

FITCH DOWNGRADES RIO NUEVO, AZ'S REVS TO 'BBB'; AFFIRMS COPS; OUTLOOK NEGATIVE

Fitch Ratings-Austin-11 June 2014: Fitch Ratings has taken the following rating action on Rio Nuevo Multipurpose Facilities District (Rio Nuevo or the district), Arizona:

--\$67.4 million subordinate lien excise tax revenue bonds, series 2008 downgraded to 'BBB' from 'A';
--\$11 million certificates of participation (COPs) (City of Tucson Convention Center Expansion Project), series 2009 affirmed at 'A+'.

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

The Rating Outlook on the COPs remains Negative.

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). Additionally, the bonds are secured by a standard, cash-funded debt service reserve fund (DSRF).

The COPs are secured by lease payments from the city of Tucson, subject to annual appropriation. The leased property consists of the improved property comprising the Tucson Convention Center. There is no DSRF.

KEY RATING DRIVERS

DOWNGRADE REFLECTS EXTREME VOLATILITY: The downgrade of the excise tax bonds results from extreme sales tax volatility, resulting in part from a predated and chronic history of tax collection control failures.

PROCEDURAL TAX COLLECTION PROBLEMS: The Negative Outlook reflects uncertainty over how long it will take for the district to insure that collections accurately reflect sales activity within the district.

ECONOMIC RECOVERY UNDERWAY: Regional recovery from the severe recession continues at a moderate pace, as evidenced by a number of economically sensitive indicators. The regional economy remains diverse and relatively stable, with a good mix of higher education, military and government employment.

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 (GOs) rated 'AA'; Outlook Negative (see 'Fitch Rates Tucson, AZ GOs 'AA'; COPS 'AA-'; Outlook Negative, dated May 14, 2014).

RATING SENSITIVITIES

COVERAGE ADEQUACY: The investment grade rating on the excise tax revenue bonds assumes resolution of the district's operational issues, pledged revenue improvement and coverage stability consistent with the underlying activity in the district.

COPS DEPENDENCY ON TUCSON: Negative rating action on the city's GOs would result in negative rating action on the district's COPS.

CREDIT PROFILE

Rio Nuevo MFD is a public improvement district and a political taxing subdivision of the State. The district covers downtown Tucson and extends east and west of downtown, along Broadway Boulevard, beginning at Park Place Mall and extending just west of Interstate 10. Within the eastern part of the district reside three multi-purpose facilities-- the Tucson Convention Center (TCC), Fox Theater, and Rialto Theater -- historic buildings and the University of Arizona Campus. The western portion of the district contains new mixed-use development projects, the terminus of the new light-rail system and large parcels of undeveloped property.

VOLATILE REVENUE TRENDS

The district's pledged revenues have been exceptionally volatile, sliding 48% between fiscal 2007 and 2010 due to recessionary pressures, gaining 42% in fiscal 2011 benefitting from a construction activity, and dropping 27% during fiscal 2012 and 2013. Officials project a further 8% pledged revenue decline in overall fiscal 2014 revenues.

It appears that the most recent downward trend of pledged revenues reflects the district's inability to accurately collect and monitor sales tax revenues given the lack of access to taxpayer data. Officials report that they will soon receive access to taxpayer data pursuant to an intergovernmental agreement underway with ADOR which will provide information to equip management to confirm that all eligible businesses within the district are properly filing tax returns and to accurately monitor collections. Fitch believes this remains a significant risk to pledged revenue performance regardless of economic activity.

WEAK DEBT SERVICE COVERAGE

Fiscal 2013 pledged revenues of \$9.8 million provided a low 1.09x coverage on total (series 2005 and series 2008) debt service of \$9 million, down from 1.35x based on fiscal 2012 pledged revenues. With the maturity of series 2005 junior lien bonds (senior to the subordinate issue) in 2013, the fiscal 2013 revenues cover \$8.1 million of 2015 maximum annual debt service (MADS) on the remaining series 2008 bonds by 1.22x.

Fiscal 2014 pledged revenues of \$9.1 million projected by the district cover MADS by a modest 1.12x. A stress test simulating recent pledged revenue declines brings coverage below 1.0x, although this trajectory is not supported by the current economic climate or by economic development activity currently underway in the district.

BELOW-AVERAGE ADDITIONAL BONDS TEST

The series 2008 subordinate lien excise tax bonds are the only issue of outstanding excise tax bonds, although the indenture provides for a senior and junior lien issue.

Issuance of additional bonds would require coverage of 1.25x including debt service on new bonds, which Fitch views as a below-average additional bonds test (ABT). Recent weak coverage levels preclude additional issuance, and the district reports no new debt issuance plans in the near term.

The indenture provides for a monthly distribution of excise tax revenue into the subordinate lien revenue fund account in amounts equal to 1/10th of the interest and principal due in the succeeding year until requisite funds are on deposit.

DISTRICT REORGANIZATION

The district was formed in 1999 by the cities of Tucson and South Tucson to provide financing for the purpose of developing downtown Tucson. The district was managed and accounted for as a component unit of the city of Tucson from 1999 through 2009. Concern over a lack of enhancements to the Tucson Convention Center since the district's inception led the state legislature in 2009 to change the board selection authority from the two cities to state officials and expand the board membership from four to nine members.

CHALLENGES REMAIN DESPITE DEVELOPMENT UPTICK

The district and the city executed agreements between 2011 and 2013 providing clarity on property ownership and clearing the path for downtown development projects. A modest \$8 million renovation of the TCC is scheduled for completion by the end of calendar year 2014. The district anticipates pursuing a variety of private sector, state, county and city partnerships to attract further investment to the convention center over time.

Public and private investment in the district has accelerated in recent months, due in part to the new street car rail system that extends from downtown to the university campus. Development includes new restaurants, retail, and firm plans for a new Marriot Hotel.

COPS RATING LINKED TO CITY OF TUCSON GENERAL CREDIT CHARACTERISTIC

The city of Tucson is the obligor on the district's series 2009 COPs, rated three notches below the city's GOs, reflecting appropriation risk and the lack of leased asset essentiality. The current negative rating on the city's GOs reflects a persistent structural imbalance which the city is taking steps to cure. Further commentary on the city's general credit quality can be found in Fitch's May 14, 2014 rating action commentary.

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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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