

RESEARCH

West Linn, Oregon; General Obligation

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Primary Credit Analyst: Chris Morgan, San Francisco (1) 415-371-5032;
chris_morgan@standardandpoors.com
Secondary Credit Analyst: Robert Williams, San Francisco (1) 415-371-5070;
robert_williams@standardandpoors.com

Credit Profile

West Linn GO		
<i>Long Term Rating</i>	AA-/Stable	Reinstated
West Linn GO		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Reinstated
West Linn GO bnds ser 1998 dtd 12/01/1998 due 06/01/2000-2018		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Reinstated

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services reinstated its 'AA-' rating and underlying rating (SPUR) on West Linn, Ore.'s outstanding GO debt. In May 2006, Standard & Poor's suspended its ratings on the city's debt because of substantially delayed financial disclosures, a situation that created uncertainty regarding the city's financial position. We have reinstated the ratings following the release of audited financial statements through fiscal 2006 and unaudited actuals for fiscal 2007.

The GO bonds are full faith and credit obligations of the city, including the obligation to levy property taxes without limitation as to rate or amount. The property tax pledge of the city's full faith and credit bonds is limited by constitutional restrictions on revenue growth.

The city's credit strengths include its:

- Service area that shows very strong economic characteristics and is integrated with the large and diverse Portland regional economy; and
- Good financial policies and practices, including the use of long-term financial forecasting and capital planning models.

Constraining credit quality are budgetary pressures related to library and police services, which have been reinforced by recent voter rejections of property tax levy overrides.

Located 12 miles south of downtown Portland, the City of West Linn serves 24,180 residents in a 7.5-square-mile, primarily residential area. Its economic indicators are generally very strong, including median household effective buying income of 150% of the U.S. level and a per capita market value of \$184,630. Despite modest population growth, the city has experienced very strong 12.4% average annual market value growth during the past seven years to \$4.5 billion in fiscal 2008, reflecting robust regional housing market that is now retrenching.

Financial performance has varied in recent years, with good-to-very-strong available fund balances, and the city has improved its financial controls and monitoring since the discovery of embezzlement by its finance director in fiscal 2005. Starting in fiscal 2006, the city improved its financial controls through more formal divisions of responsibilities and strengthened planning and monitoring tools. This followed an almost complete turnover in political and managerial leadership in fiscals 2005 and 2006 and since reaching a low of 4.7% of expenditures in fiscal 2005, in fiscal 2007 -- the first year in which the city split out its general fund into five separate funds according to function -- the city's available balances increased to a very strong 18.5% of expenditures in fiscal 2007 (unaudited).

As is the case for most cities in the state, the city faces the challenge of managing expenditure pressures in the face of constitutional constraints on property tax revenue growth. Following three attempts to secure voter authorization to renew a levy for police services that sunset in fiscal 2007, the city implemented streets and parks fees that substantially replaced the lost levy revenues; management expects the city to try again in November 2008, with a request for the creation of a library district that would address withering county funding for library services. For fiscal 2008, management estimates that the

loss of the levy for police services and one-time capital expenditures contributed to a decline in the city's available fund balances to 13.2% of expenditures, or \$2.0 million. Looking ahead, the city projects virtually balanced operations in fiscal 2009 but that it may need to adjust its police and library budgets or secure new revenue streams to avoid exhausting its available reserves in fiscal 2013.

Combined direct and overlapping debt supported by the city's taxpayers translates into a low 2.7% of market value. Management may request approximately \$5 million in GO authorization from voters within two years to fund the replacement of its aging police facilities, and in 2009 may issue \$2 million in non-voted debt for street improvements. Based on current conditions, these issues together would represent a minor increase to the city's relative debt burden.

The city's management practices are considered 'good' under Standard & Poor's Financial Management Assessment (FMA). An FMA of 'good' indicates that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Notable among these is the use of a five-year financial forecast to build budgets, quarterly reports on budget-to-actuals performance to the city council, and a 20% of revenues budgetary contingency policy.

