

Austin, Texas

Water Revenue Bonds New Issue Report

Ratings

New Issues

Water and Wastewater System
Revenue Refunding Bonds,
Series 2017 AA-

Outstanding Debt

Combined Utility Systems
Revenue Bonds (Prior First-Lien
Obligations) AA
Combined Utility Systems
Revenue Bonds (Prior
Subordinate Obligations) AA-
Combined Utility Systems
Revenue CP Bank Bond AA-
Water and Wastewater System
Revenue Bonds AA-

Rating Outlooks

Water and Wastewater
System Revenue Bonds Stable
Combined Utility Systems
Revenue Bonds Stable

Related Criteria

[Rating Criteria for Public Sector
Revenue-Supported Debt \(June 2017\)](#)

[U.S. Water and Sewer Revenue Bond
Rating Criteria \(November 2016\)](#)

Related Research

[Fitch Rates Austin's \(TX\) Water and
Wastewater Rev Rfdg Bonds 'AA-';
Outlook Stable \(July 2017\)](#)

[2017 Water and Sewer Medians
\(December 2016\)](#)

[2017 Outlook: Water and Sewer Sector
\(December 2016\)](#)

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New Issue Details

Sale Information: Approximately \$350 million Water and Wastewater System Revenue Refunding Bonds, Series 2017, via negotiation on Aug. 1, 2017.

Security: Net revenue of Austin Water Utility (AWU) after provision for the prior first-lien obligations of the combined utility systems.

Purpose: To retire outstanding CP obligations and refund portions of outstanding parity bonds for interest cost savings.

Final Maturity: Nov. 15, 2033.

Key Rating Drivers

Strong Service Area: AWU provides water and wastewater treatment services to a growing customer base in a sizable service territory including the city of Austin, Texas (AAA/Stable) and neighboring areas beyond the city limits. Austin has a broad and diverse economy, as reflected by exceptionally low unemployment, above-average wealth levels and a highly diversified, expanding customer base.

Rate Increases and Restructuring: AWU enacted multiple rate increases, rate restructuring to increase fixed charges and substantial increases of capital recovery fees on new development. These actions taken over the past five years resulted in improved financial margins. Additional improvement is unlikely given the expectation of limited or no rate increases over the next five years.

Healthy Financial Margins: Financial margins improved during the past two years to a level commensurate with the rating due to rate adjustments and water sales volumes stabilizing following a statewide drought. Fitch Ratings' calculated debt service coverage **improved** to **1.84x, or 1.62x**, after the general fund transfer in fiscal year (FY) 2016 and **days cash on hand** increased to **181 days**. AWU's financial forecast indicates coverage levels in the same range or slightly below the FY16 level and continued modest improvements in liquidity levels.

Sufficient Supply and Treatment: Water supply and treatment capacity of the overall system are anticipated to be sufficient for the foreseeable future. Expanded wastewater treatment may be the next large capital need but is beyond the current five-year capital improvement plan (CIP). Capital needs are manageable and AWU moved into a period of lower capital spending.

High Debt to Stabilize: Debt levels are high for the rating category, reflecting strong levels of capital investment over the past decade, primarily debt financed. Debt levels should stabilize at current levels or exhibit modest decline with planned capital spending levels and AWU's plan to increase its cash funding portion of capital to nearly 50% by the end of the five year forecast period.

Rating Sensitivities

Sustained Financial Metrics: Financial metrics for the city of Austin's combined water and wastewater system strengthened to levels in FY16 in line with the rating category. Continued rating stability in the next two years will be determined largely by the ability to achieve and sustain financial margins and liquidity levels in line with FY16 performance.

