically sensitive GRT revenue
- » Elevated pension burden with perpetual tread water gap

### Rating outlook

Moody's does not generally assign outlooks to local governments with this amount of debt outstanding.

### Factors that could lead to an upgrade

- » Significant diversification of revenue stream
- » Material moderation of the city's pension liabilities
- » Continued operational surplus leading to bolstered operating reserves

## Factors that could lead to a downgrade

- » Trend of operational imbalance leading to erosion of operating reserves
- » Significant additional leverage, either via debt issuance or increase in pension liabilities
- » Material or sustained trend of economic contraction

## Key indicators

Exhibit 1

| Rio Rancho (City of), NM  | 2017        | 2018        | 2019        | 2020        | 2021        |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>Economy/Tax Base</b>   |             |             |             |             |             |
| Total Full Value (\$000)  | \$6,398,404 | \$6,716,078 | \$6,967,197 | \$7,295,494 | \$7,831,501 |
| Population  |             |             |             |             |             |
| Full Value Per Capita   | 93,317      | 94,765      | 96,210      | 97,976      | 104,046     |
| Median Family Income (% of US Median)                                     | \$68,566    | \$70,871    | \$72,417    | \$74,462    | \$75,270    |
| <b>Finances</b>   |             |             |             |             |             |
| Operating Revenue (\$000)   | \$67,549    | \$68,003    | \$75,172    | \$85,762    | \$102,140   |
| Fund Balance (\$000)  | \$21,125    | \$18,509    | \$28,074    | \$38,244    | \$65,049    |
| Cash Balance (\$000)  | \$22,607    | \$18,694    | \$37,291    | \$60,932    | \$77,663    |
| Fund Balance as a % of Revenues   | 31.3%       | 27.2%       | 37.3%       | 44.6%       | 63.7%       |
| Cash Balance as a % of Revenues   | 33.5%       | 27.5%       | 49.6%       | 71.0%       | 76.0%       |
| <b>Debt/Pensions</b>  |             |             |             |             |             |
| Net Direct Debt (\$000)   | \$42,820    | \$37,249    | \$49,221    | \$67,470    | \$57,914    |
| 3-Year Average of Moody's ANPL (\$000)                                    | \$195,317   | \$210,729   | \$221,399   | \$218,064   | \$247,688   |
| Net Direct Debt / Full Value (%)  | 0.7%        | 0.6%        | 0.7%        | 0.9%        | 0.7%        |
| Net Direct Debt / Operating Revenues (x)                                  | 0.6x        | 0.5x        | 0.7x        | 0.8x        | 0.6x        |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 3.1%        | 3.1%        | 3.2%        | 3.0%        | 3.2%        |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)   | 2.9x        | 3.1x        | 2.9x        | 2.5x        | 2.4x        |

Sources: Rio Rancho's audited financial statements; Moody's Investors Service; US Census Bureau

## Profile

Rio Rancho is located in central New Mexico (Aa2 stable) adjacent to [Albuquerque](#) (Aa3 positive), the state's largest city. The city is the third largest city in New Mexico with a population of 104,046 per the 2020 US Census.

## Detailed credit considerations

### Economy and tax base: city will benefit from major Intel Corporation expansion

The city's economy is likely to remain in modest expansion mode over the next several years. Intel Corporation announced a \$3.5 billion expansion of its advanced manufacturing capabilities in the area; Intel is formally located in unincorporated Sandoval County but is completely surrounded by Rio Rancho. The city benefits from its proximity to the City of Albuquerque (Aa3 positive) and anchor employers such as [University of New Mexico](#) (flagship campus; Aa3 stable), Sandia National Labs, [Hewlett-Packard](#) (HP Inc.; Baa2 stable), and Kirtland Airforce Base. Management also reports the expansion of aerospace and other advanced manufacturing capabilities in the area are driving the demand for skilled workers.

Similar to the rest of the nation, there is a high demand for residential housing and management reports some 3,500 lots are in various stages of development, including master planned communities and multifamily residential development. The growing economy is

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pushing commercial development as well, including in the fast casual and quick service dining space with a number of new restaurants opening recently.

