

RatingsDirect®

Summary:

Cottonwood, Arizona; Miscellaneous Tax

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Credit Profile

US\$12.335 mil pledged rev rfdg obligations ser 2016 dtd 08/30/2016 due 07/01/2027

<i>Long Term Rating</i>	AA-/Stable	New
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Cottonwood misc tax (AGM)

<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Upgraded
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Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating to 'AA-' from 'A+' on Cottonwood, Ariz.'s series 2015 pledged revenue obligations. At the same time, S&P Global Ratings assigned its 'AA-' long-term rating to the city's series 2016 pledged revenue refunding obligations. The rating action on the series 2015 bonds is based on the new debt service schedule as a result of the series 2016 refunding, increased coverage, and track record of pledged revenue growth. The outlook is stable.

The ratings reflect our view of the city's:

- Very strong 6.9x maximum annual debt service (MADS) coverage for the senior lien; and
- Stable growth trend in the historical pledged tax revenue trends.

These strengths are offset somewhat by our opinion of the city's only adequate per capita effective buying income (EBI) and reliance on tourism for sales tax revenues.

The series 2016 and 2015 pledged revenue obligations are secured by a senior-lien pledge of excise tax revenues and state-shared sales and income tax revenues. The series 2016 bonds will refund, in entirety, the city's loan agreement with the Greater Arizona Development Authority (GADA) that represented a senior-lien on the state-shared sales and income tax revenues and a parity lien pledge on local limited sales tax revenues. The result is a parity senior lien debt service structure for the series 2015 and 2016 obligations.

Based on the new debt service schedule, we calculate MADS coverage to be a very strong 6.9x. The pledged revenues, including the senior lien, consist of local sales taxes (82% of estimated actuals for fiscal 2016), state-shared income taxes (8%), state-shared sales taxes (7%), licenses and permits (2%), and fines and forfeitures (1%). The local sales tax is largely concentrated in retail as the total fiscal 2016 estimated actual was \$8.9 million or about 66% of total sales tax revenues. We note that the retail trade contribution continues to be about 66% of the overall local excise tax suggesting even growth across the city's local tax revenues. This is followed distantly by real estate, rental, and lease revenue at \$1.3 million or about 8.4%. The retail trade contribution, despite the economic recession, did not see a single year of decline since fiscal 2010 and its contribution has increased from 63% (\$6.8 million) in fiscal 2010 to the current estimated result for fiscal 2016.

Looking ahead, the city is projecting a \$388,000 increase in total local tax revenues in fiscal 2016 led by continued growth in the retail trade line item and we expect pledged revenues to continue to grow at the historical rate based on our view of the continued local and regional growth. For more information, please refer to the article, U.S. State And Local Government Credit Conditions Forecast, published July 27, 2016 on RatingsDirect.

Finally, the top 10 taxpayers, historically, contribute about 50% of the total local sales tax or about 40% of total pledged revenues. The top 10 taxpayers are generally large big-box retail entities.

Total pledged revenues continue to remain strong after only one year of decline in fiscal 2011 when total pledged revenues declined by 6% or about \$750,000 from the prior fiscal year. The decline was largely in the form of state-shared income taxes as it contributed about half of the total pledged revenue decline. The city is projecting a fairly modest pledged revenue growth of 3% when the books close for fiscal 2017 to \$16.9 million from \$16.4 million in fiscal 2016. The projections include about \$388,000 of new total local sales taxes and about \$123,000 of new state-shared revenues, of which the 2015 bond is now senior. State-shared revenues are distributed according to population relative to the total state population, so the city's population growth continues to increase its share of the state's overall population and state-shared revenue.

The additional bonds test (ABT) is moderate at 1.5x, based on historical collections from the preceding fiscal year during the succeeding 12-month period for all new and existing bonds. Legal provisions for the bonds also include a rate covenant requiring that limited sales tax and state shared revenues be maintained at levels providing at least 2.0x current annual debt service. The city does not need voter approval to increase its sales and use rate. In total, pledged revenues continue to represent about 70%-75% of the city's total governmental funds revenues, reducing the likelihood the city will issue bonds to the fullest extent of its ABT.

Cottonwood is located 100 miles northwest of Phoenix in the Verde Valley. The city's economy is a mix of regional goods and services as well as tourism as the city accesses nearby Sedona Verde Valley, an area known for viticulture. The city's per capita EBI is adequate a 90% of the national level. The local population in the city is about 12,455. Per capita retail sales are strong at 175% of national average, due in part to the linkage to tourism.

Outlook

The stable outlook reflects our view of the city's growing population and stable pledged revenue growth, as well as our expectation that pledged revenues will continue to provide debt service coverage at levels we consider at least very strong. As a result, we do not expect to change the rating within the two-year outlook horizon.

Upside scenario

We could raise the ratings should the local economy diversify away from tourism and retail trade or if MADS coverage were to significantly grow above our current expectations.

Downside scenario

Should the city experience a decline in pledged revenue, resulting in significantly lower coverage, we could lower the ratings. We could also lower the ratings if the city were to bond down to its ABT.

Related Criteria And Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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