

RatingsDirect®

Summary:

Oro Valley, Arizona; Miscellaneous Tax; Sales Tax

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Credit Profile

US\$18.13 mil excise tax rev oblig ser 2021 due 06/01/2038

Long Term Rating AA+/Stable New

Oro Vy excise tax rev obligs (CREBs)

Long Term Rating AA+/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Oro Valley, Ariz.'s expected \$18 million series 2021 taxable excise tax revenue obligations. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the town's outstanding excise tax revenue bonds. The outlook is stable.

The 2021 obligations are being issued to fund a portion of the town's legacy obligations to the Public Safety Personnel Retirement System (PSPRS). At the same time, the town is using \$10 million of general fund reserves to reduce the PSPRS obligations. The combined contribution of the town and the obligations are expected to fully fund the police liability. The town intends to continue to make additional pension contributions along with debt service payments.

A first-lien pledge of the town's excise taxes secures the bonds. Oro Valley's excise taxes consist of town sales and franchise taxes (60% of pledged revenue in fiscal 2020), state-shared income tax (18%), state-shared sales tax (14%), licenses and permits (7%), and fines. The state-shared tax revenue is allocated to cities and towns based on each municipality's share of all incorporated cities and towns in the state.

Credit overview

Oro Valley's excise tax revenue bond credit profile reflects its location as a suburban town within the broad and diverse Tucson, Ariz., metropolitan statistical area (MSA). The town is a popular location for retirees, second homeowners, and residents who work in the higher education, aerospace and defense, and other industries in Tucson and other parts of the MSA. With a pledged revenue stream that has demonstrated moderate-to-low historical volatility, the town has consistently produced extraordinarily strong maximum annual debt service (MADS) coverage on its excise tax revenue bonds and parity private placements. Given a very strong additional bonds test (ABT) that requires historical revenue produce no less than 2.0x MADS coverage and the town's reliance on the pledged revenue stream to fund its operations, we expect coverage will remain at a level we consider extraordinarily strong.

Key credit considerations include:

- Oro Valley's strong economic fundamentals, given its high income levels and location within a broad and diverse MSA;
- The excise tax revenue bonds' very strong coverage and liquidity assessment, supported by a very strong 2.0x ABT and extraordinarily strong MADS coverage;

- The moderate-to-low volatility of the pledged revenue stream; and
- Our view that the town's general creditworthiness does not constrain the rating on its excise tax bonds.

Environmental, social, and governance (ESG) factors

We analyzed the town's ESG risks relative to its economy, management, financial measures, and debt and liability profile. We view the town as facing somewhat elevated environmental risk posed by the region's exposure to drought, wildfires, and extreme heat. We believe environmental risks have been somewhat mitigated by the town's efforts to secure water rights from various sources to support its growing population. We consider the town's social and governance risks in line with our view of the sector standard.

Stable Outlook

Upside scenario

We could raise the rating if we observe material improvement in the town's already strong economic fundamentals, including population size.

Downside scenario

Although unexpected, we could lower the rating if the town's economic fundamentals unexpectedly worsen or if a combination of substantial additional debt issuance and declining pledged revenue materially suppresses all-in MADS coverage.

Credit Opinion

Economic fundamentals: Strong

The town, with a 2020 population of 46,273, is located in Pima County, 12 miles north of downtown Tucson and just west of the Santa Catalina Mountains. The town is a largely residential community and is a popular home for retirees and second homeowners, many of whom relocate to the area during the winter months to take advantage of the desert climate. Local residents benefit from access to the broad and diverse Tucson MSA, which is home to the University of Arizona and several employers in the aerospace and defense industries. Town-level per capita effective buying income levels are high, at 141% of the national level in 2020.

Reflecting its popularity among retirees attracted to the warmer weather, golf courses, and other local amenities, the town's population skews much older than the national population. Town residents aged 65 and older represent 32.1% of the total town population, 102.2% greater than the proportion of residents in that age at the national level. In addition to the high dependent population, the exposure of the town's economy to seasonality tempers the economic fundamentals assessment. We consider the economic base subject to a moderate degree of seasonality, given the region's exposure to extreme summer temperatures and its relatively high level of second homeowners who relocate to the town in the more temperate shoulder seasons and winter months.

Coverage and liquidity: Very strong

The town's \$32.9 million in pledged revenue produced 6.9x MADS coverage in fiscal 2020 on all excise tax obligations.

The town's estimated \$34.1 million in fiscal 2021 pledged revenue produced 7.0x all-in MADS coverage on all excise tax-secured obligations.

Legal provisions for the excise tax revenue bonds include an ABT that requires that pledged revenue collected during the most recent fiscal year produce no less than 2.0x MADS coverage on existing and proposed parity obligations. We believe the town is unlikely to issue additional debt to the fullest extent of the ABT, given its reliance on the pledged revenue stream to fund operations. In fiscal 2020, pledged revenue equaled 62% of total governmental fund revenue, and a substantial majority of general fund revenue.

Given the strength of current and historical MADS coverage, the 2.0x ABT, and the town's reliance on pledged revenue to fund operations, we expect coverage metrics will remain at a level we consider extraordinarily strong.

The bonds have a springing debt service reserve (DSR) requirement, whereby the DSR must be funded if coverage on all parity obligations falls below 2.5x, a prospect we consider unlikely for the reasons described above. Given our coverage and volatility assessments, we do not apply a liquidity factor adjustment to the coverage and liquidity assessment for the excise tax revenue bonds.

The series 2010 and 2012 excise tax revenue bonds are parity obligations with the town's 2013, 2015, 2016, 2017, and 2018 private placements. Although each of the private placement obligations is secured by excise tax revenue, the town reports the 2013 and 2018 private placements as obligations of its water fund, and the town pays those two obligations with water net revenue.

Volatility: Low

We assess the volatility of pledged revenue to evaluate the likely availability of revenue across different economic cycles. We have two levels of volatility assessment: macro and micro. Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. We use the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles to inform our expectations of volatility.

Because sales taxes represent a majority of Oro Valley's pledged revenue, we select national sales tax revenue as the baseline for our macro volatility assessment. To determine our view of the volatility of sales taxes, we used total retail food and service sales data from the U.S. Census Bureau. On a macro level, we assess the revenue volatility of sales taxes as low.

On a micro level, we observe that Oro Valley's pledged revenue stream has demonstrated low historical volatility. Although the presence of state-shared income and sales tax revenue within the excise tax pledge adds a degree of stability compared to a pledge of strictly locally levied taxes, the town's pledged revenue stream has demonstrated somewhat greater historical volatility than sales taxes nationally. Pledged revenue fared very well during the most recent COVID-19 recession, continuing to rise despite significant headwinds. Although the town did not fare as well during the Great Recession, we expect that revenue performance during the most recent recession is a more accurate reflection of the town's revenue stability .

Obligor linkage: Close

We believe the priority lien of pledged revenue provides some protection from operating risk. However, because taxes are collected monthly by the town, which then transfers them to the trustee, we consider the flow of pledged revenue to be within the town's direct control. Under our criteria and given the flow of funds, we consider the linkage between the priority-lien revenue pledge and the obligor's general creditworthiness close.

Rating linkage to Oro Valley's general creditworthiness

We assess the town's general operations, because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax. Supporting the town's general creditworthiness are its favorable wealth and income levels and positive property value and population growth trends. We consider the town's finances well managed, and we note as additional credit positives the town's high available fund balances and liquidity, and manageable overall debt burden. Based on our analysis and per our criteria, the town's general creditworthiness does not constrain the rating on its excise tax revenue bonds.

Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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