

# RatingsDirect®

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## Summary:

# Cottonwood, Arizona; Miscellaneous Tax

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## Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

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### Credit Profile

US\$16.37 mil pledged rev obligs ser 2015 dtd 06/25/2015 due 07/01/2034

*Long Term Rating*

A+/Stable

New

## Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to Cottonwood, Ariz.'s series 2015 pledged revenue obligations. The outlook is stable.

The ratings reflect our view of the city's:

- Strong 5.6x maximum annual debt service (MADS) coverage for the lien; and
- Stable growth trend in the historical pledged tax revenue trends.

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

The 2015 pledged revenue obligations are secured by a senior-lien pledge of excise tax revenues and a subordinate-lien on state-shared sales and income tax revenues and limited local sales tax revenues. The city's loan agreement with the Greater Arizona Development Authority (GADA) represents the senior-lien on the state-shared sales and income tax revenues and local limited sales tax revenues. We understand that the 2015 bond proceeds will be used to finance and construct general projects, street, water, wastewater, and reclaimed water project improvements.

Based on the audited fiscal 2014 historical pledged revenues, including the senior lien, we calculate MADS coverage to be a strong 5.6x. The pledged revenues, including the senior lien, consist of local sales taxes (82% of audited 2014 historical pledged revenues), state-shared income taxes (9%), state-shared sales taxes (6%), licenses and permits (2%), and fines and forfeitures (1%). The local sales tax, inclusive of the senior limited sales tax lien, is largely concentrated in retail as the total fiscal 2014 contribution was \$7.9 million or about 66% of total sales tax revenues. This is followed distantly by real estate, rental and lease revenue at \$1.17 million or about 10%. 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 66% (\$7.9 million) in fiscal 2014. The city is projecting a \$300,000 increase in new retail trade revenues in fiscal 2015 or 66% of total sales local sales tax revenues. Finally, the top 10 taxpayers contribute about 48% of the total local sales tax or about 40% of total pledged revenues. The top 10 taxpayers are generally large big-box retail entities.

Pledged revenues, including the senior lien, have rebounded during the past several years 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 5% when the books close in fiscal 2015 to \$15.5 million from \$14.76 million in fiscal 2014. The projections include about \$520,000 of new total local sales taxes, excluding the senior limited sales tax, and about \$174,000 of new state-shared revenues, of which the 2015 bond is subordinate. State-shared revenues are distributed according to population relative to the total state population, so the city's growth in population increased 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 2x current annual debt service. The city does not need voter approval to increase its sales and use rate. In total, pledged revenues constituted about 73% of the city's total governmental funds revenues in audited fiscal 2014, 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 66% of the national level. The local population in the city is just under 11,500 and it has grown by approximately 1,500 within the past decade. Per capita retail sales are strong at 171% of national average, due in part to the linkage to tourism.

## **Outlook**

The stable outlook reflects our view of that debt service coverage will remain very strong given the city's lack of future bonding plans. We could raise the rating in our two-year outlook if the city's economic profile were to significantly improve, including its per capita EBI. While unlikely, we could lower the rating if the city's pledged revenues significantly decline.

## **Related Criteria And Research**

### **Related Criteria**

USPF Criteria: Special Tax Bonds, June 13, 2007

### **Related Research**

U.S. State And Local Government Credit Conditions Forecast, April 2, 2015

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