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Summary:

Tucson Industrial Development Authority, Arizona Rio Nuevo Multipurpose Facilities District; Tax Increment

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Credit Profile

Tucson Indl Dev Auth, Arizona

Rio Nuevo Multipurpose Facs Dist, Arizona

Tucson Indl Dev Auth (Rio Nuevo Multipurpose Facs Dist) jr lien excise tax rev bnds (IDA of Tucson, Fox Theatre Proj)

Long Term Rating

AA+/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' long-term rating on the Tucson Industrial Development Authority, Ariz.'s taxable series 2005 junior-lien excise tax revenue bonds, issued for the Rio Nuevo Multipurpose Facilities District's Fox Theatre project. The outlook is stable.

The rating reflects our view of the district's:

- Extremely strong coverage of debt service;
- Strong local economy (Tucson; AA-/Stable general obligation rating), characterized by a growing and diverse tax base and plentiful employment opportunities that include government, tourism, health care, and services; and
- Closed lien on pledged revenue.

Partly offsetting the above strengths, in our view, are the district's:

- High base-year to total sales tax revenue volatility ratio of 0.66 for fiscal 2011, suggesting high sensitivity in tax increment revenue to changes in overall tax collections; and
- History of large annual swings in pledged state transaction privilege revenue, including 13.4% and 30.3% declines in pledged incremental revenue in fiscal years 2008 and 2009, respectively, and then 27.6% growth in fiscal 2011.

The series 2005 junior-lien bonds were issued by the Industrial Development Authority of the City of Tucson and were loaned to the Rio Nuevo Multipurpose Facilities District under the terms of a loan agreement between the authority and the district. The bonds are secured by a junior lien on state transaction privilege tax revenue increments over the fiscal year 2000 base-year level that the district is entitled to receive pursuant to Section 42-5031 of the Arizona Revised Statutes. Currently, there is no senior-lien debt outstanding on the 2005 bonds, although the 2005 indenture allowed for it, with a 2x additional bonds test. Separately, the district issued \$80 million in subordinate-lien debt in December 2008, and in doing so closed its 2005 senior and junior liens. As such, the rating on the 2005 junior-lien bonds reflects its senior, closed-lien status per the 2008 indenture, and extremely strong debt service coverage of 15.5x

in 2011. A reserve fund funded at \$1 million, or approximately 130% of annual debt service, provides additional security and is entirely funded by the district and not by bond proceeds. Although no rate covenant exists, sales tax rates may be adjusted as needed upon approval of the cities of Tucson and South Tucson. In addition, although not specifically pledged, the general fund of Tucson could potentially make debt service payments if circumstances warrant.

The bonds were issued to partially fund the renovation and restoration of the Fox Theatre, which is located in the district.

The district, a component unit of Tucson, is a tax-levying public improvement district that was formed in July 1999 by the cities of Tucson and South Tucson to develop the Rio Nuevo project in Tucson. The district lies along a main retail corridor of downtown Tucson along Broadway Boulevard and includes two of the city's three largest shopping centers, which have approximately 2.4 million combined square footage. The Rio Nuevo Plan is a multifaceted master-planned project incorporating cultural and recreational amenities and improvements, including the restoration of the Fox Theatre and other various renovations and projects. The primary component of the plan is the Tucson Convention Center, located in downtown Tucson.

In 2009 the legislature appointed seven members to the district's board, retracting the appointment authority of the cities.

The district began receiving state transaction privilege tax revenue increments in fiscal 2004, with the base-year tax revenue calculated as of fiscal year 2000 (revised in 2006). The district was originally permitted to collect tax increment revenue for 10 years, until 2013, but this has been extended to 2025. The district's state transaction privilege tax increment revenue increased to \$16.2 million in fiscal year 2007 from \$5.1 million in fiscal 2004, an annual growth rate of 47%. However, revenue has subsided since the fiscal year 2007 high, mainly as a result of the contraction in the overall national economy that also led to the closing of two big-box retailers within the district. Fiscal year 2011 saw a nearly 28% increase in pledged revenue to almost \$12.6 million. The large fluctuations in pledged revenue are a result of the high volatility ratio of base year to gross sales tax revenue of 0.66 for fiscal 2011. The high volatility ratio results in high fluctuations in pledged revenue from small changes in gross revenue. The volatility ratio has remained above 0.60 for the past five years. Historically, pledged excise tax revenue is about 70% retail, 12% restaurants, 11% from amusements, and the balance in contracting, rental, and other revenue.

Given fiscal year 2011 revenue of \$12.5 million, coverage of the senior 2005 obligations was 15.5x. However, a large final payment of \$1.8 million in fiscal 2013 would reduce coverage to 5.15x. The district also has a cash-funded reserve fund equal to \$1 million, which we understand will be used to partially pay for last year's of debt service. The district is projecting fiscal 2012 revenue to be lower again, at \$9.3 million. The lower revenue is a function of contraction within the district's retail provider base, partially stemming from the demolition of some development to make space for the extension of the city's street car rail.

Tucson, with a population of 520,000, is the seat of Pima County. It has a broad-based economy centered on tourism, higher education, retail, military, government, and various high-tech and health care employers. Major employers include the University of Arizona (11,635 employees), Davis-Monthan Air Force Base (7,700), missile manufacturer

Raytheon (11,850), and U.S. Army Intelligence Center and Fort Huachuca (6,300). The unemployment rate for the Tucson metropolitan statistical area in December 2011 was 7.9%. Median household effective buying income is adequate, in our opinion, at 76% of the U.S. average, reflecting in part the city's large student, retiree, and military populations.

Outlook

The stable outlook is based on the closed-lien status of the bonds, with further dilution of coverage possible only to the extent that the district realizes additional declines in pledged revenue. As such, the outlook reflects our anticipation that the district will maintain extremely strong coverage despite taxpayer concentration and despite inherent sensitivity in retail spending patterns to possible additional economic downturns or other macroeconomic effects. We do not anticipate changing the rating during our two =0year outlook horizon.

Related Criteria And Research

USPF Criteria: Special Tax Bonds, June 13, 2007

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