S&P Global
Ratings

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Summary:

Queen Creek, Arizona; Miscellaneous Tax

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Credit Profile		
US$55.0 mil excise tax and state shared rev obligations ser 2018A due 08/01/2043		
Long Term Rating	AA/Stable	New
US$20.0 mil excise tax and state shared rev obligations ser 2018B due 08/01/2043		
Long Term Rating	AA/Stable	New
Queen Creek Twn excise tax and st shared rev rfdg obligated ser 2016 due 08/01/2036		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Queen Creek, Ariz.'s series 2018A and 2018B excise tax and state-shared revenue obligations. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating on the town's excise tax and state-shared revenue refunding obligations outstanding. The outlook is stable.

The series 2018 bonds are secured by a first lien of excise taxes, which include transaction privilege (sales) taxes, state-shared revenues, and franchise fees, and will be on parity with the town's series 2014A Greater Arizona Development Authority (GADA) loan and series 2016 excise tax and state-shared revenue obligations. Proceeds from the series 2018 bonds will be used to finance various street and public safety capital improvements.

The rating reflects our view of the town's:

- Participation in the diverse Chandler and Phoenix metropolitan statistical area economies, coupled with good to very strong income indicators;
- Strong legal provisions, with an above-average additional bonds test (ABT) of 3.00x and a covenant to raise excise taxes if pledged revenues fall below 1.25x annual debt service;
- Recent and projected pledged revenue growth; and
- Maintenance of very strong, 3.7x maximum annual debt service (MADS).

Partly offsetting the above strengths, in our view, are the town's below-average per capita retail sales.

Economy

Queen Creek, with an estimated population of 36,096, is located primarily in southeastern Maricopa County, with a small portion located within Pinal County, about 38 miles southeast of Phoenix and 14 miles southeast of Chandler. In our opinion, the town's median household effective buying income (EBI) is very strong, at 149% the national level, and its per capita EBI is good, at 98% the national level. Per capita retail sales were 50% of the national average in 2016. The county's unemployment rate has been improving and remains below the state and national levels at 4.5% in 2016.

Currently, the town encompasses an annexed area totaling 26 square miles, including a recently annexed auto center and Banner Regional Hospital. We understand that there is potential for additional annexation within the near term, which management estimates could generate an additional $2 million in annual revenue for the town if successful.

The town's local economy, which was formerly dominated by agriculture, has experienced continuous expansion with industrial, commercial, and residential development. The major sectors contributing to revenue generation include retail, construction, and food services. Management indicated that residential development has been on the rise since the recent recession, although it remains below prerecessionary rates. However, the recent residential development trend and a diversification in the town's retail base have resulted in a reduction in the town's reliance on construction-related revenues. The 10 largest sales taxpayers, excluding construction, consist primarily of big-box retailers, grocery, and utilities, make up about 43% of sales tax collections.

Pledged revenues

In 2016, pledged revenue consisted primarily of sales privilege and use tax revenue (55%), charges for services (24%), state-shared income tax revenue (10%), state-shared sales tax revenue (7%), and vehicle license tax revenue (3%). Management also indicated that about one-third of its retail sales tax revenues are generated from nonresidents, which could be attributed to the town's location near the unincorporated area of San Tan Valley.

Pledged revenue has been on an increasing trend since the recent recession, growing at an average annual rate of nearly 17% between fiscals 2011 and 2016. In fiscal 2016, pledged revenues totaled $32.8 million, representing an 11% increase from the fiscal 2015 figure. Unaudited actuals for 2017 report a 16% increase in pledged revenues to $38 million. Looking ahead, management has budgeted for a more modest growth in revenue of 4% to $39.5 million in fiscal 2018, which assumes an increase in sales tax collections overall, but a 4% decline in construction-related sales tax revenues. Officials anticipate pledged revenue collections to outperform their current projections at year-end, which we view as likely given the town's historical trend of better-than-budgeted performance.

Based on fiscal 2017 actual pledged revenue, we calculate MADS coverage on the bonds to be very strong, at 3.7x, including the remaining GADA loan. Debt service for the GADA loan is relatively modest, and because that debt service is included in the overall debt service mentioned above, any seniority of the shared pledged revenue would not affect the bonds. Projected pledged revenues for fiscal year 2018 also provide what we consider very strong MADS coverage of about 3.9x. Only the state-shared portion of the pledged revenues is subject to the state intercept for the GADA loans, and we calculate that the projected fiscal 2017 non-state-shared revenues could cover MADS by 2.8x.

Additionally, we understand that the town has implemented an infrastructure funding placeholder to fund pay-as-you-go capital expenses and debt service for new infrastructure, which will supplement pledged revenues for debt service on the bonds. The placeholder was created over the last two fiscal years with increased state-shared revenues and debt service savings and is currently funded at $6.5 million.

The town's population relative to the state's affects its distribution of state-shared revenues. Current population estimates place the growth rate at 36.5% between 2010 and 2016, compared to 8.3% statewide, based on 2016 special census results. We expect the town to receive a proportionally greater share of state-shared revenues in the future compared with cities whose population has grown more slowly than the state's. While we believe that current long-term economic and demographic trends in Arizona point to an increase in aggregate state-shared revenues, we note that a strong dollar and slowdown in global markets could put pressure on statewide sales and income tax revenues in the short term.

Legal provisions

An ABT provides for the issuance of additional parity debt as long as pledged revenue in the most recent fiscal year covers MADS on the parity bonds and GADA loans by 3.0x, which we consider strong. The town also covenanted to raise sales tax rates or institute new sales taxes to maintain 1.25x annual debt service, if necessary. There is no debt service reserve for the excise tax bonds.

As of 2017, $3.4 million of the town's series 2014A GADA loan remains outstanding. The loan is secured by a parity first lien on pledged revenue. The loan agreement, however, includes an additional provision that allows the state to intercept state-shared revenue. At this time, we understand that the town has no additional debt plans for the next five years. We have confirmed that the town has no excise tax-secured direct purchase or variable-rate debt outstanding.

Outlook

The stable outlook reflects our view of the town's growing local economy, as well as our anticipation that pledged revenues will continue to provide what we consider very strong coverage on the bonds. However, we do not anticipate the potential annexation to drastically improve pledged revenues on its own given the residential nature of the areas. We do not expect to change the rating within our two-year outlook horizon.

Upside scenario

Should the local economy continue to strengthen, through natural progression or further annexation, resulting in an increase in per capita retail sales and debt service coverage to levels commensurate with those of higher rated peers, we could raise the rating.

Downside scenario

We could lower the rating if MADS coverage were to fall to levels well below the ABT due to a significant decline in pledged revenues or the issuance of additional debt.

Related Research

Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015