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While Arizona Cardinals Soar, Legal Battle Puts Stadium Investors in Red Zone.

Dispute over rental-car taxes that help cover stadium's payments highlights risks for bond investors

The Arizona Cardinals are one of the National Football League's hottest teams, leading their division with a 4-2 record.

Their stadium, however, is on a losing streak with investors. Its operator, along with state tax collectors, have lost two court rulings since last year over the legality of rental-car taxes used to fund the \$455 million University of Phoenix Stadium in Glendale. The battle threatens the authority's capacity to collect revenue that accounts for nearly a third of the stadium's bond payments.

A lawyer for the operator, the Arizona Sports and Tourism Authority, said he expects the state agency to prevail on appeal.

The legal fight highlights the risk borne by investors who buy stadium bonds.

U.S. state and local governments from Florida to Arizona have financed stadium construction and improvements by linking bonds to tourism taxes, such as on hotels and rental cars. But the practice can backfire when collections decline, leaving taxpayers on the hook and investors facing downgrades and falling bond prices.

"These fluctuate and people cut back on things like tourism expenses when the economy's down," versus, say, a bond backed by water or utility fees, said Howard Cure, director of municipal research at Evercore Wealth Management.

Now, litigation is proving another risk. Rental-car agencies contend that the fees Arizona levies are a vehicle tax, which the state's constitution limits to supporting roads. A state court last year agreed, and in August, the state was ordered to refund what could amount to tens of millions of dollars while it appeals the case.

Those taxes make up about one-third of the payments on the authority's almost \$270 million of municipal bonds. Without them, the Arizona stadium debt may be downgraded, ratings firms have warned. The bonds enjoy an investment-grade rating now. But Fitch Ratings said in an August report that the absence of legislative action to replace the money "could result in ratings dropping to below investment-grade levels."

Some Arizona Sports and Tourism Authority bonds maturing in 2036 traded recently at yields around 4%, about half a percentage point above comparably rated debt, according to Thomson Reuters Municipal Market Data. Yields rise as prices fall.

Tourism taxes are one of the most-common sources of public money for stadiums nationwide. U.S. cities and states owe around \$3.5 billion in bonds backed in some part by hotel and rental-car payments, according to a Wall Street Journal analysis of Bloomberg and Electronic Municipal Market

Access data. The money has helped build stadiums for teams including the Houston Texans, San Antonio Spurs and the under-construction ballpark for the Atlanta Braves.

Fitch downgraded bonds that paid for Orlando's basketball arena to junk in 2010, citing fluctuations in revenue from tourism taxes and warning officials would need to tap reserves to pay investors. The rating firm upgraded the bonds this year.

The use of tourism taxes is the result of public officials' attempting to make stadium borrowing more palatable to voters by passing on the cost to outsiders, several analysts said.

"For local officials, it makes it more appealing to say this particular tax is going to fall on nonresidents," said David Swindell, director of the Center for Urban Innovation at Arizona State University. "We saw that in authorities across the country during the recession—they took a big hit because they were so dependent on tourism dollars." That can leave taxpayers facing higher bills to make up the difference.

Now, lawyers for rental-car companies suing the stadium authority are asking a judge to escrow the taxes while the state appeals, a process that could mean years of uncertainty for bondholders. Shawn Aiken, who represents the plaintiffs, said that in Arizona, those taxes are reserved for highways and he is confident the state can find other sources of money to pay investors.

"The building of a football stadium is clearly a non-highway purpose," he said.

Timothy Berg, a lawyer who represents the stadium authority, said it will oppose the motion to withhold the taxes while it appeals.

While bonds sold for stadiums tend to be lower-rated and more volatile than other municipal debt, even the worst-off facilities typically avoid long-term distress, said John Miller, co-head of fixed income at Nuveen Asset Management LLC. His firm holds some of the Arizona bonds, as well as those that paid for Chicago's Soldier Field, ballparks for the New York Yankees and Mets, and Houston's venues.

"They tend to be lower rated, because of the reliance on these entertainment and travel sources of revenue," Mr. Miller said. "They're more economically sensitive, but they've come back stronger since 2009," as tourism rebounded after the recession.

The problems with the rental-car taxes are just the latest wrinkle in the region's misadventures hosting big league sports, Mr. Swindell said.

The city of Glendale suffered downgrades after it built a hockey arena for the Arizona Coyotes and spent tens of millions covering the team's losses, amid broader financial difficulties for the city.

The state stadium authority has already struggled to make ends meet. A legislative audit last month found tourism revenue was insufficient to fulfill its financial obligations, which include promoting tourism and funding youth sports. Tourism money has also fluctuated widely, exacerbating shortfalls, while debt payments are scheduled to increase in coming years.

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