

THE BOND BUYER

Laredo's \$66 million bond sale comes amid tangled NAFTA trade talks

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DALLAS – Laredo, Texas, the nation's largest inland port, is preparing to market \$66 million of debt as doubts about the future of the North American Free Trade Agreement cloud the border city's economic prospects.

The sale of bonds and certificates of obligation scheduled for Nov. 5 includes \$11.5 million for improvement projects on two of the city's four international toll bridges. Mario Carrasco, head of Southwest public finance for book-runner Citibank, is lead banker on the deals.

Despite reported doubts from negotiators that agreement on NAFTA can be reached by the December deadline, and President Trump's comments that the U.S. may kill the 23-year-old trade pact, the risk has not harmed Laredo's ratings.

"Laredo's always been a pretty logistically stable location," said Noe Hinojosa Jr., chief executive of Estrada Hinojosa & Co. and the city's municipal advisor.

"Whether we have NAFTA or not, Mexico will always be a trading partner with the U.S. I think there's a lot of speculation that what is said in D.C. is not favorable, but we're still hopeful."

Moody's Investors Service identified a change in trade policy as an event that could lead to a downgrade for some Laredo credit. However, Moody's this month upgraded the city's water and sewer debt to Aa3 from A1 ahead of a \$21.8 million sale of revenue bonds.

Analysts also applied a stable outlook to Laredo's Aa2 general obligation rating for \$12.6 million of GO refunding bonds, \$17.1 million of certificates of obligation and \$4.2 million of contractual obligations.

The rating "reflects the city's large and growing tax base along the U.S.-Mexico border, and recognizes the city's national importance as the home to the largest land port in the U.S.," analyst Denise Rappmund said.

Laredo has doubled to a population of a quarter-million since NAFTA removed trade barriers between the United States, Canada and Mexico. Since then, the volume of trade between the three countries has tripled.

Laredo's international bridge system connects with its sister city, Nuevo Laredo in the Mexican state of Tamaulipas. Nearly 7.3 million commercial and non-commercial vehicles crossed the system in 2016, as well as nearly 3.1 million pedestrians, according to Moody's analysts, who said numbers have been steadily growing over the past five years. The main imports coming over the bridge are vehicles and auto parts as well as produce.

"The city's tax base will continue to grow due to ongoing commercial and residential development," analysts predicted. "The city's tax base as of fiscal 2018 is large at \$13.2 billion, and has expanded annually at an average rate of 4.6% over the past five years."

A 50-cent toll rate increase for commercial vehicles to \$4.75 per axle goes into effect Thursday, and tolls for pedestrian traffic will increase when the bridge is completed.

A recently announced Kansas City Southern Railway cargo processing facility could significantly increase the number of trains that can be processed at the border, generating more commercial traffic for the toll bridges. However, Moody's notes that the facility would likely service petroleum product transports, which usually deliver in rail tank cars, rather than trucks.

"The distribution industry is key in the city given the presence of the international bridge system, though it faces perennial competition from other border points such as McAllen and El Paso, and the downside risk of an unfavorable outcome from possible NAFTA renegotiation," Rappmund said. "While reports of NAFTA renegotiation continue to surface, no changes to the agreement have been made to date."

The city transfers toll revenue that exceeds debt service to the general fund under ordinance that requires a 15% operating reserve in the Bridge Fund.

"Therefore, the level of trade activity at the international bridges is critical to the general fund," analysts said. "Additionally, the city's sales tax revenues are bolstered by residents of Nuevo Laredo coming to the city to shop, though this does leave the city vulnerable to exchange rate fluctuation between the dollar and the peso."

Laredo saw a dip in sales taxes of \$2.2 million in fiscal 2016, representing a drop of 6.4% year-over-year, as the peso's value fell against the dollar. But the peso regained some of its losses during fiscal 2017, spurring modest sales tax growth in Laredo. For the current year, sales tax revenue is running 2.2% ahead of last year, according to Texas Comptroller Glenn Hegar.

An \$88 million improvement project is designed to improve efficiency and security on Bridge 1, otherwise known as Gateway to the Americas International Bridge, and Bridge 2, the Lincoln-Juarez International Bridge. In 2014 Congress allocated \$61.6 million for the project.

To complement the projects, the city is building a new outlet mall near the port and beautifying the roadway leading to the site.

Moody's gives the toll revenue bonds for the bridge system an A2 rating that applies to \$39 million of outstanding senior lien debt. The \$14.6 million of subordinate-lien debt is a notch lower at A3. Both ratings have a stable outlook.

"Financial metrics have remained relatively stable due to timely toll rate increases, control of operating expenses, and generally rising traffic in the last four years," analysts said. "We note as credit weaknesses, the annual transfer of excess cash flow to the city that limits the build up of cash balances for the system and that potential credit challenges would arise due to future changes in the NAFTA agreement or in federal policies that would reduce international trade and commercial border crossings."

Few economists are sure what would happen if the current NAFTA talks fail and tariffs are reimposed. Major industries, particularly automakers, have adapted their supply chains to cross border trade. Auto parts between factories in the U.S. and Mexico make up a large portion of the cargo crossing Laredo's bridges.

One of the U.S. demands in the current talks is an increase in the percentage of vehicle parts originating in the U.S.

Laredo's population has continued to grow since the 2010 census, reaching 266,673 as of 2016. Median family income in the city is well below average at 65% of the national median, according to Moody's, and poverty is high at nearly 31% of the population. Unemployment in the city remains low.

"Moody's expects the economic base of the City of Laredo will grow moderately in 2017, led by continued gains in its important logistics cluster," analysts said. "Absent any new federally imposed restrictions on border crossings or trade, we expect the (bridge) system's fundamental market position to remain strong and

the fundamental strategic importance of the assets for US trade with Mexico remains a key rating driver.”

New U.S. demands unveiled this week in line with Trump’s “America First” agenda have increased the odds of NAFTA’s demise, Reuters reported. Chances of completing negotiations by the end-of-year-deadline also appear to be slipping away.