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Ratings

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Summary:

Terre Haute, Indiana
Terre Haute Redevelopment District; Tax Increment

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Terre Haute Redevelopment District (Terre Haute) tax incre rev bnds		
Long Term Rating	BBB+/Stable	Downgraded

Rationale

S&P Global Ratings lowered its long-term rating to 'BBB+' from 'A-' on Terre Haute Redevelopment District, Ind.'s series 2011A tax-increment revenue bonds. The outlook is stable.

The bonds are secured by tax-increment financing (TIF) revenues from the city's Central Business District Urban Renewal Tax Allocation Area.

The rating revision is based on a clarification of our understanding of the additional bonds test (ABT) and an increased risk this presents, compared to prior reviews. More specifically, we now understand the ABT permits additional parity TIF-backed debt without meeting any coverage requirements if the additional debt also pledges either ad valorem property taxes or local income taxes. We feel this ABT makes future coverage less predictable and introduces into the TIF analysis a certain level of operating risk related to the city. We also feel that the risks of the ABT have heightened as the city's credit conditions deteriorated since prior reviews (evidenced by the underlying rating being lowered to 'BB' from 'BBB+'), and that the TIF pledge is no longer commensurate with the previous 'A-' rating.

Additional factors supporting the 'BBB+' TIF rating include:

- A well-developed tax base in the center of the city's main downtown business district and next to Indiana State University, consisting of mostly commercial properties and including two hotels, a medical office complex, banks, and additional office space; and
- Stable taxable values supporting stable revenue collections that provide very strong coverage of debt service, which afford it the ability to lose several taxpayers and still maintain coverage.

Offsetting credit factors include:

- High taxpayer concentration, which is common for TIF securities, due a geographically smaller tax base;
- A weaker overall economic climate for the city as a whole; and
- Our view of the permissive ABT.

Security and parity obligations

The series 2011A bonds are secured by a first lien on TIF revenue from the city's Central Business District Urban Renewal Tax Allocation Area (the allocation area). The bonds are additionally secured by a cash-funded debt service reserve fund equal to maximum annual debt service (MADS). The pledge is on parity with the district's series 2015A tax-increment revenue bonds. There are three series of outstanding subordinate bonds, each secured by TIF revenue from different individual taxpayers within the allocation area. The pledge of TIF revenues from these individual taxpayers is junior and subordinate to the TIF revenues pledged to the senior-lien 2011A and 2015A bonds. We understand the district may soon be pledging up to $500,000 of annual TIF revenues from the allocation area to an interlocal agreement with Vigo County, to help support the financing of a new convention center. Officials indicate this pledge would also be a subordinate pledge. The convention center would likely be within the allocation area, which could help generate additional commercial activity nearby. All debt but the series 2011A bonds were privately issued, but, in our view, do not create undo contingent liability risk.

Permissive additional bonds test, despite the strong coverage ratio

According to the bond resolution, the city can issue additional debt with a parity pledge of TIF revenues as long as annual debt service payable from TIF revenues exceeds 1.75x. On its own, this is a strong coverage requirement. However, the provisions also indicate that if the additional parity TIF-backed debt also pledges either ad valorem property taxes or local income taxes, the 1.75x minimum coverage requirement does not have to be met. In other words, if the city decides to issue additional debt supported by both income taxes and TIF revenue or by both ad valorem property taxes and TIF revenues, the 1.75x coverage requirement can be disregarded and actual coverage of parity debt by TIF revenues alone could fall below 1.75x, or even 1x.

In our view, this creates essentially no contractual limitation on the issuance of additional parity obligations, and it is unpredictable how the flexibility of the ABT could affect TIF coverage. Further, by combining all these revenues together in the ABT, we feel that it introduces some level of operating risk related to the city, specifically if it were to leverage this flexibility for additional debt. Though we think it would be unlikely for the city to issue additional dual pledge TIF-backed debt to an extent that would severely weaken TIF-only coverage (factoring very strong coverage in excess of 7x and no additional parity debt plans), we feel the risks of the ABT are heightened when considering the noninvestment-grade credit quality of the city.

Strong tax allocation area, though modest concentration

The Central Business District Urban Renewal Tax Allocation Area lies in the city's main downtown business district, so it benefits from a stable area of economic activity that has many of the city's strongest taxpayers. It is also adjacent to the Indiana State University campus. The area was formed in 1986 and last expanded in 2007. It does not have a large geographic footprint, at only 223 acres, which results in taxpayer concentration. We understand it is about 90% built out, which can limit future revenue growth. However, management notes that Vigo County may be building a new convention center and parking garage in the area, and that private developers may also be constructing a new hotel and parking garage next to this project, should it proceed. These projects have the potential to diversify the base, trigger additional ancillary development, and eventually spur increasing TIF revenues.

The tax base remains stable, but taxpayer concentration remains a rating limitation and weakness, though it has softened slightly in recent years, and could improve with the additional developments just mentioned. The tax base is mostly commercial based. Based on certified 2019 valuations, total net assessed value (NAV) for the allocation area $92.9 million. This was a 24% increase over 2018 NAV, mostly due to commercial property reassessments. From 2015 to 2018, NAV grew only 4.6%. Incremental AV is $69.5 million, and increased 27% in 2019 over 2018 levels. Similarly, incremental AV only grew 5.7% in the three years prior. Given the district's later creation in the city's already established downtown area, the base assessment accounts for a higher 25% of total NAV.