The city's tax base expanded at an annual average rate of 4.8% over the past five years, including 7.3% growth to \$7.8 billion in fiscal 2021 (derived from an assessed valuation of \$2.6 billion). Resident income is slightly below average with median family income equal to 94.3% of the US, though the metric compares more favorably at 120.6% of the state. The city's February 2022 unemployment rate of 4.4% compared favorably to the state's 4.9% and slightly lagged the nation's 4.1% for the same period. Positively, both labor force participation and the number of employed persons edged the pre-pandemic 2019 figures, indicating a strong recovery from the economic impact of the pandemic.

#### **Financial operations and reserves: strengthened financial policies and strong GRT performance a positive**

The city's financial operations are expected to remain stable over the next several years, driven by strengthened financial policies and conservative budgeting practices. The city recently adopted a policy to maintain general fund reserves equal to at least 25% of expenditures. Additionally, in March 2022, voters approved the creation of a Permanent Fund. The fund will be seeded with an initial investment of \$10 million. Proceeds will be invested and 50% of annual returns will be directed to the general fund with the remaining 50% reinvested in the fund.

The city's operating funds (general, gross receipts and debt service funds) posted an \$11.7 million operating surplus in fiscal 2021 (June 30 fiscal year end), pushing available operating reserves to \$65.1 million, representing 63.7% of operating revenue. The surplus was attributable to better than anticipated revenue collection, particularly within GRT, which between the municipal and state share, comprises roughly 48% of operating revenue. The city also benefited from a material increase in federal aid that offset costs associated with the coronavirus pandemic.

The city's general fund reserves are projected to revert to around the 25% mark by the end of fiscal 2023 as the city stands up the Permanent Fund (initial \$10 million contribution from the general fund) and provides for one-time capital investments in the community including deferred maintenance projects on residential roads, cybersecurity upgrades, and public safety and park facility improvements. Positively, the city has an additional 2/8th hold harmless GRT remaining, and although there are no plans to implement, Rio Rancho can do so without voter approval. Each 1/8th generates around \$1.1 million per year in additional revenue.

The city's five-year forecast (fiscal 2022 to fiscal 2026) anticipates annual surplus operations ranging from \$7.1 million to \$12.7 million during the five year span. Net of transfers, general fund reserves will revert to around 25% in fiscal 2023, as described above, before improving to roughly 35% in fiscal 2027. The city was awarded \$12.9 million under the American Rescue Plan Act (ARPA) and plans to use the funds for infrastructure projects.

#### **Liquidity**

The city closed fiscal 2021 with \$77.7 million in operating liquidity, representing a very strong 76% of operating revenue. The city pays annual debt service in August, thus, cash is at its peak at fiscal year-end.

#### **Debt and pensions: manageable debt burden with rapid principal amortization; pension burden to benefit from legislative reform**

The city's debt burden will likely decline in the near-term given rapid principal amortization and no plans to approach voters for additional general obligation authorization until early 2024. Inclusive of the current issuance, the city's debt burden is a manageable 0.8% of fiscal 2021 full value. Included in the profile are \$31.2 million in GO bonds, \$16.4 million in GRT bonds (unrated) and \$10.4 million in loans privately placed with [New Mexico Finance Authority](#) (Aa1 stable).

#### **Legal security**

The city's GOULT bonds are payable from ad valorem property taxes to be levied, without limitation as to rate or amount, against all taxable property within the city. The bonds are secured by the city's full faith and credit pledge.

#### **Debt structure**

The city's GOULT debt is fixed rate and matures over the medium term (final maturity in fiscal 2034). Principal amortization is rapid with 92% of principal repaid within 10 years.

### Debt-related derivatives

The city is not party to any interest rate swaps or other derivative agreements.

### Pensions and OPEB

The city's pension liabilities are above average, though recent legislative reform is likely to have a positive impact on the unfunded liability. The city participates in PERA, a statewide, cost-sharing defined benefit plan, and reports its share of the plan's unfunded liability on its balance sheet. In 2020, legislative reform reduced benefit payouts and increased employer and employee contribution rates (employer contribution increases begin July 1, 2022). The reform is fairly moderate in nature though higher contributions will help lower the growth rate of PERA's unfunded liabilities for all participants. For more information, please refer to our sector comment "[Pension changes will lower liabilities for New Mexico and its municipalities, a credit positive.](#)"

Moody's fiscal 2021 adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is \$247.7 million, or an above average 2.4 times operating revenue. Perpetual underfunding of "tread water," the annual contributions required to prevent the reported net pension liability from increasing under plan assumptions, is likely to continue, irrespective of the state reform. The gap has declined from a peak of 5.9% of operating revenue in fiscal 2017 to 3.6% in fiscal 2021, equal to roughly \$3.6 million.