Rating History

| Rating | Action | Outlook/ Watch | Date |
|--------|----------|-------------------|----------|
| AA- | Affirmed | Stable | 7/20/17 |
| AA- | Affirmed | Stable | 5/3/16 |
| AA- | Affirmed | Negative | 5/19/14 |
| AA- | Affirmed | Stable | 6/13/13 |
| AA- | Affirmed | Stable | 6/15/12 |
| AA- | Affirmed | Stable | 10/26/11 |
| AA- | Affirmed | Stable | 11/8/10 |
| AA- | Affirmed | Stable | 5/21/10 |
| AA- | Affirmed | Stable | 10/27/09 |
| AA- | Affirmed | Stable | 2/3/09 |
| AA- | Affirmed | Stable | 11/25/08 |
| AA- | Affirmed | Stable | 7/16/08 |
| AA- | Affirmed | Stable | 4/28/08 |
| AA- | Affirmed | Stable | 11/2/07 |
| AA- | Affirmed | Stable | 10/23/07 |
| AA- | Affirmed | Stable | 4/4/07 |
| AA- | Affirmed | Stable | 3/19/07 |
| AA- | Affirmed | Stable | 11/8/06 |
| AA- | Affirmed | Stable | 10/10/06 |
| AA- | Upgraded | Stable | 5/5/06 |
| A+ | Affirmed | Stable | 11/2/05 |
| A+ | Affirmed | Stable | 10/6/05 |

Source: Fitch.

Credit Profile

AWU operates as an enterprise fund of the city of Austin, TX providing water treatment and distribution, primarily on a retail basis, to approximately 225,000 customers. Wastewater collection and treatment is also provided to a slightly smaller number of customer accounts. AWU benefits from a strong and stable service area that includes the city of Austin and neighboring portions of Travis and Williamson counties.

The system's customer base continues to experience steady growth, due in large part to the city's role as the state capital and the service area's exceptionally strong economy. Water supply and overall treatment capacity are ample and the region's recent drought conditions have abated.

Governance and Management

AWU is owned and operated by the city of Austin and governed by a mayor, elected at-large, and 10 council members elected to represent each of the 10 districts for staggered three-year terms. The council approves AWU's budget, capital plans, rates and bond transactions. The council also appoints the city manager, who, in turn, oversees the city-owned utility systems.

Among the primary goals of the utility's management team in recent years is the improvement of the water and sewer system's financial metrics, principally liquidity, through rate adjustments and changes in the rate structure, including the significant increase in capital recovery fees implemented in FY14. Positive results were slow to materialize as several years of declining water sales largely offset the imposition of annual rate hikes. Management's adherence to achieving financial targets ultimately outpaced declining sales in FY15, resulting in healthier cash flow, liquidity metrics and notable improvement by FY16.

Financial Profile

Charges and Rate Affordability

Austin's water and sewer rates, despite continued escalation, remain generally affordable relative to income levels for the service area. The establishment of AWU's rates and fees requires only the approval of the city council. The Public Utilities Commission of Texas maintains oversight of rates charged to customers residing outside the city's boundaries.

The system's rate structure is composed of a fixed monthly account charge, a volumetric rate, a monthly-tiered minimum charge and a volumetric surcharge to build the water revenue stability reserve fund. The monthly-tiered minimum charge was implemented in recent years in an effort to decouple a portion of the overall rate structure from volumetric pricing given the current trend of declining consumption. Additional recent adjustments include a sizable shift in the volumetric block rates applied to lower consumption threshold levels versus higher blocks of usage. The higher rates being applied to lower consumption levels is expected to generate better cost recovery. The changes in rate design are viewed positively by Fitch, although fixed charges still only account for a modest 25% of total revenue.

In FY14 the city significantly increased capital recovery fees charged for new development. The fees previously provided economic incentive for development within the city but rates were revised to the maximum allowable level by state law. The increased capital recovery fees are expected to provide approximately \$25 million annually through FY25 to defease debt related to previously funded development-related projects.

Combined Annual Rate Increases

(Audited FY Ended June 30)

| Year | % Increase |
|------|------------|
| 2009 | 7.0 |
| 2010 | 4.5 |
| 2011 | 4.5 |
| 2012 | 5.1 |
| 2013 | 6.2 |
| 2014 | 5.0 |
| 2015 | 8.1 |
| 2016 | 4.9 |
| 2017 | 3.0 |
| 2018 | 0.0 |

FY – Fiscal year.
Source: Austin Water Utility.

