2018-2019 BUDGET QUESTION

Response to Request for Information

DEPARTMENT: Austin Water

REQUEST NO.: 121

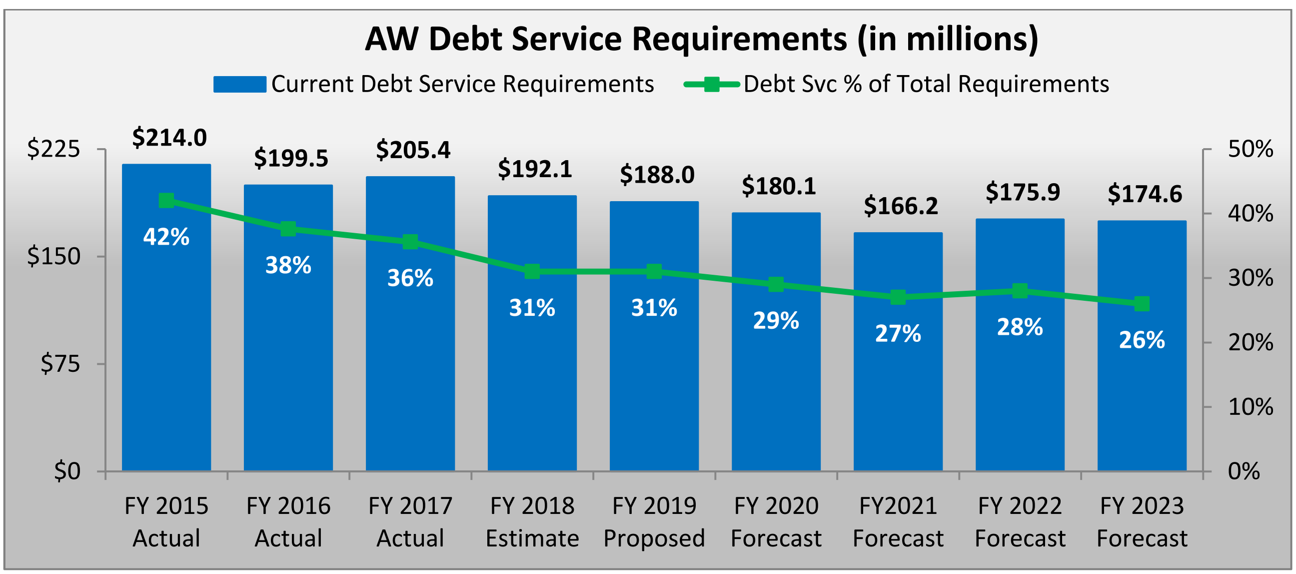
REQUESTED BY: Alter

DATE REQUESTED: 8/30/18

DATE POSTED: 9/7/18

REQUEST: Please provide additional information regarding Austin Water's recent debt history and what effect, if any, changes to the impact fees had on their ability to manage their debt.

RESPONSE: Austin Water's (AW's) annual debt service requirements are estimated at $192.1 million for FY 2018 and projected at $188.0 million for FY 2019, which both represent about 31% of AW's total requirements. Debt service requirement levels have shown significant improvement since FY 2015, when debt service requirements totaled $214.0 million and comprised 42% of AW's total requirements. Over the next five years, AW projects that debt service requirements will continue to reduce, eventually reaching a level of 26% of AW's total requirements in FY 2023.*



