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Summary:

South Padre Island, Texas; General Obligation

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Credit Profile		
US$3.8 mil GO bnds ser 2011 dtd 06/01/2011 due 03/01/2031		
Long Term Rating	AA-/Stable	New
South Padre Island GO		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its underlying rating (SPUR) on South Padre Island, Texas' general obligation (GO) debt one notch to 'AA-' from 'A+' based on Standard & Poor's assessment of the city's improved financial management practices, strengthening its support of, what Standard & Poor's considers, the city's historically very strong financial position. The outlook is stable.

At the same time, Standard & Poor's assigned its 'AA-' long-term rating, and stable outlook, to the city's series 2011 GO bonds.

The rating also reflects our opinion of the city's:

- Stable local economy concentrated in tourism;
- Low property tax rate, providing added revenue-raising flexibility; and
- Low overall net debt burden based on market value with, what we consider, above-average debt amortization.

We believe the city's vulnerability to adverse weather conditions and related damages somewhat offsets these strengths.

The city's full-faith-and-credit pledge secures the bonds. Officials plan to use series 2011 bond proceeds to finance the design and construction of a fire and emergency services station.

South Padre Island, with a population estimate of 5,900, is in Cameron County on a half-mile-wide barrier island that extends for 34 miles. The Laguna Madre Bay to the west and the Gulf of Mexico to the east surround the island. The local economy is heavily concentrated in the tourism- and vacation-related industries with more than 3.5 million annual visitors. Visitor travel might fluctuate depending on the nation's, state's, and northern Mexico's economic conditions. Management, however, does not expect the current economic downturn to have a significant effect on revenues because most Texas residents will likely be more apt to travel to a local vacation destination. In addition, the city's location makes it prone to experiencing severe weather-related damage that could have an adverse effect on the city's economy.

South Padre Island has experienced solid property tax base growth. Assessed valuation (AV) has increased by an aggregate 36% over the past five years to more than $2.5 billion in fiscal 2011. Significant appreciation of existing properties and steady development of high-end condominium towers and townhomes continue to drive the city's rapid tax base expansion. Officials expect growth to continue with further development as management explores potential annexation opportunities north of the island, including additional waterfront properties. We view the tax base as very diverse with the 10 leading taxpayers accounting for just 5.1% of AV. In our opinion, city income levels are very strong with per capita effective buying income at 145% of the national level and good based on median household effective buying income at 97% of the national level. Due to commercial resorts, property market value is, in our view, an extremely strong $437,284 per capita based on the city's year-round population.

The city's financial position is, what we view as, very strong with an unreserved general fund balance ranging between 62% and 70% of expenditures during the past five fiscal years and consistently exceeding management's reserve policy of six months' operations. Due to added expenses related to the design of the new fire station and planning services for the entertainment district and Padre Boulevard, the city incurred a $336,000 drawdown during fiscal 2010; it, however, still maintained, what we consider, very strong reserves at 62% of expenditures, or a $6.1 million unreserved fund balance. Management is projecting fund balance to remain stable by fiscal year-end 2011, and it plans to adopt a fiscal 2012 balanced budget.

The city's low direct property tax rate has remained, what we regard as, a stable 24.56 cents per $100 of AV since fiscal 2008, providing, what we consider, significant revenue-raising flexibility due to the $1.50 levy cap. In fiscal 2010, property tax revenues accounted for 57% of general fund revenues while sales and franchise taxes accounted for an additional 30%. The city keeps hotel-motel taxes separate from the general fund and uses this revenue stream for tourism, advertising, and promotion.

Standard & Poor's revised its Financial Management Assessment (FMA) of South Padre Island's management practices to "good" from "standard" based on Standard & Poor's assessment of the city's recently adopted formalized capital planning and debt management policies. An FMA of "good" indicates financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them. The city conservatively budgets revenues and expenditures based on historical trends and expenditure growth rates. Officials report budget results to the city council quarterly, and they can amend the budget at any time throughout the year. Formalized policies include:

- An investment policy that follows state guidelines with at least quarterly updates to the governing body,
- A five-year capital improvement plan that identifies possible funding sources for some projects, and
- A debt management policy.

The city is currently developing a five-year operating plan that will emphasize program needs.

The city participates in the Texas Municipal Retirement System (TMRS), a statewide defined-benefit pension plan. The city's contribution rate is actuarially determined annually. Its net pension obligation at fiscal year-end 2010 was about $98,000, which management is addressing through contribution rates set by TMRS over an eight-year period; the city is currently in its third year. The city also offers health benefits to retirees; eligibility requirements are quite stringent and based on the number of years of service, along with service credits; as of May 2011, the city only had one eligible employee with the city paying $125 annually for benefits.

Following this issuance, the overall net debt burden remains, in our opinion, a low 2% of market value, or a high $8,759 per capita, reflecting the city's small year-round population. The debt service carrying charge was, in our view, a moderate 9% of general fund expenditures in fiscal 2010. Debt amortization is, what we regard as, above average with officials planning to retire 59% of debt over the next 10 years. Officials do not plan to issue additional debt within the next two years.

Outlook

The stable outlook reflects Standard & Poor's expectation that despite the city's reliance on tourism-based activity, its financial position will likely remain, what Standard & Poor's considers, very strong, in accordance with the city's stated policy. We do not expect the rating to change within the stable outlook's two-year parameter because we believe the city will likely continue to maintain, what we regard as, balanced operations while managing through the current national recession.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006

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