Fitch Rates Southlake, Texas' $14MM COs 'AA'

AUSTIN, Texas -- Fitch assigns its 'AA' rating to Southlake, Texas' (the city) $14.085 million tax and waterworks and sewer system (limited pledge) revenue certificates of obligation (COs), series 2008, scheduled to sell Feb. 19, 2008 via negotiation. In addition, Fitch affirms the 'AA' rating on the City's $74.1 million in outstanding general obligation bonds and $54.2 million in outstanding COs. The Rating Outlook is Stable.

The COs are payable from the proceeds of an annual ad valorem tax levied on all taxable property within city, limited to $2.50 per $100 taxable assessed valuation (TAV) and a limited pledge (up to $1,000) of the surplus net revenues of the city's waterworks and sewer system. Proceeds will be used for drainage improvements, street improvements and extensions to the City's combined waterworks and sewer system.

The 'AA' rating reflects the city's continued expansion of its already large financial reserves, ongoing tax base growth and diversification, strong local wealth indicators, and modest future debt plans. Also incorporated in the rating is the city's high debt burden, accumulated during its recent high-growth period. The city's tax base has benefited from considerable high-end residential development and management is now focused on diversifying its tax base with commercial, industrial and mixed use development. Additionally, the income and employment characteristics of Southlake are positive. Despite the operating and capital pressures associated with growth, the city has prudently managed its finances, provided the necessary infrastructure and services, and created alternate funding sources for capital improvements.

Southlake, with an estimated 2007 population of 26,314, is located in northeast Tarrant County approximately 15 miles northwest of Dallas and 10 miles northeast of Fort Worth. The city is also five miles northwest of the Dallas-Fort Worth International. Due to the housing boom of the late 1990's and early 2000's, Southlake's residentially zoned land is 85% developed and a total build-out population of about 35,000 is projected by 2024. Accordingly, the city's TAV growth has slowed from previous years' levels of 20% or more to still solid rates of growth. Current residential permit activity has remained modest but steady, centered on smaller high-end developments, roughly 600 homes sold in 2007, with an average price of $616,711. The recently improved State Highway 114 has evolved into a major growth corridor attracting large retail and commercial construction.

The city's financial position has been historically strong with undesignated general fund reserves of roughly 29% of expenditures. The undesignated/unreserved fund balance will be reduced to approximately 25% of expenditures in 2008 due to transfers to a strategic initiative fund (SIF) for infrastructure maintenance, technology infrastructure, and capital projects. The City plans to transfer unreserved/undesignated funds to this new fund, when fund balances exceed 25% of operating expenditures. Due to conservative budgeting, the city has consistently exceeded its fund balance policy of 15% - 25% of expenditures. Fiscal 2006 results included a large 47% undesignated general fund balance in addition to $6 million in the SIF. Unaudited fiscal 2007 results point to an operating surplus, all of which will be transferred to the SIF. The fiscal 2008 budget is balanced, with a level nominal property tax rate of .462

per $100 of TAV, a conservative 5% sales tax growth projection, and an additional $2 million transfer to the SIF.

General fund revenues are diverse and led by property taxes, with manageable sales tax revenue exposure of approximately 28% of fiscal 2007 revenues (unaudited). Numerous dedicated funding sources have mitigated operating and capital pressure on the general and debt service funds; voters approved separate sales taxes for parks and crime control as well as a tax increment reinvestment zone (TIRZ) for a new town hall and infrastructure needs within the city's mixed use town center.

Including sales tax debt, the city's direct debt levels are well above average at more than $4,700 per capita and 2.7% of TAV. The city's overall debt burden is high at approximately $10,800 per capita and 6.2% of TAV. The city's 2008-2012 capital improvement plan (CIP) totals over $125 million and is sized to preclude any tax rate increases under conservative TAV growth assumptions. With scheduled annual issuances of about $6 million going forward, overall debt levels as a percentage of TAV should fall below 5% assuming modest rates of tax base growth.