

Municipal Credit Update

Williamstown, KY's Ark Encounter May End Up Sinking Investors

August 2016

Do you know what is in your portfolio? While investors justifiably expect their municipal assets to serve as the safe and stable component of their investment portfolio, the spectrum of obligors and creditworthiness within the municipal market is wide. Though high-quality, traditional municipal obligors abound, lurking in the shadows are projects and obligors that few would associate with the municipal market. Risky economic development schemes can access the municipal market if associated with not-for-profit entities, and the municipal market's opaque nature may make it difficult for some to recognize that the debt is not supported by a state, city, or county government.

Municipal investors relying on the peace of mind gained from the stability and predictability characterized by high-quality obligors' tax or essential service utility revenue-backed bonds may be surprised to find that their "municipal" investments are anything but municipal. In the deepest corners of the municipal market are not-so-traditional projects that push the boundaries of risk and suitability for a municipal bond portfolio. Stadiums, aquariums, and museums are projects we often find in the municipal bond market with varying degrees of creditworthiness and governmental revenue support, or lack thereof. Ultimately, understanding the securitizing revenue

source and the drivers for debt repayment are the most important components of our credit analysis.

In 2013, the city of Williamstown, Kentucky (the City) sold \$62 million of bonds in the municipal market, the proceeds of which would subsequently be loaned by the City to Crosswater Canyon, Inc. and Ark Encounter, LLC. The funds financed the "initial phase of a biblically themed educational and entertainment complex to include a replica of the Ark of Noah and related facilities."¹ Importantly, the City made no guarantees on the bonds, offered no tax support or credit enhancement to investors, and debt repayment would rely solely on the success of the project. Bondholders of the City's Taxable Industrial Building Revenue Bonds, Series 2013 are exposed to risks more characteristic of a corporate bond than a municipal one, and some may look back on this project and wonder how they were ever exposed to this type of investment in what is supposed to be the most protected component of their investment portfolio.

On July 7, 2016 the doors of Ark Encounter opened to the public in Williamstown, Kentucky with the help of municipal investors who contributed \$62 million in bond proceeds toward the amusement park in hopes that future revenues generated from admissions would be

¹ City of Williamstown, KY Official Statement for Taxable Industrial Building Revenues Bonds, Series 2013 (Crosswater Canyon, Inc. Project).

sufficient to pay them back. The potentially optimistic projections may end up sinking investors, as we have seen in the past, with other similar endeavors whose “if you build it, they will come” mentality never materialized when people did not show up.

The \$100 million Ark Encounter that seeks to recreate the biblical Noah’s Ark, true to scale as described in the Book of Genesis, opened its doors as a tourist attraction on July 7 and is expected to bring 1.2 million to 2 million visitors in its first year of operation.² As is the case with many economic development or tourism-focused projects, the feasibility report provides a broad array of factors that contribute to the projected attendance, including, regional economy, population, travel and tourism characteristics, and comparable attractions. Though few comparable attractions exist to measure the viability of the Ark’s admission projections, we can look toward the Creation Museum (owned by same group as Ark Encounter), which operates a biblically themed museum that purports to “represent a biblical account of the origins of the universe” about 45 miles north of Williamstown. The offering statement for Ark Encounter shows that the Creation Museum has seen declining admissions every single year since its first full year of operation, with a staggering 40% decline between its peak attendance of 394,185 in 2007 and 2013.³ To further place the Ark Encounter’s projections in perspective, drawing 2 million visitors annually would place it just outside of the top 20 amusement and theme parks in the United

States – the 20th most visited park in 2015 was Busch Gardens in Williamsburg, Virginia, which drew 2.7 million visitors – and would place it ahead of all but two water parks in the nation.⁴ Two million visitors is more than all but nine museums in the United States drew in 2015, placing its projections above art, science, and history museums in major metropolitan areas such as Los Angeles (the Getty drew 1.5 million), Chicago (the Art Institute drew 1.5 million), San Francisco (the California Academy of Sciences drew 1.4 million) and Boston (the Boston Museum of Science drew 1.3 million).⁵

