Moody's Investors Service

Rating Update: **MOODY'S DOWNGRADES CITY OF WEST LINN (OR) G.O. BONDS TO A1 FROM Aa3**

Global Credit Research - 07 Jun 2006

APPROXIMATELY $10.0 MILLION IN RATED DEBT AFFECTED

West Linn (City of) OR
Municipality
OR

Opinion

NEW YORK, Jun 7, 2006 -- Moody's Investors Service has downgraded the City of West Linn, Oregon's General Obligation Bonds to A1 from Aa3; consequently, the City has been removed from Moody's Watchlist for possible downgrade. The downgrade reflects the continuing uncertainty regarding the City's financial position due to the lack of audited financial statements since fiscal year 2003. Uncertainty is compounded by the City's ongoing investigation of its former finance director, arrested for embezzling an estimated $1.4 million from the City, over the last several years. The A1 rating continues to reflect the fundamental strength of the affluent City's diverse and growing economy as well as new management's efforts to implement financial controls and strict budgetary oversight.

LACK OF FINANCIAL AUDITS SINCE 2003; UNAUDITED FIGURES SHOW WEAKENED FINANCES

The City's financial position appears weak, though recent audited results are not available. As of the last available audit in fiscal year 2003, the City's fund balances in its General Fund represented a lean $620,683, or 8.1% of revenues. These figures represented a steady but rapid decline from $1.5 million, or 18.1% of revenues in fiscal year 2000. This level of reserves is considerably weaker than its peer rating group. Audited results for more recent years are not available, causing uncertainty regarding the City's financial position. The City has presented unaudited figures showing a significant decline in fund balances through 2005. For fiscal year 2004 and 2005, the City currently estimates ending General Fund balances of $281,146 (3.6% of revenues) and $227,599 (2.5% of revenues). New management attributes this weakened position to lack of financial oversight and budgetary controls within and over the finance department.

In April 2006, the former finance director was charged with embezzling approximately $1.4 million of city funds over a multi-year period. Currently, the City is attempting to recover these funds through theft insurance coverage and from the director's personal assets. Depending on how the theft is reported, the City may be able to recover up to $450,000 based on two separate insurance plans. Management is also currently reviewing coverage levels to ensure proper coverage for the near future.

CURRENT RESERVES ARE SLIM, BUT SATISFACTORY; CITY TAKES STEPS TOWARDS FINANCIAL RECOVERY

Although audits for the past fiscal years are expected to show a weakened state, Moody's expects the City will stabilize reserves at current forecast levels at a minimum. Management's preliminary results for fiscal 2006 General Fund balance are approximately $577,885, or 5.8% of revenues. The most recent financial report provided to Moody's by the management team reports a cash reserve of approximately $1.6 million in the General Fund as of March 31, 2006.

With the aid of independent financial consultants, a new management team plans to address these challenges through a multi-year strategic plan. Management reports commitment to strengthening the City's financial position moving forward, focusing on rebuilding reserves and implementing financial controls. The City has added a staff accountant to provide additional oversight, while new budgetary procedures and controls are in place to ensure a more accurate process, including additional review of account statements, quarterly financial updates to the city council and cash management training for all department heads.

Next month, the city council will vote on increasing the property tax levy to the maximum rate of $.7550/$1,000 of assessed valuation, as approved in 2002. The levy, currently set at $.4800/$1,000, is set to expire at the end of fiscal year 2007. At that time, the City will have to go to voters to renew the levy for an additional 5 years, which may prove difficult due to financial uncertainty of the City and the negative publicity the City has received due to the on-going investigation. In addition to this renewal, the City Manager is expected to recommend increases in utility rates for operational and debt service needs; the City's utility rates are currently on the low end of the City's neighboring communities. Moody's views continued community support as a critical component to supporting the City's current rating.

The A1 rating reflects Moody's expectation that the City's financial position will remain stable or even improve from current levels. While the City's financial position is currently quite narrow, its resources appear more than sufficient to meet its current obligations, including debt service payments. Moody's will continue to monitor the City's finances closely, with the expectation that the City will be able to maintain an upward financial trend in its general fund balance.

RESIDENTIAL TAX BASE GROWTH; CITY BENEFITS FROM PROXIMITY TO PORTLAND

In fiscal year 2006, full valuation for the City reached a healthy $3.2 billion, a 9.1% increase from 2005. Increases in full value have averaged a solid 8.4% annually over the past five years. Moody's expects growth to continue due to the strength of the Portland area economy and the continued demand for high-end housing. Wealth indices for this largely residential community are well above average relative to other Oregon cities, reflecting the relatively affluent population that resides in the district. Per capita and median family incomes improved in the 2000 census and were very strong at 165.6% and 171.0% of state levels respectively. The City's high full value per capita of $127,103 is especially impressive since the City is primarily a residential bedroom community to Portland with relatively little commercial industry of its own. Unemployment levels have also continued to improve to 5.6% in February 2006, from a high of 7.4% in 2003 due to the nationwide recession.

LOW DEBT BURDEN; NO IMMEDIATE BORROWING PLANS

Moody's expects the City to maintain a low debt level given anticipated tax base growth and limited future borrowing plans. The City currently has approximately $10.0 million outstanding general obligation bonds and approximately $3.7 million in full faith and credit obligations. The City's direct debt burden is typical relative to its A1 peers at 0.5%.

KEY STATISTICS:

2004 Estimated population: 25,051

2006 Full value: $3.2 billion

Average annual growth in full value, 2001 to 2006: 8.4%

2006 Full value per capita: $127,103

1999 Per capita income: $34,671 (165.0% of state)

1999 Median family income: $83,252 (171.0% of state)

Direct debt burden: 0.5%

FY2003 audited general fund balance: $620,683 (8.1% of revenues)

FY2004 unaudited general fund balance: $281,146 (3.6% of revenues)

FY2005 unaudited general fund balance: $227,599 (2.5% of revenues)

Parity debt outstanding: $10.0 million

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