Based on Moody's calculations, the county's fiscal 2021 unfunded OPEB liability is \$31.5 million, or an average 31% of operating revenue. Fixed costs, including debt service, pension and OPEB contributions, were 16% of operating revenue in fiscal 2021, which is average. Positively, pension contributions that equal "tread water" would only increase the city's fixed costs to 19.5% of operating revenue, indicating the city has capacity to both contribute at "tread water" and absorb the increased reform contribution levels without a material negative impact to the city's financial position.

## ESG considerations

### Environmental

Rio Rancho's exposure to environmental considerations is moderately negative (E-3), primarily reflecting water stress and heat and wildfire risks. The city addresses exposure to drought conditions and water stress through its Water Resources Management Plan (WRMP). The plan is updated every five years (most recently in 2020) and touches on seven broad areas: water conservation, education and outreach, water reuse, water supply and infrastructure, source water protection, economic development, and enforcement. A key point of the plan is to recharge the Santa Fe Group Aquifer, the city's sole source of drinking water, by directly injecting cleaned water into the aquifer. Water that is injected back into the aquifer is available to the city without the requirement to purchase additional water right or pumping permits, effectively creating a storage tank for future use.

### Social

The city's exposure to social considerations is neutral-to-low (S-2). Resident income is average with median family income equal to 94.3% of the US, though the metric compares more favorably at 120.6% of the state. The city's February 2022 unemployment rate of 4.4% compared favorably to the state's 4.9% and slightly lagged the nation's 4.1% for the same period. Both labor force participation and the number of employed persons edged the pre-pandemic 2019 figures, indicating a strong underlying economy.

### Governance

Rio Rancho's exposure to governance considerations is neutral-to-low (G-2). The city is governed by a mayor elected at-large and six council members elected from individual districts elected to four-year staggered terms. The city manager is the Chief Administrative Officer of the city, in charge of day-to-day administration of all city affairs. The city recently strengthened its financial policies by increasing the minimum general fund reserve to 25% of expenditures, which is three times the minimum 1/12th general fund reserve required under New Mexico statute. General fund reserves have exceeded the 25% threshold annually since 2011. The city also created a Permanent Fund designed to use excess reserves of the city to generate a new recurring revenue source.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching adjustments dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

### Rio Rancho (City of), NM

| Scorecard Factors and Subfactors   | Measure     | Score |
|--|-------------|-------|
| Economy/Tax Base (30%) <sup>[1]</sup>  |             |       |
| Tax Base Size: Full Value (in 000s)  | \$7,831,501 | Aa    |
| Full Value Per Capita  | \$75,270    | Aa    |
| Median Family Income (% of US Median)  | 94.3%       | Aa    |
| Finances (30%)   |             |       |
| Fund Balance as a % of Revenues  | 63.7%       | Aaa   |
| 5-Year Dollar Change in Fund Balance as % of Revenues  | 43.7%       | Aaa   |
| Cash Balance as a % of Revenues  | 76.0%       | Aaa   |
| 5-Year Dollar Change in Cash Balance as % of Revenues  | 55.1%       | Aaa   |
| Notching Adjustments: <sup>[2]</sup>   |             |       |
| Unusually volatile revenue structure   |             | Down  |
| Other Scorecard Adjustment Related to Finances: 5-year trends projected to moderate in 5-year financial plan |             | Down  |
| Management (20%)   |             |       |
| Institutional Framework  | Aa          | Aa    |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)                         | 1.1x        | Aaa   |
| Debt and Pensions (20%)  |             |       |
| Net Direct Debt / Full Value (%)   | 0.8%        | Aa    |
| Net Direct Debt / Operating Revenues (x)   | 0.6x        | Aa    |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)                                    | 3.2%        | A     |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)                            | 2.4x        | A     |
| Scorecard-Indicated Outcome  | Aa2         |       |
| Assigned Rating  | Aa2         |       |

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Source: Rio Rancho's audited financial statements; Moody's Investors Service; US Census Bureau

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