Should the Ark Encounter experience a similar fate to the Creation Museum and see admissions fall well below projections, the feasibility of maintaining sufficient cash flows to repay an ascending debt structure that does not have a final maturity until 2028 becomes highly speculative. The attendance figures were questioned by an independent consultant before the doors even opened. The consultant, Hunden Strategic Partners of Chicago, indicated the project “would attract up to 640,000 visitors in its best year” – well below the figures quoted by the project’s developers.⁶

Additionally, at a \$40 per adult admission price, the Ark Encounter is more expensive than most of the nation’s most renowned and visited museums and tourist attractions – many of which again draw less than 2 million visitors per year despite being located in

² City of Williamstown, KY Official Statement for Taxable Industrial Building Revenues Bonds, Series 2013 (Crosswater Canyon, Inc. Project).

³ City of Williamstown, KY Official Statement for Taxable Industrial Building Revenues Bonds, Series 2013 (Crosswater Canyon, Inc. Project) Feasibility Report, page 33.

⁴ Aecom Global Attractions Attendance Report. “2015 Theme Index.” Retrieved from http://www.aecom.com/content/wp-content/uploads/2016/05/2015_Theme_Index__Museum_Index.pdf, August 4, 2016.

⁵ Aecom Global Attractions Attendance Report. “2015 Theme Index.” Retrieved from http://www.aecom.com/content/wp-content/uploads/2016/05/2015_Theme_Index__Museum_Index.pdf, August 4, 2016.

⁶ Loftus, Tom. “Noah’s Ark Park attendance projections cut in half.” Retrieved from <http://www.usatoday.com/story/news/nation/2015/01/21/noahs-ark-park-attendance-projections-cut-in-half/22131911/>. August 1, 2016.

large metropolitan cities with a multitude of dining, nightlife, and entertainment options for travelers. The expectation that the masses would converge in Williamstown, Kentucky, with a population of less than 4,000 and located more than 50 miles from the nearest major metropolitan area (Cincinnati, Ohio) and little else in the way of tourist attractions or entertainment, seems quite optimistic to us.

The municipal market has an array of speculative projects that do not benefit from the security of a government providing bondholders with an interest in tax or essential revenue support. As just one example of a project that we believe bears similarities to the Ark Encounter, we would present the case of Marineland of Florida. The harsh reality of the “if you build it, they will come” mentality was felt by investors in the defaulted aquatic park located in St. Augustine, Florida. The expectation was that bond-financed restoration of one of the nation’s oldest aquariums and aquatic theme parks would boost sagging attendance trends and help Marineland compete with other attractions in Florida. Given Marineland’s similarly weak economic and tourism characteristics as Williamstown, Kentucky and a debt repayment structure that also relied on ticket sales and concessions, the attendance markers simply failed to materialize for the aquarium, which ultimately resulted in a bond default and subsequent bankruptcy filing. Uninformed investors who expected the municipal market to be a safe haven for investing were exposed to the harsh reality that not all municipal bonds are truly municipal. Ultimately, bondholders received \$245 for every \$1,000 invested.⁷

In recent months, our Municipal Credit Updates have focused on the hidden risks of the municipal market and the Ark Encounter in Williamstown, Kentucky is emblematic of what lurks in the corners. By no means is this project an isolated incident. In many of our portfolio reviews for prospective clients we find economic development projects, financed through conduit issuers, that have little semblance to what we expect to see in a municipal portfolio. It is possible that these clients have taken on more risk in their municipal portfolios than they may even be aware of or comfortable with. The feasibility of these offerings and the promise of profitability should always be viewed with a degree of skepticism. Most importantly, our depth and breadth of knowledge and experience in the municipal market allows our Credit Research team to better identify these risks and provide protection for our clients against loss of principal due to credit risk.

Please feel free to contact us at research@gurtin.com for additional information.

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⁷ The New York Times. “Aquarium Bonds Worth 25 Cents on Dollar. Retrieved from <http://www.nytimes.com/2001/11/28/business/aquarium-bonds-worth-25-cents-on-dollar.html>. Retrieved on August 2, 2016.

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