**Forecast amounts have been updated since the publishing of the Proposed Budget.*

Debt Management Efforts

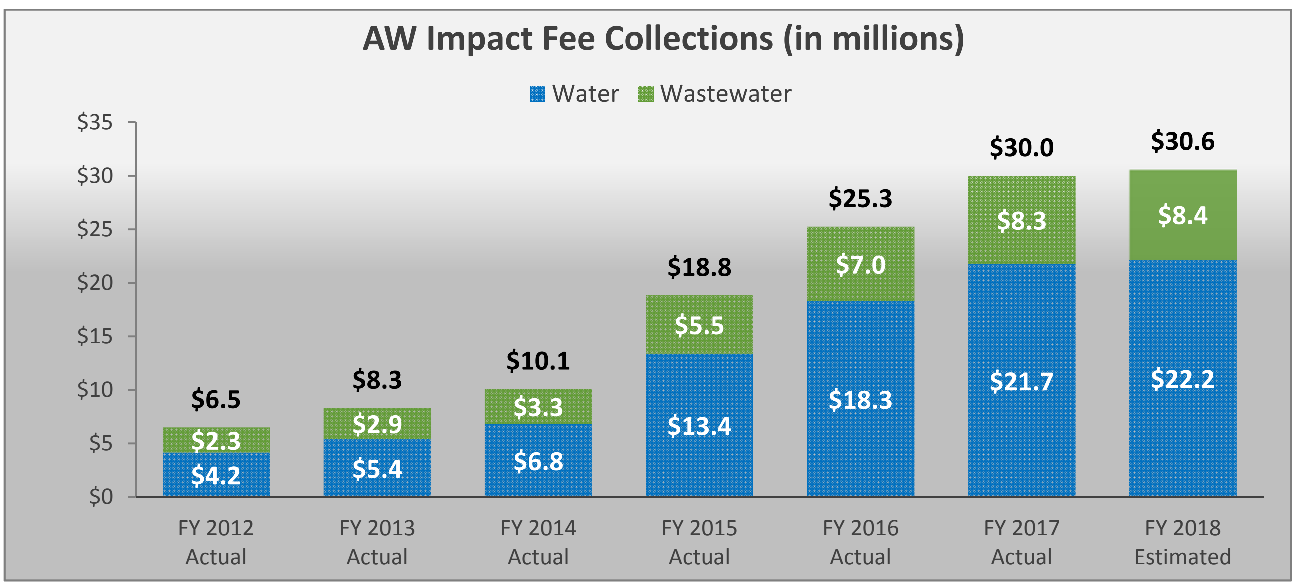
Over the last few years, AW has utilized bond refundings, debt defeasance transactions, and, more recently, low interest loans from the Texas Water Development Board to reduce the overall level of annual debt service requirements from $214.0 million in FY 2015 to $188.0 million in FY 2019,

Bond refunding transactions are similar to refinancing a home mortgage at a lower interest rate. Bond refundings in FY 2015, FY 2016, and FY 2017 cumulatively reduced AW's total debt service requirements by $64.8 million from FY 2016 actuals through FY 2023 forecast.

In addition, AW expects to reduce debt service requirements over the same time frame by an additional $106.5 million through the use of debt defeasance transactions in FY 2016, FY 2017, and FY 2018. A debt defeasance uses available cash funding to pay off a portion of the outstanding revenue bond debt early, creating debt service savings in future years. AW has used capital recovery fee (CRF), or impact fee, collections, which State law restricts to the payment of debt service or debt defeasance, as the primary funding source for previous and planned defeasance transactions.