The size of AWU's combined water and wastewater rate increases were sizable in several years over the past decade, as shown in the table *Combined Annual Rate Increases* to the left, in an effort to outpace declining consumption levels driven by the drought. As a result, rates are higher than other areas of the state. The average monthly residential bill calculated at Fitch's standard usage level of 7,500 gallons of water monthly and 6,000 gallons of wastewater flows monthly was 2.4% of median household income (MHI). Based on AWU's lower actual usage levels, rates remain in compliance with the city's goal of a combined bill less than 1.5% of MHI.

From FY09 through FY16, the annual combined rate increase averaged nearly 6.0%, which may have resulted in some rate sensitivity. In 2017, with the stronger revenue performance, AWU proposed foregoing any rate increase in FY18. AWU's financial forecast anticipates modest rate adjustments of 2.0% in only two of the next five years, including FY19 and FY21. The ability to implement 0% increases in future years will rely on cost saving measures implemented previously, planned debt defeasances funded from anticipated capital recovery fees, and rate increases producing higher revenue in light of consumption levels stabilizing following the drought.

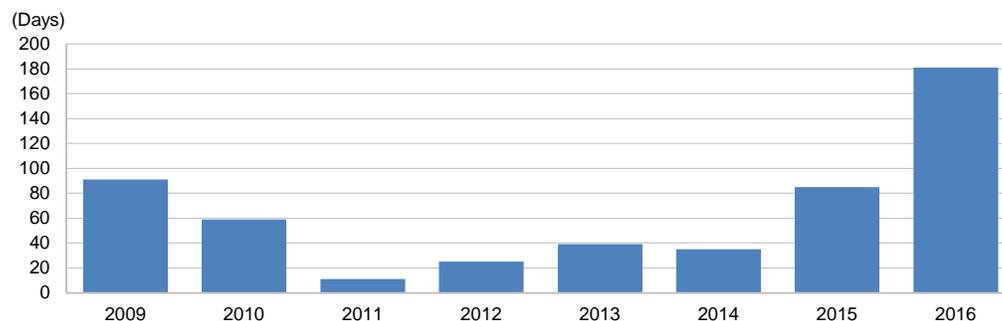
Financial Performance

AWU's financial margins improved during the past two fiscal years. Following a multi-year period of weakened financial performance in FY12 through FY14, driven principally by weather conditions, the cumulative effects of annual rate increases and rate restructuring efforts resulted in improved debt service coverage levels and improved liquidity. Fitch-calculated all-in debt service coverage improved to 1.84x in FY16 from 1.45x in FY15, following a low-point of 1.25x in FY14. The coverage levels include capital recovery fee revenue that nearly doubled to \$22 million in FY17 from \$14 million in FY14. The revenue is being used by AWU to defease outstanding debt in future years.

Debt service coverage, after incorporating the utility's annual transfer to the city's general fund, was slightly weaker at 1.62x in FY16 from 1.27x in FY15. The annual transfer subordinate to all other obligations is limited to 8.2% of total revenue averaged over the prior three fiscal years.

Liquidity metrics exhibited strong improvement, with unrestricted cash and investments increasing substantially to \$117 million, or 181 days, in FY16 from \$21.8 million or 35 days in FY14. Cash balances are not expected to continue to increase at this pace in the future but should enjoy modest growth. Unrestricted cash balances do not include AWU's additional revenue stability fund, which can be used if water revenue shortfalls of 10% or more occur with a maximum use of 50% of the balance permitted in any one year. Use of the restricted reserve requires city council approval. As of FY16 end, the fund had \$28 million, or 85 days cash on hand for water operations. AWU anticipates reaching the 120 day goal by FY18 end.

Days Cash on Hand



Source: Fitch.

