

## **FITCH AFFIRMS RIO NUEVO MFD, AZ COPS AND EXCISE TAX REVS**

Fitch Ratings-Austin-03 July 2013: Fitch Ratings affirms the following ratings for Rio Nuevo Multipurpose Facilities District (Rio Nuevo or the district), Arizona:

--\$71.3 million subordinate lien excise tax revenue bonds, series 2008 at 'A';

--\$11.8 million certificates of participation (COPs) (City of Tucson Convention Center Expansion Project), series 2009 at 'A+'.

The Rating Outlook on the excise tax revenue bonds is Stable. The Rating Outlook on the COPs is revised to Negative from Stable.

### **SECURITY**

The bonds are secured by a subordinate lien on 1/2 of state sales tax collected on activity within district boundaries. The bonds are also payable from appropriated amounts under certain limited circumstances by the city of Tucson (the city).

The COPs are secured by lease payments from the city, subject to annual appropriation. The leased property consists of the improved property comprising the Tucson Convention Center.

### **KEY RATING DRIVERS**

**ADEQUATE DEBT SERVICE COVERAGE:** The rating on the excise tax revenue bonds reflects only adequate coverage of maximum annual debt service (MADs), a history of volatile revenue performance, and a small revenue base concentrated in two shopping malls. Fitch does not rate to the city of Tucson security support based on the conditional nature of the support.

**COP RATING REFLECTS OBLIGOR CREDIT:** The district's COPs rating reflects the general credit characteristics of the city of Tucson (the city), general obligation bonds rated 'AA', with a recently revised outlook to Negative from Stable (see 'Fitch Rates Tucson, AZ GOs 'AA'; Outlook to Negative, dated May 23, 2013).

**ECONOMIC RECOVERY UNDERWAY:** The Tucson area economy, of which the district is a part, appears to be in the early stage of recovery, remains diverse and relatively stable with a good mix of higher education, military and government employment.

### **RATING SENSITIVITIES**

**COVERAGE ADEQUACY:** A material decline below fiscal 2012 debt service coverage will likely result in negative rating action.

### **CREDIT PROFILE**

Rio Nuevo MFD is a public improvement district and a political taxing subdivision of the State formed in 1999 by the cities of Tucson and South Tucson to provide financing for the purpose of developing downtown Tucson. The district comprises 658 acres and stretches from downtown Tucson along Broadway Boulevard, encompassing Park Place Mall and El Con Mall, the 2nd and 3rd largest shopping malls in the city. Tucson is the state of Arizona's second largest city with an estimated population of 525,000.

### **ADEQUATE DEBT SERVICE COVERAGE DESPITE VOLATILE REVENUE TRENDS**

Pledged revenues declined more than 40% from fiscal 2007 through fiscal 2010 due to recessionary pressures. A strong 42% improvement in fiscal 2011 pledged revenues recaptured about 80% of peak values. Reflecting ongoing volatility and a still-recovering economy, fiscal 2012 pledged revenues declined 8% to \$12.2 million, providing adequate 1.35 times (x) coverage on total (series 2005 and series 2008) debt service of \$9 million. With the maturity of series 2005 junior lien bonds in 2013, the fiscal 2012 revenues cover \$8.1 million of 2015 MADs on just the remaining series 2008 bonds by 1.50 times (x).

## REPORTING IRREGULARITIES EXACERBATE INHERENT SALES TAX VOLATILITY

Fitch notes a marked year-over-year decline in accrual-based fiscal 2013 pledged revenues for the nine months ending in March 2013. District officials attribute a good portion of the interim decline to reporting aberrations and audit adjustments and expect that final accrual based fiscal 2013 pledged revenues could approximate those of fiscal 2012.

While still volatile on a monthly basis Fitch sees the development of favorable trends on most recent cash-based distributions from the state. Corroborating an improving trend, Fitch notes close-to-100% reported occupancy rates at the Park Place and El Con Malls and new commercial and retail activity underway, as well as favorable city-wide sales tax trends. However, Fitch also recognizes that recovery has not entirely taken root in Tucson as noted by a multi-year trend of work force declines. Fitch will continue to closely monitor the district's pledged revenue trends and ensuing debt service coverage levels.

## BELOW-AVERAGE ADDITIONAL BONDS TEST

Issuance of additional bonds would require coverage of 1.25x including debt service on new bonds, which Fitch views a below-average additional bonds test (ABT). However, Fitch notes that the district does not anticipate new debt issuance in the near term. The indenture provides for a monthly distribution of excise tax revenue with priority application on debt service.

## CITY AND DISTRICT SETTLE LONG-STANDING DISAGREEMENTS

The district was managed and accounted for as a component unit of the city of Tucson from 1999 through 2009. Concern over the focus and direction of the district's capital program led the state legislature in 2009 to change the board selection authority from the two cities to state officials and expanded the board membership from four to nine.

The district and the city executed a revised intergovernmental agreement in 2011 to provide a framework for governance of the district. Executed in February 2013, the settlement agreement resolves all outstanding issues between the district and the city. The agreement provides clarity on property ownership and obligations, clearing the path for both parties to engage in shared development projects including a \$10 million Tucson Convention Center renovation.

## TUCSON ECONOMIC RECOVERY UNDERWAY

Tucson is the second largest city in Arizona. Growth of the city's residential base has slowed from its peak in 2001, when it recorded 3,800 single-family home permits; only 360 new housing permits are projected for fiscal 2013, but that number is up from 240 issued in fiscal 2011. Home prices also are showing improvement, with the most recent median and average sale prices registering double-digit percentage increases from a year ago.

Unemployment levels historically have been below those of the state and nation. Although the city's April 2013 rate of 7.3% reflects modest year-over-year improvement and is favorable to the state (7.8%), Fitch notes that the lower unemployment rate reflects labor force contraction and not job growth.

Services, military, higher education and government are the area's prominent employment sectors. The military presence in the Tucson area is substantial with U.S. Army Intelligence Center, Fort Huachuca, and Davis-Monthan Air Force Base. Public sector employment is led by state and local

government agencies and public and higher education, including the University of Arizona main campus, which employs roughly 12,000.

Raytheon Missile Systems is the largest private employer in Tucson, also with a staff of 12,000. Management and local media report that the anticipated effects of federal sequestration on the Tucson economy are expected to be manageable, but with the large number of government and civilian contract workers in the local workforce some effect is likely.

Public and private investment in downtown Tucson has accelerated in recent months, due in part to the new street car rail system that will extend from downtown to the university campus (scheduled to begin operations in 2014). City management reports nearly \$800 million invested in various projects since 2008, with another \$90 million projected for 2014.

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

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