FITCH AFFIRMS RIO NUEVO, AZ'S REVS AT 'BBB'; OUTLOOK TO STABLE

Fitch Ratings-Austin-20 May 2015: Fitch Ratings has affirmed the following Rio Nuevo Multipurpose Facilities District (Rio Nuevo), Arizona bonds:

--$67.3 million subordinate lien excise tax revenue bonds, series 2008 at 'BBB'.

The Rating Outlook is revised to Stable from Negative.

SECURITY

The bonds are payable from a subordinate lien on one-half of state sales tax collected above the 1999 base amount 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).

KEY RATING DRIVERS

STABLE REVENUE BOND OUTLOOK: The Outlook revision reflects removal of uncertainty on the district's ability to monitor the accuracy of collections in relation to sales activity within the district based on taxpayer data provided by the Arizona Department of Revenue (ADOR) pursuant to a recently executed intergovernmental agreement (IGA) between ADOR and the district.

IMPROVING PLEDGED REVENUES EXPECTED: Improvement of sales tax revenues reflects significant new retail development associated with the revitalization of downtown Tucson and high occupancy rates in the district's retail centers. Near-term private investments bodes well for ongoing pledged revenue growth.

RECOVERING REGIONAL ECONOMY: Economic activity continues to recover at a moderate pace from the severe recession. The regional economy remains diverse and relatively stable, with a good mix of higher education, military and government employment.

RATING SENSITIVITIES

PLEDGED REVENUES; COVERAGE STABILITY: Future credit assessments will hinge on pledged revenue trends and coverage stability. Improvements in these factors could lead to positive rating action, while material deterioration could put negative pressure on the rating.

CREDIT PROFILE

Rio Nuevo 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. Three multi-purpose facilities are located within the eastern part of the district: 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.

STABILIZING OUTLOOK ON VOLATILE REVENUES

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 construction activity, then dropping 31% during fiscals 2012 through 2014. The district reports a 5.4% uptick in the first half of fiscal 2015 and expects to see about the same year over year growth for fiscal 2015 as a whole, which Fitch considers reasonable based on strong retail and restaurant activity.

Officials have gained access to taxpayer data pursuant to an IGA with ADOR effective October 2014. The IGA provides information allowing the district to confirm that all eligible businesses within the district are properly filing tax returns and allowing the district to accurately monitor collections. ADOR can audit payors once every four years at the request of the district with potential audit adjustments reflecting a four year historical time frame. Fitch will continue to monitor the impact of this payor transparency on the district's pledged revenue collection rate.

WEAK DEBT SERVICE COVERAGE

Fiscal 2014 pledged revenues of $9.1 million provided a low 1.14x coverage on series 2008 debt service of $8 million and covered MADs by 1.12x. A stress test simulating recent pledged revenue declines brings coverage below 1.0x. Fitch considers this scenario unlikely in the near term, given the current economic climate and development activity underway, but it underscores the risk associated with pledged revenue volatility.

BELOW-AVERAGE ADDITIONAL BONDS TEST

The series 2008 subordinate lien excise tax bonds are the only series outstanding, although the indenture provides for parity, senior lien, and third lien debt.

The additional bonds test is relatively permissive, requiring coverage of 1.25x including debt service on new subordinate lien bonds by historical revenues (2.0x for senior lien bonds and sum sufficient for third lien bonds). Recent weak coverage levels preclude additional subordinate issuance, and the district reports no new debt issuance plans.

The indenture provides for a monthly distribution of sales 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 at which time they are transferred to the trustee for debt service payments.

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. It 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.

ECONOMIC RECOVERY EVIDENT IN DISTRICT TRENDS

The district and the city executed agreements between 2011 and 2013 providing clarity on property ownership and clearing the path for downtown development projects, including a recently completed $8 million TCC renovation. The district anticipates pursuing a variety of private sector, state, county and city partnerships to attract further investment to the convention center. Pursuant to the pending sale of 8.5 acres in the west side of the district to a private developer, the district anticipates an estimated $100 million of new construction. Officials also report sale of The Rialto theatre to a local nonprofit organization.

Public and private investment in the district has accelerated over the past year, 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 Marriott Hotel.

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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