Capital Improvement Plan

Fitch expects capital needs through 2021 will remain manageable. The current five-year program is very similar to recent years with much of AWU's large spending projects completed. The five-year CIP has a projected cost of \$890.4 million, around 60% of which will be debt financed. AWU has set a goal of reaching 50% of cash funding of capital by the end of the five-year forecast. The goal is in excess of the formal financial policy to fund a minimum of 20% of capital from cash flow. Significant capital projects include installation of automated meters in much of the service area over the next seven years, improvements at the South Austin Regional wastewater plant and improvements at the Davis water plant.

Debt Profile

AWU's debt levels and related leverage metrics are relatively high but should remain at an acceptable level for the current rating category through the forecast period. Total debt outstanding, including prior first- and subordinate-lien obligations allocated to the water and wastewater system, escalated by nearly 40% between FY09–FY15, principally due to growth-related needs. Consequently, debt/net plant assets and debt/funds available for debt service now stand at 75% and 7.3x, respectively, compared with the median ratios of 47% and 6.2x for the rating category. Fitch does not expect the utility's aggregate debt levels will increase significantly through the forecast period. Scheduled payout of existing bond principal will be replaced by a near like amount of additional debt expected to fund AWU's capital program.

Annual debt service costs remain elevated, consuming 35% of gross revenue in FY16, well over the 20% median for similarly rated systems. After peaking in FY15, scheduled debt service payments related to current debt outstanding declined, providing adequate capacity to absorb the additional financing programmed into the current financial forecast. Annual debt service is projected to account for an average of about 33% of gross revenue through the forecast period.

The prior first- and subordinate-lien bonds outstanding totaled \$146.8 million at FY16 end. Outstanding debt allocated to the water and wastewater system accounts for slightly less than one-half of the total amounts borrowed under both liens combined.

AWU had just \$113.9 million of variable-rate bonds outstanding at FY16 end, equal to a modest 10% of total debt obligations when combined with outstanding CP. The variable-rate bonds are backed by a LOC agreement provided by Citigroup Inc. (A/Stable) extending to October 2018 and synthetically swapped to a fixed rate through an interest rate swap with The Goldman Sachs Group, Inc. (A/Stable). All additional debt is fixed rate.

The city is authorized by ordinance to issue, and hold outstanding at any one time, a maximum of \$400 million in CP notes for interim financing for capital projects of the electric, water and wastewater systems. AWU had approximately \$42 million in CP outstanding at the close of FY16, while Austin Energy had approximately \$75 million. The balance of AWU's CP notes will be refunded by the series 2017 bond proceeds. Outstanding notes are backed by LOC agreements with two different providers extending through October 2017.

Outstanding Debt

| (\$ Mil.) | Rating | Par Outstanding | Final Maturity | Lien Status |
|------------------------------------|--------|-----------------|----------------|-------------|
| Prior-Lien Obligations | AA | 27.8 | 2018 | Closed |
| Prior Subordinate-Lien Obligations | AA- | 119.0 | 2025 | Closed |
| Separate-Lien Obligations | AA- | 2,259.9 | 2045 | — |
| Total | | 2,406.7 | | |

Source: Fitch.

Legal Provisions

The series 2017 bonds are secured by net revenue of AWU, after provision for the prior first-lien obligations of the combined utility systems. The bonds are on parity with the prior subordinate-lien obligations of the combined utility systems and all outstanding water and wastewater revenue bonds. The newly-issued bonds will not carry a debt service reserve.

The prior first- and subordinate-lien obligations are secured by a joint and several pledge of net revenue of the combined utility systems, consisting of AWU and Austin Energy (AE). The issuance of additional bonds secured by a joint and several pledge of net revenue of AWU and AE is no longer permitted by the master bond ordinance, making both liens effectively closed. A default on the prior subordinate-lien obligations and water and wastewater bonds would not trigger a default on the prior first-lien bonds. CP notes are secured by a joint and several pledge of AWU and AE net revenue. Unlike the prior first- and subordinate-lien obligations, the city may continue to issue CP notes with a joint and several pledge of both systems' net revenue. CP is payable after provision for all outstanding long-term debt.