Outlook

The stable outlook reflects the substantial restoration of the city's financial disclosures and enhanced policies and practices that have both reduced the risk of future financial control failures and improved its ability to transparently consider the long-term implications of budget decisions. The revenue framework the city operates under presents its management with a challenging budgetary environment for the foreseeable future, particularly given voters' demonstrated distaste for levy overrides in recent years. As such, we would view the failure of votes on the funding of a police station replacement and the creation of a library district as compounding this challenge, although such an outcome would not necessarily put pressure on credit quality unless the city was unable to adjust its expenditures in response.

Discovery of Mismanagement Spurred Improved Policies

The city has made changes both in operational and policy terms that we believe represent a substantial turnaround following delays in the release of its financial statements and inadequate internal controls that allowed the embezzlement of \$1.4 million by the city's finance director during fiscals 2001-2005. The most prominent development has been a near full turnover of its leadership since January 2005, including its mayor, city council, city manager, and finance director. By fiscal 2006, this new group approved upgrades to the city's internal controls policies, which included the creation of an audit committee with monthly monitoring of financial performance, a new auditing firm, and enhanced divisions of responsibilities among staff. The city also has made progress on the release of its financial statements, although its new auditor did not issue an opinion on the city's fiscal 2004 financial statement, due to the embezzlement. The fiscals 2005 and 2006 statements include qualified opinions related to inadequate tracking of the value of developer contributions to capital, which management expects to correct prior to the release of its fiscal 2008 statement at the end of this year. The city expects to release its fiscal 2007 audit by September.

Financial Management Assessment: 'Good'

The city's institutionalized policies and practices include an analysis of assessed value trends, compensation settlements with bargaining units, vendor surveys to build budgets, and a five-year financial forecasting model. Also guiding budgeting decisions is a 20% contingency requirement for funds substantially relying on property tax revenues. Management prepares quarterly financial reports to the council that address revenue expenditure trends and convenes monthly executive meetings regarding financial performance. The city's capital plan parallels its five-year financial planning horizon and identifies funding sources, although the city does not have a formal debt management policy.

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West Linn Press Release

Chris Jordan, City Manager: 503-657-0331

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Contact:

Kirsten Wyatt, 503-722-3428

kwyatt@ci.west-linn.or.us

Standard & Poor's Restores West Linn's AA- Bond Rating

National ratings agency cites the City's "good financial policies and practices... and long term financial forecasting and capital planning models" as reasons for rating restoration

WEST LINN – Standard & Poor's rating services reinstated the "AA-" rating on the City of West Linn's outstanding General Obligation (GO) debt. The City's debt ratings were suspended in 2006 because of substantially delayed financial reporting and general financial mismanagement.

A *Ratings Direct* report issued by Standard & Poor's refers to "[a] service area that has very strong economic characteristics and is integrated with the diverse Portland economy; and good financial policies and practices, including the use of long-term financial forecasting and capital planning" as the main credit strengths of the City of West Linn.

City Manager Chris Jordan recognized the work of the City Finance Department, but indicates that the City will continue to improve its internal controls, financial reporting, and overall management, which can improve the bond rating.

"In a community like West Linn, we should strive for an even higher standard. However, given what occurred in this City during the first half of this decade, the restoration of an "AA-" bond rating demonstrates remarkable improvement in our financial management in just two years. For that reason, the staff and the City Council should be proud," said Jordan.

Mayor Norm King referenced several Council-directed initiatives, including five-year forecasting, capital planning, and financial reporting, that were also cited in Standard & Poor's financial assessment of the City.

"The restoration of the bond rating is an important cornerstone to this City Council's goal of rebuilding the financial credibility of the City. There are continued enhancements that the City will make, but we are on the right track. West Linn will become a model for municipal financial management," said Mayor King.

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Attachment: Ratings Direct report from Standard and Poor's

About the City of West Linn:

The City of West Linn is a community where citizens, civic organizations, businesses and city government work together to ensure that the community retains its hometown identity, high quality of life and its natural beauty. The estimated population is 24,180. The City Council consists of the Mayor and four Councilors who act as the board of directors of the City of West Linn municipal corporation. The Council sets policies for the city government, enacts ordinances and hires, directs, and evaluates the city manager. Municipal services are provided by City employees and headed by the City Manager. The city operates its own police department, municipal court, water, wastewater and storm water utilities, street operations, planning, engineering, library, and parks and recreation program.