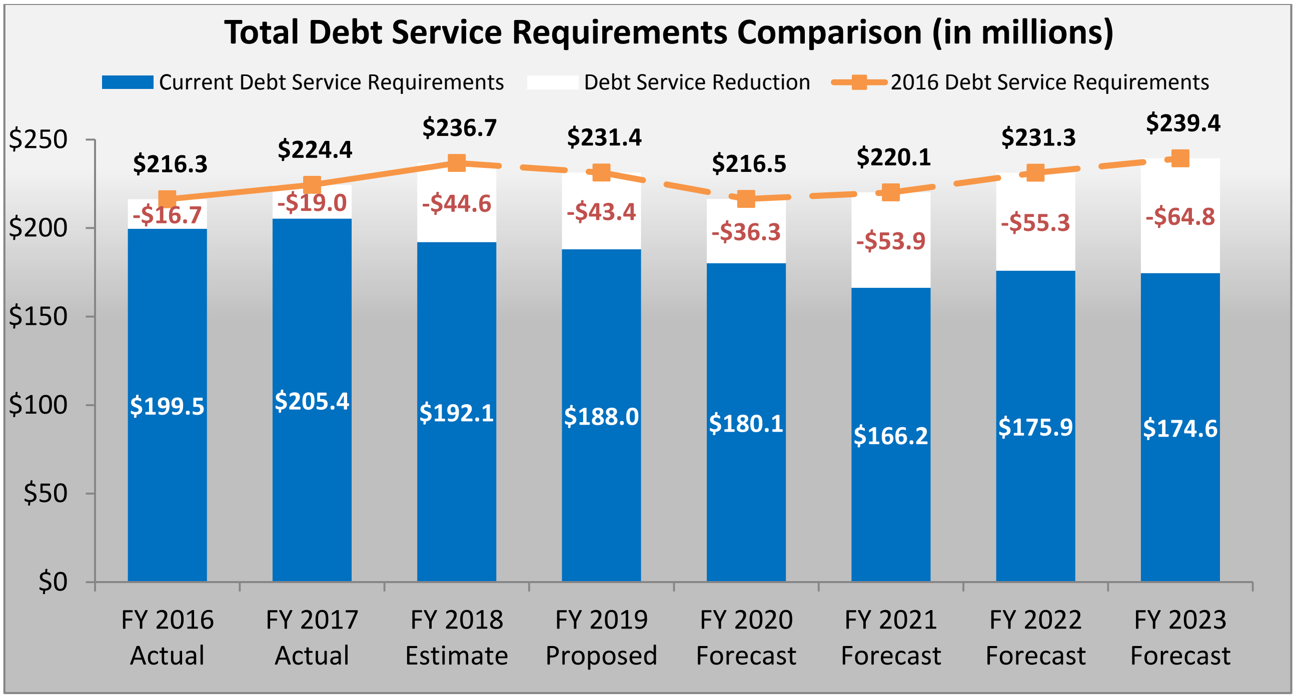
CRF or Impact Fees

AW charges impact fees to new customers for connecting to the water and wastewater systems. The impact fees concentrate the costs of expanding the capacity of these systems directly to the new growth of customers. Determination of the fee is prescribed by state law (Texas LGC Section 395), which includes a requirement that the fee be updated at least every five years. Prior to January 1, 2014, the City incentivized growth in several "desired development zones" by setting water and wastewater CRF at rates lower than the maximum amount allowed by State law. In 2013, the 2012 Joint Committee on Austin Water's Financial Plan recommended to "Adopt an impact fee policy that calculates the maximum impact fee allowed by law and consider the elimination of the current zone discount policy that has the effect of subsidizing infrastructure for new development," with the philosophy that new growth should pay for itself and should not be borne by the current rate payers through service rates. With this recommendation, Council adopted water and wastewater CRF rates that fully recovered the costs of water and wastewater improvement projects included in the 2013 impact fee update, with implementation on January 1, 2014. As shown in the following chart, annual impact fee collections have increased significantly since the 2013 update.



Impact of CRF on Debt Management Efforts

The chart below shows the impact of AW's debt management efforts since FY 2015. The orange line shows the projected level of annual debt service as of 2016, which is compared to the current and projected level of annual debt service requirements (blue bars). The white area represents the annual savings in scheduled debt service resulting from AW's debt management efforts, comparing 2016 and current projections. The cumulative reduction in scheduled debt service from FY 2016 to FY 2023 is expected to be $334.1 million.



The use of CRF collections to defease debt has been the biggest factor in AW's reduction in debt service requirements and has contributed to shifting the burden of system expansion costs from rate payers to developers. AW's recent rate reduction, approved by Council on March 8, 2018 and effective on May 1, 2018, would not have been possible without the use of CRF collections to defease debt in FY 2016, FY 2017, and FY 2018. In fact, AW customers would have likely seen higher service rates of approximately 15% in FY 2018 if not for AW's debt management efforts.