Rate Covenant

Pursuant to the prior-lien ordinance, gross revenue of the respective systems must be sufficient to fund operations, maintenance costs and amounts owed to all reserve funds and produce net revenue equal to 1.25x annual debt service (ADS) for the prior first-lien obligations and separate-lien obligations, plus 1.10x ADS for the prior subordinate-lien obligations.

Pursuant to the master lien ordinance, AWU gross revenue must be sufficient to fund operations, maintenance and produce net revenue after provision for prior first- and subordinate-lien obligations, equal to the greater of ADS on all outstanding parity bonds or 1.25x ADS on all outstanding parity bonds, including available water and wastewater revenue.

Additional Bonds Test

Additional bonds can be issued if net revenue in any 12 consecutive months of the 15 months immediately preceding the issuance of additional parity water and wastewater obligations, after deductions for the prior first- and subordinate-lien bonds, and together with other available revenue, equal at least 125% average ADS of the parity water and wastewater obligations then outstanding and proposed.

Operating Profile

Customer Growth and Concentration

The strength and diversity in both AWU's customer base and the city's economy underpin the utility's sound overall credit profile. Austin's economy continues to outperform many other large metropolitan areas in the U.S. The city's role as the state capital and home to seven colleges and universities, including the University of Texas (University of Texas System; AAA/Stable), anchors the region's economy and provides a solid buffer from economic downturns.

High-technology manufacturing, attracted to the area by a well-educated work force, and the availability of major research facilities serve as economic drivers. Numerous large technology firms, including Samsung Group and NXP Semiconductors N.V. (formerly Freescale Semiconductors Inc.) rank among AWU's largest customers. The city's population, around 926,000 in 2016 continues to grow at around 3.0% annually. Wealth indicators for the area are comparatively high, and the city's May 2017 unemployment rate of 3.0% was exceptionally low relative to state and national averages. Accordingly, customer delinquencies are negligible and revenue collection is consistently strong.

Customer Profile

AWU provides water and wastewater service on a retail basis to a strong service territory, including the city of Austin, TX, and neighboring portions of Travis and Williamson counties. The system's 10 largest water customers accounted for just 5% of total water and wastewater revenue in FY16, showcasing the utility's highly diverse customer base and related revenue. The two largest customers are Samsung and the University of Texas.

The number of customers served steadily grew during the past 10 years, increasing by a healthy annual average of about 1.5%, even during the most recent economic recession. However, water sales fell in eight out of the last 10 years, outpacing the service territory growth and resulting in a gradually declining trend of per capita consumption.

Annual Water Customers and Consumption

(FY Ended June 30)

| Year | Customers | Consumption (mgd) | % Change |
|------|-----------|-------------------|----------|
| 2007 | 198,883 | 112 | (17.1) |
| 2008 | 202,057 | 131 | 17.0 |
| 2009 | 208,424 | 130 | (0.8) |
| 2010 | 210,225 | 109 | (16.2) |
| 2011 | 211,760 | 136 | 24.8 |
| 2012 | 212,964 | 117 | (14.0) |
| 2013 | 215,882 | 116 | (0.9) |
| 2014 | 216,897 | 106 | (8.6) |
| 2015 | 221,506 | 103 | (2.8) |
| 2016 | 225,566 | 103 | (0.0) |

FY – Fiscal year. Mgd – Millions of gallons per day.
Source: Austin Water Utility.

AWU Assets

Water System

Water Supply

AWU has an ample long-term water supply from a single river system, pursuant to an agreement with the Lower Colorado River Authority (LCRA) running through 2050 and can be extended through 2100 at AWU's option. The agreement gives AWU independent rights to impound, divert and use water from the Colorado River and tributaries. These rights are adjudicated before the Texas Commission on Environmental Quality.

The agreement, for which AWU made a \$100 million up-front payment, provides the utility with up to 325,000 firm acre-feet of water per year, or 290 million gallons per day (mgd). The supply is limited by the available treatment capacity of 335 mgd, still well in excess of AWU's average daily production level of around 122 mgd in FY16. Even at the high production level of 144 mgd in FY11 during extreme drought, supplies are ample.

