

FITCH AFFIRMS PRESCOTT, ARIZONA'S GO AND MPC REV BONDS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-03 December 2014: Fitch Ratings affirms the 'AA' ratings on the following outstanding bonds for which Prescott, AZ is the obligor:

--\$520,000 GO bonds series 2007; and
--\$20.075 million Prescott Municipal Property Corporation (the corporation) excise tax revenue bonds series 2007 and 2010.

The Rating Outlook is Stable.

SECURITY

The GO bonds are payable from an unlimited ad valorem tax levied on all taxable property in the city. The revenue bonds are special obligations of the corporation payable from payments made by the city. The bonds carry a pledge of and first lien on the city's excise tax and state-shared revenues.

KEY RATING DRIVERS

SOUND FINANCIAL POSITION: Management maintains a solid financial cushion, a key credit mitigant to economically sensitive revenues which fund the preponderance of city's operations.

ROBUST COVERAGE; STRONG ABT: A post-recessionary trend of improving excise tax revenue continues to provide strong coverage of maximum annual debt service (MADs), also a credit mitigant to volatile excise tax revenues. A strong additional bonds test (ABT) and the reliance on excess revenue for the city's operating budget should protect against substantial additional leverage.

RESUMPTION OF ECONOMIC GROWTH: Economic recovery is evidenced by the aforementioned trend of improved excise tax receipts and more recently an uptick in the city's ad valorem tax base, reflecting activity from two year's prior.

LOW DEBT; UNDER-FUNDED PENSIONS: Fitch anticipates the city to maintain a manageable debt burden based its current low level, moderate payout and modest new issuance plans. However, underfunded pensions have the potential to pressure the city's currently moderate carrying costs.

RATING SENSITIVITIES

SOUND FINANCES AND COVERAGE: The rating is sensitive to shifts in the city's fundamental credit characteristics including strong reserve and coverage levels. The stable outlook reflects Fitch's expectation that such shifts are unlikely.

CREDIT PROFILE

Prescott is located roughly 100 miles northwest of Phoenix and 90 miles south of Flagstaff in Yavapai County. With a population of about 40,000, the city serves as a regional retail and commercial center. A moderate climate and scenic surroundings contribute to the city's tourism and growing retirement sectors.

SOLID RESERVES BENEFIT FROM COST RESTRAINTS

The city typically outperforms the budget and has maintained healthy reserves throughout the recession. Government operations are supported primarily by pledged revenues, sales tax (43%) and state shared revenues (36%), with property taxes contributing a low 3.4%. A fiscal 2013 net surplus of \$3.0 million (10.4% of spending) reflects strengthening revenue trends and flat expenditures. Year-end unrestricted reserves of \$13.9 million represent a strong 48.3% of spending.

An unaudited fiscal 2014 net surplus brings unrestricted reserves to a sizable \$17.5 million, 60.1% of spending, as revenues continued to improve and the city continued cost restraint. Fitch anticipates favorable fiscal 2015 financial performance based on a structurally balanced budget and favorable fiscal year to date trends.

RESUMPTION OF GROWTH REFLECTED IN IMPROVED PLEDGED REVENUES

Excise taxes pledged to pay debt service on the corporation bonds include a locally levied 1% transaction privilege (sales) taxes, franchise taxes, licenses and permits, charges for services, and fines and forfeitures. The state-shared revenues consist of state-shared sales taxes and state revenue sharing (income tax) distributed to localities based on population.

The city sales tax is the largest excise tax component, comprising about 50% of total excise tax revenues in fiscal 2013. State-shared revenues comprise another 36%. Fiscal 2013 excise tax receipts of \$27.2 million are up a strong 8.6%, the third year of improvement subsequent to an 18% slide during fiscal 2009 and 2010. Fiscal 2013 MADs of \$3.5 million is covered a high 7.7x by fiscal 2013 revenues and a stronger 7.9 times by unaudited fiscal 2014 excise tax revenues of \$27.9 million.

LOW DEBT; UNDERFUNDED PENSIONS

Overall debt is low at 1.3% of market value. Management reports no immediate debt issuance plans. The city's five-year capital plan reflects a manageable \$35 million in street projects, expected to be partially cash-funded through fiscal 2020.

The city contributes to two pension plans, which include disability, death and healthcare benefits. The general employee plan is through the Arizona State Retirement System (ASRS), a cost-sharing, multiple-employer plan. The city has made 100% of its annual required contribution (ARC) in recent fiscal years. The funding level for ASRS at June 30, 2013 is 75.3% but drops to a lower estimated 67.8% using Fitch's more conservative 7% investment return rate.

The city also contributes to the Arizona Public Safety Personnel Retirement System (PSPRS), an agent, multiple-employer plan, making its full ARC payments. The funding level for PSPRS at June 30, 2011 was weak 40.3% (police) and 55.1% (fire); funding drops to an estimated 35.4% (police) and 48.4% (fire) when a more conservative 7% return is assumed. Carrying costs, including debt service and pension/OPEB contributions, are a manageable 14.1% of fiscal 2013 governmental spending. Fitch believes they will be pressured in the medium term by increasing PSPRS contribution rates.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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