



*Jim*  
c: Meyer + Comm.

**Moody's Investors Service**

August 23, 2007

Anthony Covacevich  
City Manager  
City of Weslaco  
255 S. Kansas Ave  
Weslaco, TX 78596

Plaza of the Americas  
600 North Pearl St., Suite 2165  
Dallas, Texas 75201  
Tel: 214-220-4350

Dear Mr. Covacevich,

*CMD*

We wish to inform you that on August 16, 2006, Moody's Investors Service reviewed and assigned a **Baa1** rating to the City of Weslaco's Tax & Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series 2007.

In order for us to maintain the currency of our ratings, we request that you provide ongoing disclosure, including annual financial and statistical information.

Moody's will monitor the rating and reserves the right, at its sole discretion, to revise or withdraw the rating at any time in the future.

The rating as well as any revisions or withdrawals thereof will be publicly disseminated by Moody's through normal print and electronic media and in response to verbal requests to Moody's rating's desk.

Should you have any questions regarding the above please do not hesitate to contact me or the analyst assigned to this transaction, Mierya Loewe at 214-220-4381.

Sincerely,

Douglas Benton  
Vice President/Senior Credit Officer

cc: Ann Burger Entrekin  
First Southwest company Inc  
70 Northeast Loop 410 Suite 850  
San Antonio, TX 78216

DB/mjd



Moody's Investors Service

Global Credit Research

New Issue

19 AUG 2007

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New Issue: Weslaco (City of) TX

**MOODY'S DOWNGRADES CITY OF WESLACO'S (TX) RATING TO Baa1 FROM A3; ASSIGNS Baa1 RATING TO \$33.4 MILLION TAX AND WATERWORKS AND SEWER SYSTEM SURPLUS REVENUE CERTIFICATES OF OBLIGATION, SERIES 2007**

**RATING DOWNGRADE AFFECTS \$53.1 MILLION IN OUTSTANDING PARITY DEBT, INCLUDING THE CURRENT ISSUE.**

Weslaco (City of) TX Water & Sewer Ent  
Municipality  
TX

**Moody's Rating**

ISSUE	RATING
Tax and Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series 2007	Baa1
<b>Sale Amount</b>	\$33,375,000
<b>Expected Sale Date</b>	08/22/07
<b>Rating Description</b>	General Obligation Limited Tax

**Opinion**

NEW YORK, Aug 19, 2007 -- Moody's Investors Service has downgraded the City of Weslaco's rating to a Baa1 from A3. The rating downgrade affects \$25.3 million in outstanding parity debt. Concurrently, Moody's has assigned a Baa1 rating to the city's current \$27.8 million Tax and Waterworks and Sewer System Surplus Revenue Certificates of Obligation, Series 2007. The rating actions reflect the city's structural imbalance in financial operations that has led to a significant reduction to its reserve levels. Also considered are an elevated but manageable debt burden, and strong tax base growth with low wealth levels. The current issue will fund various equipment purchases and various improvements to streets, water and sewer, and other facilities. Security on the certificates is provided by an ad valorem tax pledge on all taxable property within the city within the limits prescribed by law.

**MULTIPLE YEAR DEFICITS DIMINISH RESERVES**

In recent years, the city's financial position has significantly deteriorated. After posting deficits in fiscal years 2003 through 2005, the general fund balance decreased from \$4.5 million (32.9% of general fund revenues) in fiscal 2002 to \$1.7 million (10% of revenues) in fiscal 2006. Some of these deficits were due to over-estimation of sales tax revenues, a decrease to the property tax rate in fiscal 2004, and increases to both operating and one-time capital expenditures. For fiscal 2007, officials estimate the general fund balance will further decrease to \$634,000. About 65% of the \$1 million deficit estimated for fiscal 2007 will be due to salary increases and new positions. Some of these increases were given to police and fire personnel through two-year, meet-and-confer bargaining contracts that became effective on October 1, 2006 and run through September 30, 2009. Officials indicated that the city has currently frozen the hiring of additional personnel in order to achieve the estimated \$634,000 general fund balance this year. However, these positions will be opened again at the start of the new fiscal year on October 1, 2007. For fiscal 2008, officials anticipate only minimal improvement to the general fund balance. Although the city has had an informal policy of maintaining 25% in the general fund balance, the city does not expect to reach this level until fiscal 2012. Officials indicated the city is working on adopting a new budgeting and forecasting model, which city council is scheduled to adopt by the end of August. They are planning to use this new financial tool to regain structural balance and rebuild reserves. In fiscal 2006, approximately 36.4% of operating revenues came from property taxes and 26.6% came from sales tax. Sales tax revenues have been increasing as a result of new retail and have grown 6.2% annually over the last five years, including significant growth in fiscal 2005 and 2006 of 18.9% and 12.8%, respectively. Year-to-date figures for sales tax reflect continued strong growth. Moody's believes the city's aggressive revenue growth expectations and lax expenditure controls have created a

structural imbalance that has weakened its financial position which is inconsistent with an A3 rating. Moody's also believes the current and near future financial projections are reflective of the new Baa1 rating assignment.

#### TAX BASE CONTINUES TO EXPAND

The City of Weslaco is located in Hidalgo County (Moody's rated ) in south Texas, between the cities of McAllen (Moody's rated A1) and Harlingen (Moody's rated A2). The city has benefited from steady growth over the last several years, with the tax base growing annually at an average of 6.7% over the last five years. In fiscal 2007, the assessed valuation grew to \$998 million, an 8% increase over the previous year. The most recent certified values for fiscal 2007 indicate the AV increased by 13.5% to \$1.13 billion. The top ten taxpayers are diverse and only comprised 8.4% of the fiscal 2007 assessed value. Growth has been primarily driven by residential and retail development. Officials estimate there are currently about 1,000 platted lots scheduled to be developed over the next ten years. The City also has a large tourism component as a result of four certified birding centers. The expansion of the South Texas Community College District Weslaco campus and the Knapp Medical Center in recent years have increased employment opportunities, decreasing the unemployment rate from 13.65 in 2003 to 5.7% in May 2007. Moody's believes that historical growth rates will continue over the medium-term given the ongoing and planned development.

#### ELEVATED DEBT BURDENS AIDED BY CONSIDERABLE SUPPORT FROM THE WATERWORKS AND SEWER SYSTEM

The city's debt burden is elevated. Including the current issue and considering the debt previously supported by the waterworks and sewer system and sales tax revenues, the direct and overall debt burdens are high at 4.4% and 5.9%, respectively, both expressed as a percentage of assessed valuation. When \$21.65 million of the current issue are also considered as self-supported by the waterworks and sewer system, these ratios are reduced to more manageable levels of 2.5% direct and 4.0% overall. General obligation debt payout is below average with 40.2% of principal retired in ten years and all debt is retired by 2027. Officials indicated the city will likely issue an additional \$7 million in about three years to complete the necessary capital projects planned for the next five years. Moody's believes that the city's debt burden will continue to be elevated but will become more manageable given expected tax base growth, self-support from the waterworks and sewer system, and modest plans for additional debt.

#### KEY STATISTICS:

Estimated 2007 population: 31,442

2008 full valuation: \$1.13 billion

2003 full value per capita: \$36,013

Direct debt burden net of self-supported: 2.5%

Overall debt burden net of self-supported: 4.0%

Principal payout within ten years: 40.2%

2006 general fund balance: \$1.7 million (10% of General Fund revenues)

Projected 2007 general fund balance: \$634,000

Post-sale outstanding parity debt: 53.1 million

#### Analysts

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Moody's Investors Service