

FITCH AFFIRMS HARLINGEN, TX'S GOS AND COS AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-Austin-25 June 2012: Fitch Ratings has affirmed the 'AA-' rating on the following Harlingen, Texas general obligation bonds (GOs) and certificates of obligations (COs):

- \$2.9 million combination tax and revenue COs, series 2010;
- \$1.7 million GO refunding bonds, series 2010;
- \$9.5 million GO bonds, series 2007;
- \$19.4 million combination tax and revenue COs, series 2007;
- \$2.6 million GO bonds, series 2006;
- \$3.8 million GO refunding and improvement bonds, series 2005.

The Rating Outlook is Stable.

SECURITY

The bonds and certificates are secured by a limited ad valorem tax levied against all taxable property in the city. The certificates are secured further by a limited pledge of surplus revenues of the city's Butler golf course.

KEY RATING DRIVERS

HEALTHY RESERVES MAINTAINED: The city has a relatively stable financial history. Strong financial flexibility is evident in the maintenance of high reserve levels.

DEPENDENCE ON SALES TAXES: The city relies heavily on sales tax revenues for operations, but Fitch notes its high reserve levels as a mitigating factor.

MODERATE DEBT LEVELS: The city's overall debt burden is moderate with limited near-term borrowing plans; principal amortization is average.

ECONOMIC GROWTH: Harlingen is located in south Texas near the U.S.-Mexico border. Tax base and economic growth have remained positive despite the recession, but the region continues to suffer structurally high unemployment and low wealth levels. Proximity to Mexico and an extensive and expanding transportation network support strong international trade activity.

CREDIT PROFILE

STABLE FINANCIAL OPERATIONS WITH STRONG RESERVE LEVELS

The city's financial reserves have remained strong despite three years of modest drawdowns (fiscal years 2008-2010) that were primarily attributable to pay-go capital outlays. For fiscal 2011 the city reported a modest increase to fund balance of roughly \$330,000 and ended the year with \$10.9 million in unrestricted fund balance (committed, assigned and unassigned per GASB 54), or 30.1% of spending. These results were consistent with previous years, as the city has reported reserve levels exceeding 30% of spending annually since fiscal 2006. For fiscal 2012, management reports that revenues are ahead of budget with expenditure levels below budget, and they anticipate ending the year with a surplus, adding roughly \$500,000 to fund balance.

The general fund receives over 40% of its revenues from a 1.5% sales and use tax. Despite the volatile nature of sales tax revenues, this revenue source has grown at an average annual rate of 2.5% in the last ten years. Fiscal 2010 was the first time in a 17-year period that sales tax revenues declined (down 6.8%), but they immediately rebounded in fiscal 2011 with 3% growth. For fiscal

2012, management reports that sales tax receipts through April are up nearly 8% from the same time last year. The city attributes this growth to a new retailer, Bass Pro Shops, which opened in November 2011. In addition to the 1.5% sales and use tax for the general fund, the city collects a one-half-cent sales tax for economic development programs.

Property taxes account for approximately one-third of total general fund revenues. The tax base is well diversified and has grown at a compound annual growth rate of 3.4% since fiscal 2007 to \$2.7 billion in fiscal 2012. The top 10 taxpayers represent a moderate 6.8% of the total. City officials expect 4% growth in the tax base over the next several years, due to the Bass Pro Shops addition to the tax base and additional commercial development underway.

MANAGEABLE DEBT LEVELS WITH LIMITED DEBT ISSUANCE PLANS

The city's overall debt burden is moderate after adjusting local school district debt for state debt service assistance, and principal amortization is about average. Overall debt per capita is \$1,593 and 3.9% of fiscal 2012 market value. The city has no GO debt authorization currently and has no plans to approach voters for additional authorization in the near term. Officials report that the city's capital improvement plan is being updated, and the only borrowing under consideration is an estimated \$6 million for infrastructure in the tax increment financing reinvestment zone.

Pension benefits are provided through the Texas Municipal Retirement System (TMRS), a statewide agent multiple employer plan. The city's funding position is a healthy 99.5% as of December 2010 with an aggregate unfunded actuarial accrued liability (UAAL) associated with the plan at a low \$406,000 as of the December 2010 actuarial valuation, equal to a modest 0.05% of full market value. Funded on a pay-go basis, other post employment benefits (OPEB) liabilities are higher. The fiscal 2011 pay-go contribution comprised less than 1% of general fund spending. The UAAL as of September 2011 totaled \$12.8 million, equal to 0.4% of full market value.

DIVERSIFIED ECONOMY

The area economy has long been linked to the agriculture, tourism, trade, and manufacturing sectors. However, the local economy continues to diversify, aided by the city's economic development incentive programs and an extensive transportation network that includes the city-owned and operated Valley International Airport. The city is slowly positioning itself as a regional healthcare hub. The Regional Academic Health Center, a branch of the University of Texas-San Antonio Health Science Center, has brought a nationally recognized institute of health science education and research to the Rio Grande Valley. The South Texas Veterans Administration Health Care Center at Harlingen was recently completed, and a \$40 million surgical and ambulatory facility to supplement the center is now open, employing over 200 medical professionals.

The Bass Pro Shops completed construction of its retail store on a 110-acre site and opened in November 2011, spurring additional retail development and attracting more shoppers to the area. Higher education is also a major economic component. Texas State Technical College Harlingen is a two-year institution whose new Articulation and Career Center, which opened in August 2011, offers degrees to area students from other universities in the state and the U.S. Fitch views these developments favorably, as they should promote stability and attract higher quality jobs to the region. At 8.6% in April 2012, unemployment levels have improved from the prior year but remain higher than the state (6.5%) and the U.S. (7.7%) averages. Wealth levels are well below average compared to the state, but are in line with those of other border communities. The area's very low cost of living offsets this credit risk.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, Zillow.com, National Association of Realtors, and Texas Municipal Advisory Council.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria', dated Aug. 15, 2011;

--'U.S. Local Government Tax-Supported Rating Criteria', dated Aug. 15, 2011.

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Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648898

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648842

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