

FITCH AFFIRMS PHARR, TX'S CERTIFICATES OF OBLIGATION AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-Austin-04 January 2011: Fitch Ratings affirms the following ratings for Pharr, Texas' limited tax bonds as part of its continuous surveillance efforts:

--\$2.7 million combination tax and limited pledge revenue certificates of obligation (COs), series 2001, affirmed at 'AA-'.

The Rating Outlook is Stable.

RATING RATIONALE:

--The health of the city's financial profile has been restored by new management which has implemented numerous positive financial management practices.

--Despite contraction in the city's second largest revenue stream, sales and use tax revenues, the city's financial reserves have rebounded significantly and are expected to far exceed the city's new 25% fund balance goal in fiscal year 2010.

--The debt profile of the city is mixed, characterized by limited debt plans and rapid principal amortization, balanced against an above average overall debt burden.

--The city's wealth levels are very low but their growth is outpacing state and national averages as the local economy transitions from its historical agricultural roots to retail, international trade and manufacturing.

KEY RATING DRIVERS:

The maintenance of solid reserve levels is key to preserving current credit quality.

SECURITY:

The 2001 COs are secured by a property tax levy, limited to \$2.50 per \$100 taxable assessed valuation plus a subordinate lien on surplus revenues of the water and sewer system revenues (not to exceed \$1,000).

CREDIT SUMMARY:

Located four miles east of McAllen in Hidalgo County, Pharr's historically agricultural-based economy has been diversifying into retail, shipping and distribution, and light manufacturing. Local international trade activity is aided by the presence of the city-owned Pharr International Bridge into Mexico. The bridge has stimulated development within several adjacent industrial parks, however, due to increased security concerns and competition from other bridges, total bridge crossings have trended downward like most other border municipalities. The city's unemployment rate remains high, at 10.2% in October 2010, relative to the state and national average of 7.9% and 9.3%, respectively. However, the economy continues to expand despite the recession, with job growth of 13.1% from 2006 to 2010, and the overall dependence on agriculture continues to decline. Typical of many U.S.-Mexico border municipalities, the city's wealth levels are very low, with median household incomes equal to about one-half of the U.S. average. Pharr's population growth has been rapid, increasing to an estimated 66,231 in 2010, a 40% increase since 2000.

The city's debt profile is mixed, evidenced by a rapid principal payout rate and limited future debt plans, balanced against its above average overall debt burden (even after adjusting for state funding of local school district debt). The city's pension is adequately funded and elected officials are actively considering the creation of a trust for its other post employment benefits (OPEB). Pension and OPEB costs consume a reasonable share of total general fund spending.

The city underwent an overhaul of its financial management in the wake of the fiscal 2007 audit in which a new auditor deemed several general fund receivables as non-current. As a result, the city was required to offset these receivables with reserves for non-current advances, leading to a

negative \$6.4 million unreserved fund balance, equal to a large 20% of spending. Under new financial management, the city eliminated the deficit position through transfers from associated funds and enterprise systems. Improved financial monitoring, cost controls, and financial management policies enabled the city to promptly restore its finances, increasing its unreserved fund balance to a healthy \$8.3 million or 28% of spending by fiscal 2009, in excess of its new 25% fund balance policy. Notably, the city attained positive results despite erratic sales tax trends that posted a 6.6% decline in fiscal 2009. Furthermore, unaudited fiscal 2010 results point to a large \$6.7 million operating surplus, further increasing its reserves to a very large 50% of spending. The 2011 budget is balanced, based on conservative growth assumptions for sales tax receipts.

Contact:

Primary Analyst

Jose Acosta

Senior Director

+1-512-215-3726

Fitch Inc.

111 Congress Avenue, Suite 2010

Austin, TX 78701

Secondary Analyst

Gabriela Gutierrez

Director

+1-512-215-3731

Committee Chairperson

Michael Rinaldi

Senior Director

+1-212-908-0833

Media Relations: Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com.

Additional information is available at 'www.fitchratings.com'

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, LoanPerformance, Inc., and IHS Global Insight.

Applicable Criteria and Related Research:

'Tax-Supported Rating Criteria', dated Aug. 16, 2010.

'U.S. Local Government Tax-Supported Rating Criteria', dated Oct. 8, 2010.

For information on Build America Bonds, visit www.fitchratings.com/BABs.

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564566

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF

INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE.