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Summary:
Weslaco, Texas; General Obligation

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Credit Profile

Weslaco GO

Unenhanced Rating

BBB+(SPUR)/Stable

Downgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services lowered its underlying rating (SPUR) on Weslaco, Texas' general obligation (GO) debt to 'BBB+' from 'A-' and revised the outlook to stable from negative.

The downgrade is due to a continued deterioration of the city's financial reserves. Rating factors include the city's:

- History of uneven financial performance, coupled with a negative fund balance in fiscal 2008, despite substantial support from the utility fund;
- Adequate wealth and income levels; and
- Moderately high debt ratios.

The rating also reflects our view of the city's participation in the increasingly diversified economies of McAllen and Harlingen.

Weslaco is in southeast Hidalgo County near the Mexican border. The city is a regional commercial center midway between McAllen and Harlingen and is nine miles north of the Rio Grande River. The population has grown slowly but steadily this decade to roughly 31,000. The city, acting as a regional commercial center, serves a regional population of 180,000 within nine square miles. Winter tourism, ecotourism, agriculture, and international trade are the local economy's primary drivers.

Property tax-base growth has been strong until fiscal 2010. Following assessed value (AV) growth of about 9% annually since fiscal 2005, the tax base declined less than 1% in fiscal 2010. However, we think the tax base remains healthy, with an AV of \$1.3 billion in fiscal 2010. AV growth has mirrored the city's strong residential and commercial expansion. Although wealth and income have exhibited some improvement since 1995, median household effective buying income is still what we consider adequate at just 69% and 67% of state and national levels, respectively. We believe market value remains adequate at \$40,460 per capita.

Over the past three years, Weslaco has seen a significant reduction in its unreserved general fund balance to negative \$213,000 in fiscal 2008 from a high of \$2.4 million in fiscal 2005. The fund balance has fluctuated significantly over the past several years due mainly to management's use of the reserve balance to fund one-time capital expenditures, and overly aggressive revenue assumptions.

Management attributes the fiscal 2008 deficit to slow revenue growth in the past two years and considerable increases in public safety and other administrative expenditures. During fiscal 2009, management took corrective actions, including adjusting fees for city services and cost-containment measures. Unaudited fiscal 2009 results

reflect a general fund surplus of roughly \$1.1 million, which is projected to bring the unreserved general fund balance to \$961,570, or what we consider a good 4.5% of expenditures. The city achieved the surplus through the transfer of utility funds into the general fund. The utility fund's performance is strong, with about 900 days' cash on hand in fiscal 2008.

For the fiscal 2010, management maintained the tax rate of 69.67 cents per \$100 of AV. The city adopted a balanced budget. Property tax collections are currently higher than budgeted by about 1.5% compared with year earlier. However, sales tax revenues, which accounted for roughly 13% of 2009 revenues, are down by 3.4% from a year earlier. Over the past two months, sales tax revenue collections have improved slightly.

Standard & Poor's revised its view of Weslaco's management practices to "vulnerable" from "standard" under its Financial Management Assessment methodology. A "vulnerable" assessment indicates that management lacks policies in many of the areas deemed most critical to supporting credit quality, including the lack of what we consider to be realistic revenue and expenditure assumptions in budget planning. In addition, the city lacks a reserve and liquidity policy and long-term financial and capital planning.

After calculating offsetting state support for debt service on bonds issued by Weslaco Independent School District, we consider the overall net debt burden moderate at \$2,659 per capita and a moderately high 6.6% of market value. In the past, officials have in general used fund balance for capital project. Meanwhile, continued residential and commercial growth has put pressure on the city's infrastructure. Management officials have conveyed to us they have no plans to issue additional GO debt at this time.

Outlook

The stable outlook reflects our expectation that the city's utility fund will continue to demonstrate strong financial margins and liquidity, especially given that the fund self-supports the city's tax-secured debt and that it is also, in essence, the sole source for all general government operating liquidity, as well as capital-outlay funding. Weslaco's maintenance of at least minimal, but positive, general fund balances and reasonable operating liquidity across all funds, and ability to increase utility rates when necessary, are important factors supporting its rating.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

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