

Summary:

Weslaco, Texas; General Obligation

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Credit Profile

US\$25.0 mil tax and wtrwks and swr sys surplus rev certs of oblig ser 2012 due 02/15/2032

Long Term Rating

BBB+/Stable

New

Rationale

Standard & Poor's Ratings Services revised its outlook on Weslaco, Texas' general obligation (GO) debt to stable from negative based on the city's improved financial performance and return to structurally balanced operations. At the same time, Standard & Poor's affirmed its 'BBB+' rating on the city's GO debt.

In addition, Standard & Poor's assigned its 'BBB+' rating and stable outlook to the city's series 2012 tax and waterworks and sewer system surplus revenue certificates of obligation.

The 'BBB+' rating reflects our opinion of the city's:

- Adequate financial position based on unaudited fiscal 2011 results;
- Moderate overall debt level based on market value, with additional debt-financed capital needs;
- Status as a regional commercial center serving nearby communities in Texas and Mexico; and
- Adequate, but below-average, wealth and income levels.

The series 2012 certificates of obligation are secured by the city's ad valorem tax pledge and a pledge of surplus net revenues of the city's waterworks and sewer system. Management will use bond proceeds for water treatment plant improvements.

Following years of structural imbalances under a previous administration, which placed significant budgetary pressure on the city's finances, current management, which consists of several members with less than three years' experience with the city, outlined a plan to build reserves to \$5 million by the end of fiscal 2015, which would be roughly 25% of expenditures. The fiscal 2012 budget is operationally balanced and projects a \$467,462 increase in the general fund balance. Officials have conservatively budgeted for a 1.5% decline in property taxes and a 2% decline in sales tax collections from fiscal 2011 unaudited results, despite a relatively stable property tax base in the past three fiscal years and a growing sales tax base for the past six years, including a 7% increase in fiscal 2011. Also supporting balanced operations was a reduction-in-force in August 2011 that eliminated 25 positions, with an estimated annual saving of \$1 million in personnel expenses.

For unaudited fiscal 2011, management is conservatively estimating to end the year with an \$859,000 surplus and a \$767,000 unreserved general fund balance, or 3.7% of expenditures which we view as adequate. The improved financial position is partially due to the rescindment of \$550,000 previously held as a revolving loan contingency and to a volunteer separation program that drew 54 employees. The city was previously overstaffed, which contributed to its structural imbalances.

The city ended fiscal 2010 with a negative \$35,000 unreserved general fund balance, or a negative 0.1% of expenditures. Officials attribute the deficit to a voluntary separation agreement with 54 employees under which it

paid each one a lump sum payment based on the number of years of service. In addition, the city transferred \$164,040 from the utility fund to support the general fund. Primary revenue sources include property taxes (44%) and sales tax revenues (42%).

The utility fund makes debt service payments on roughly two-thirds of the city's outstanding tax-backed debt. The water and sewer fund had a \$750,921 unrestricted cash balance, or what we consider an adequate 43 days' cash on hand, at unaudited fiscal year-end 2011. The cash balance also equated to 3.6% of general fund expenditures. Historically, management had supported general fund operations with transfers from the utility fund, but officials indicate that they discontinued this practice in fiscal 2011. Current water and sewer rates are \$56.21 for 7,500 gallons. Both water and sewer rates are scheduled for an 18% increase to support the debt incurred for system improvements related to capacity issues. Unaudited fiscal 2011 revenues provided what we view as good 1.3x annual debt service coverage of the city's water and sewer revenue bonds, GO bonds, and certificates of obligation that are supported by the utility fund.

Weslaco's management practices are considered 'standard' under Standard & Poor's Financial Management Assessment. This indicates that the finance department maintains adequate policies in some, but not all key, areas. Under new management, the city has developed a long-term financial plan to rebuild the unreserved general fund balance. In addition, the city has identified its capital needs and plans to fund the majority of its capital expenditures in the budget.

After offsetting self-supported debt by the city's utility system and state support for debt service on bonds issued by Weslaco Independent School District, we consider the overall net debt burden low at \$1,274 per capita, but moderate at 3.4% of market value. Amortization is average, with 47% of principal due to be retired in 10 years. Debt service carrying charges were moderate, in our view, at 11.4% of fiscal 2010 general fund expenditures. Management plans to issue \$9.8 million in certificates of obligation in late 2012 for additional utility system improvements.

The city provides pension benefits through a nontraditional, joint contributory, hybrid-defined benefit plan: the Texas Municipal Retirement Plan. The city has a funded ratio of 103.1%. The Firemen's Relief and Retirement Fund administers a retirement plan for fire department employees that has an unfunded actuarial accrued liability of \$2.98 million. Retirees can continue to receive health insurance coverage under the city's plan but are required to pay the full premium.

Weslaco is in southeast Hidalgo County ('AA-' GO Rating) near the Mexican border. The city is a regional commercial center midway between McAllen ('AA+' GO rating) and Harlingen ('AA-' GO rating), and is nine miles north of the Rio Grande River. The city's population has grown slowly but steadily this decade to roughly 36,500. The city, acting as a regional commercial center, serves the midvalley regional population of 231,570. Winter tourism, ecotourism, agriculture, and international trade drive the economy. Leading employers include:

- Weslaco Independent School District (2,817 employees),
- Knapp Medical Center (1,000),
- Woodcrafters (592), and
- H-E-B Grocery Co. (407).

During the past year, the city added retailers such as Academy, Lowe's, J.C. Penney Co., and Petco. In addition,

AISLA Coat, Colimex, TDI Industries, and the Texas Department of Public Safety have relocated to the city, providing employment opportunities. As of September 2011, the city's 13.5% unemployment rate was higher than the state's 8.4% and nation's 8.8%. The median household effective buying income is adequate, in our opinion, at 68% and 67% of the state and national averages. We also consider market value per capita, an indicator of wealth, to be adequate, at an estimated \$37,148. The property tax base has remained relatively flat at \$1.3 billion for fiscal 2012 amid the economic slowdown. The leading 10 taxpayers are very diverse, in our opinion, accounting for just 9% of assessed valuation.

Outlook

The stable outlook reflects Standard & Poor's expectation that the city's major revenue streams will remain relatively stable and continue to provide sufficient coverage of operational and capital expenses, supported by conservative budgetary practices, allowing officials to maintain its adequate financial position. We also expect that the city's utility fund, supported by planned rate increases, will continue to provide adequate coverage of certain tax-secured debt. A consistent positive financial performance and further improvement in the fund balance could support an upgrade. However, a deterioration in the city's financial profile could negatively affect the rating.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of January 4, 2012)

Weslaco GO

Unenhanced Rating

BBB+(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

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