

Fitch Downgrades Zapata County, TX ULT Bonds to 'A-'; Outlook Revised to Stable

Written by Australian Business

AUSTIN, Texas--([BUSINESS WIRE](#))--Fitch Ratings has taken the following rating action on Zapata County, Texas' (the county) bonds:

--\$10.5 million unlimited tax (ULT) road bonds, series 2006, downgraded to 'A-' from 'A+'.

The Rating Outlook is revised to Stable from Negative.

SECURITY

The ULT bonds are secured by an unlimited property tax levy.

KEY RATING DRIVERS

DOWNGRADE REFLECTS SIGNIFICANT VOLATILITY: The downgrade reflects the impact of a halving of taxable assessed valuation (TAV) over the past five years on the county's ability to maintain a structurally balanced budget. Preliminary fiscal 2015 TAV indicates a sizable upturn in values associated with increased natural gas prices.

TAV CONCENTRATION AND VOLATILITY: Massive natural gas reserves have resulted in very high taxpayer concentration. Property tax collections, which represent a high proportion of county revenues, vary widely during times of natural gas price fluctuations and subsequent valuation adjustments.

MANGEMENT AND REPORTING PRACTICES: Weak management practices are demonstrated by five consecutive years of delayed financial statement audits.

Fitch Downgrades Zapata County, TX ULT Bonds to 'A-'; Outlook Revised to Stable

Written by Australian Business

AMPLE RESERVES: Reserves are expected to remain high in the near term, despite their anticipated use to fund operating deficits.

SUB-PAR ECONOMIC INDICATORS: Low wealth levels and a high incidence of poverty are typical of rural communities along the U.S.-Mexico border. Positively, the county has sustained above average employment growth.

FAVORABLE DEBT PROFILE: Overall debt and carrying costs are low, even with rapid amortization. Pensions are well-funded.

RATING SENSITIVITIES

FAILURE TO MAINTAIN HIGH RESERVES: The rating is sensitive to the county's ability to maintain sound reserves to mitigate exposure to a volatile tax base and limited economy. Further tax base declines, with the resulting drop in property tax collections, or a notable drop in reserves may lead to negative rating action.

CREDIT PROFILE

Zapata County is located on the U.S.-Mexico border near the southern tip of Texas, with a 2013 population of approximately 14,390.

SEVERE ASSESSED VALUE DECLINES PRESSURE REVENUES

The county has posted double-digit declines in TAV in each of the last five fiscal years (2010 to 2014), resulting in a sharp cumulative contraction of 61%. The tax base is highly concentrated in extractive industries, with the top 10 payers alone representing 38% of market value, and highly sensitive to natural gas price volatility.

Property taxes, representing 76.6% of the fiscal 2012 revenue base, declined in response to the TAV's volatility. Fiscal 2012 property tax revenues of \$12.7 million represented a cumulative 36.4% drop since fiscal 2009. The county projects a further 18% decline in fiscal 2013 property tax revenues to \$10.7 million. Two tax rate increases in the past few years have nearly exhausted the county's tax rate capacity and were insufficient to achieve revenue neutrality.

AMPLE RESERVES DESPITE SUSTAINED STRUCTURAL IMBALANCES

The county was able to achieve positive operating margins through fiscal 2011, with reserve draw-downs funding capital projects. A variety of expenditure reductions, including the decrease of pay-as-you go capital funding, elimination of 61 vacant positions, and across-the-board departmental cuts, were unable to counteract fully the fiscal 2012 drop in property tax collections. The county's operating deficit for the year was relatively mild at 2% of spending. The fiscal 2012 unrestricted fund balance equaled \$18 million or a high 106.4% of spending.

The county estimates a \$1 million fiscal 2013 net deficit, reflecting insufficient ongoing expenditure controls. The county's budget includes a \$2.5 million fund balance appropriation in fiscal 2014, similar to the amount budgeted in fiscal 2013. Even if the full appropriation were utilized, reserves would remain ample.

The fiscal 2014 combined O&M and debt service tax rates total \$0.756 per \$100 of TAV, resulting in little remaining capacity under the \$0.80 tax cap. However, the county reports plans for a sales tax referenda in November 2014. If successful, the county estimates that the 2% county-wide sales tax would generate between \$1.5 million and \$2 million annually (9% to 11.5% of fiscal 2013 revenue) to support operations.

CONCENTRATED, VOLATILE ECONOMIC BASE

The natural gas industry's economic prominence is visible in the top 10 taxpayers. All are oil and gas firms and represent a very large 38% of fiscal 2013 TAV (down from 59% in 2006), led by ConocoPhillips (IDR of 'A', Stable Outlook) at 13.1% of TAV. The county reports an uptick in natural gas production over the past year associated with strengthening

natural gas prices. The county's economy also incorporates the potentially volatile sectors of ranching, agriculture, and tourism (fishing).

The economy has supported consistent employment growth well-above national averages, despite large labor force increases. The county's 4.9% May 2014 unemployment rate compared favorably to the nation's 6.1%. Wealth levels are subpar, with income indicators about half of the national averages. The county's poverty rate is more than double that of the nation's. These factors are offset to a degree by the county's relatively low cost of living.

POSITIVE DEBT CHARACTERISTICS

The overall debt burden is modest, as reflected in a low debt per capita of \$2,019 and debt to market value of 1.2x. Debt service is an affordable 7.8% of spending, despite a rapid amortization rate of nearly 69% of principal retired within 10 years.

The county issued taxable debt in 2013 to refund its series 2005 LT bonds, pursuant to an IRS ruling which found that the bonds, used for jail construction, violated private use restrictions based on revenue received from housing non-local inmates. The county anticipates a near term refunding for savings, but no new money plans. Capital needs are modest.

The county's pension plan is provided through the Texas County and District Retirement System (TCDRS), an agent multiple-employer plan. The county's portion was well-funded at 92.8%, as of Dec. 31, 2012 which approximates 83.6% when using Fitch's assumption of a 7% investment return.

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

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, Winstead

PC, and the National Association of Realtors.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=839669

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](http://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. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.