The ten largest taxpayers combine to total $45.4 million in NAV, or a very concentrated 49% of total NAV and 65% of incremental AV. We note concentration figures are down slightly, with the ten leading taxpayers accounting for more than 75% of incremental AV in 2011 and 2014. The three largest taxpayers include an apartment complex (12.3% of NAV, 16.5% of incremental AV), hotel (6.9%, 9.2%), and medical office complex (4.9%, 6.6%). Other leading taxpayers include a second hotel, multiple banks, the local newspaper company, commercial real estate and office buildings, and a baking goods firm (Clabber Girl). We understand Clabber Girl was recently sold to new owners, which could potentially have a residual impact on the business. Management reports that major taxpayers remain stable, that it is not aware of any appeals, and that there is no history significant delinquencies.

Stable revenue and very strong coverage

Incremental AV is determined by subtracting the base NAV from the current NAV as of the assessment dates. The incremental AV is then multiplied by the current property tax rate to determine the tax increment. Property assessments are revalued annually to reflect sales data, changes in economic activity, and inflationary adjustments.

With the approval of the Indiana Department of Local Government Finance, the base NAV of a district may be modified to neutralize the effects of reassessments in tax-increment districts, so that growth (or declines) in the tax increment depends on actual growth or declines in the base, instead of inflationary changes in value or reassessments. The purpose of neutralization is not necessarily to stabilize TIF revenue, but rather to ensure the base doesn't unnecessarily benefit or suffer from annual trending/reassessment of real property value. This process can potentially mitigate the effects of decreases in assessments on property, if used, which is a positive factor. Accordingly, the district's tax volatility ratio--calculated as base AV divided by total district AV (a measure of how sensitive tax-increment revenues are to changes in AV), is a less precise measure of the extent to which tax-increment revenue will rise or fall with total AV fluctuations.

Actual collections have been steady, ranging from $1.56 million to $1.68 million in 2015 through 2018. Collections in 2018 totaled $1.6 million, covering MADS by a very strong 7.9x. MADS is only $202,000, occurring in 2026. Annual senior-lien debt service is mostly level, in the range of $190,000 to $200,000. Including subordinate debt, all-in MADS is $542,000. All in coverage was still a very strong 2.9x in 2018. As noted, the district may be pledging up to $500,000 of annual TIF revenue to an interlocal agreement with the county to support the convention center project. Including this, all-in coverage would fall to 1.5x, which is still strong.

Considering a volatility ratio of 0.27, at current coverage levels, the district could withstand the loss of each of the ten leading taxpayers, and still maintain coverage, which is strong. If it were to bond down to the 1.75x ABT, it could withstand a 31% loss in revenue, equivalent to the four leading taxpayers, which is adequate.

As is common for TIF securities, the district does not have direct control of the tax rates driving the revenues, after factoring overlapping taxing jurisdictions. The tax rates have been fairly stable. Additionally, tax-increment collections available for debt service are net of circuit-breaker tax caps and delinquencies. State circuit-breaker legislation places caps on the tax burden for individual properties based on the class of property. The levy net of the circuit breaker has typically been about 70% of the total levy, which is an above-average loss, but collections of the net levy have been good, with some minor delinquencies that have been caught up in the ensuring year.

While the tax caps, minor delinquencies, and exposure to tax-rate fluctuations present modest exposure to revenue volatility, we still expect the overall allocation area to remain steady and provide a very strong level of debt service coverage (DSC).

Weaker citywide economic conditions

As a whole, we consider Terre Haute's economy weak, factoring in low projected per capita effective buying income (63.4% of the national level) and below-average per capita market value of $44,646.

The city (estimated population 60,841) is in east-central Indiana, 70 miles southwest of Indianapolis on Interstate 70 along the Illinois border. Terre Haute is the county seat and economic center for Vigo County and the surrounding area. Indiana State University is in the area--the university's enrollment of 12,531 represents nearly 20% of total city's population. Terre Haute's footprint also includes a highly regarded science and engineering private college, Rose-Hulman Institute of Technology, that enrolls about 2,000. We think the presence of these two major established institutions provides relatively stability to the local economy.

In early 2018, its largest employer and taxpayer, Digital Audio Disc Corp.-Sony, eliminated 375 positions (or more than half of the workforce) in the Terre Haute factory. Two large department stores also closed last year. These events are not positive for the economy; however, the city believes that there are a number of new developments and business expansions that will offset the losses. There have been multiple hotels opened in the past few years, with additional ones being constructed. The county is also building a new convention center downtown.

The county unemployment rate was 4.4% in 2018, and the city's total NAV has been increasing (rising 9% since 2014 to $1.7 billion in 2018). These changes partially reflect cyclically beneficial economic conditions and the city's successful economic development efforts that spurred the recent new construction.

Outlook

The stable outlook reflects our view that the allocation area will remain steady, as it anchors Terre Haute's downtown business district and is one of the stronger areas of economic activity in the city. Therefore, we also expect pledged revenues will remain stable, and continue to provide very strong coverage of debt service. It also reflects our expectation that the city will not significantly dilute coverage through additional debt.

Upside scenario

We could raise the rating if there is continued new development that leads to reduced concentration. A higher rating would also depend on limited additional debt issuance and stability or improvement in the city's operating credit conditions.

Downside scenario

Should the city issue a significant amount of additional debt pledging TIF revenue, regardless of whether TIF revenues are the primary intended payment source, and this leads to lower coverage, we could lower the rating. We could also do so if taxable values deteriorate or there is general decline in economic activity within the allocation area.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014