Treatment

AWU's existing water treatment plants provide capacity estimated to be sufficient until 2030. The system's three existing facilities, the Davis Plant, Ullrich Plant and Water Treatment Plant No. 4 (WTP No. 4), have a combined treatment capacity of 335 mgd, comfortably above the system's five-year peak demand average of about 200 mgd. The WTP No. 4, recently constructed and on line in 2014, has an initial capacity of 50 mgd but is expandable to 300 mgd.

Wastewater System

AWU's two wastewater treatment plants provide 150 mgd of capacity, which was sufficient to meet average daily flows of 109 mgd in FY16. Existing treatment capacity is reportedly sufficient for the foreseeable future, and discharge permits are current through 2019 and 2020. Additional treatment capacity may be needed within the next 10 years. The system is not currently operating under any environmental judgments or consent orders.

Financial Summary — Austin Water Utility

| (\$000, Audited Years Ended September 30) | 2012 | 2013 | 2014 | 2015 | 2016 |
|--------------------------------------------------|-----------|-----------|-----------|-----------|-----------|
| Balance Sheet | | | | | |
| Unrestricted Cash and Investments | 13,168 | 23,296 | 21,832 | 51,834 | 117,113 |
| Net Working Capital | 76,385 | 85,864 | 83,278 | 115,624 | 201,042 |
| Net Fixed Assets | 3,230,035 | 3,389,536 | 3,493,744 | 3,517,169 | 3,548,823 |
| Net Long-Term Debt Outstanding | 2,487,186 | 2,613,218 | 2,733,830 | 2,727,206 | 2,653,475 |
| Operating Statement | | | | | |
| Operating Revenue | 442,707 | 476,781 | 472,593 | 516,991 | 561,834 |
| Non-Operating Revenue Available for Debt Service | 313 | 88 | 82 | 434 | 1,212 |
| Connection Fees | 9,133 | 11,675 | 14,216 | 24,188 | 35,056 |
| Total Revenue Available for Debt Service | 452,153 | 488,544 | 486,891 | 541,613 | 598,102 |
| Operating Expenditure (Excluding Depreciation) | 190,987 | 216,369 | 226,349 | 221,724 | 236,320 |
| Depreciation | 95,392 | 97,186 | 103,443 | 115,271 | 116,070 |
| Fitch-Calculated Operating Income | 165,774 | 174,989 | 157,099 | 204,618 | 245,712 |
| Funds Available for Debt Service | 261,166 | 272,175 | 260,542 | 319,889 | 361,782 |
| Senior-Lien ADS | 44,386 | 30,718 | 8,473 | 22,366 | 14,125 |
| All-In ADS | 178,167 | 192,614 | 208,697 | 221,073 | 196,511 |
| Financial Statistics (x) | | | | | |
| All-In ADS | 1.47 | 1.41 | 1.25 | 1.45 | 1.84 |
| All-In ADS (Excluding Connection Fees) | 1.41 | 1.35 | 1.18 | 1.34 | 1.66 |
| All-In ADS (Net of General Fund Transfers) | 1.29 | 1.20 | 1.12 | 1.27 | 1.62 |
| Cash on Hand (Days) | 25 | 39 | 35 | 85 | 181 |
| Working Capital (Days) | 146 | 145 | 134 | 190 | 311 |
| Debt/Net Plant (%) | 77 | 77 | 78 | 78 | 75 |
| Debt/FADS (Funds Available for Debt Service) | 9.5 | 9.6 | 10.5 | 8.5 | 7.3 |
| Outstanding Long-Term Debt Per Customer | 5,987 | 6,243 | 6,489 | 6,280 | 6,031 |
| Outstanding Long-Term Debt Per Capita | 3,029 | 3,105 | 3,114 | 3,033 | 2,867 |
| Free Cash/Depreciation (%) | 48 | 39 | 7 | 51 | 105 |

ADS – Annual debt service. N.A. – Not available. Note: Fitch may have reclassified certain financial statement items for analytical purposes.
Source: City of Austin, Texas; Fitch.

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