Fitch Ratings

Fitch Affirms Austin's (TX) Water and Wastewater Rev Rfdg Bonds at 'AA-'; Outlook Stable

Fitch Ratings - Austin - 22 November 2019:

Fitch Ratings has affirmed the 'AA-' rating on the following bonds issued by the city of Austin, TX (the city):

--Approximately $2.2 billion water and wastewater system revenue refunding bonds.

The Rating Outlook is Stable.

SECURITY

The water and wastewater revenue bonds are secured by net revenues of Austin Water (AW, or the system). The system also has prior subordinate first lien obligations outstanding that are secured by a joint and several pledge of net revenues of AW and Austin Energy (AE) the city's electric enterprise. The issuance of additional bonds secured by the combined utility pledge is no longer permitted by the master bond ordinance, making the lien effectively closed. The prior subordinate lien obligations and all outstanding water and wastewater revenue bonds are on parity.

KEY RATING DRIVERS

STABILIZED FINANCIAL MARGINS: After producing weaker metrics in the first half of the decade as a result of historic drought conditions, finances recovered and stabilized the last three fiscal years (2016-2018). Fitch-calculated all-in debt service coverage (DSC) was 1.6x in both fiscals 2017 and 2018. Liquidity improved from just 35 days cash on hand (DCOH) in fiscal 2014 to 254 in fiscal 2018, as calculated by Fitch.

HIGH DEBT BURDEN: Debt metrics are higher than similarly rated systems, but have shown general improvement over the last five fiscal years (2014-2018) as illustrated by debt/customer that decreased from nearly $6,500 to about $5,580 and debt/net plant assets that decreased from 78% to 68% over that period.

INCREASING CAPITAL PROGRAM: Planned capex have been relatively stable for the last several years, but are expected to shift toward an upward trajectory. Increased capex is expected in upcoming years to increase wastewater treatment capacity and other upgrades.

STRONG SERVICE AREA: AW provides water and wastewater treatment service to a growing customer base in a sizable service territory that includes the city (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.

LIMITED RATE FLEXIBILITY: Sizable rate increases and rate restructuring earlier in the decade have increased the combined monthly bill to slightly less than 2% of median household income (MHI), Fitch's affordability threshold.

RATING SENSITIVITIES

SUSTAINED FINANCIAL MARGINS: The rating is sensitive to the system's ability to maintain healthy levels of FCF that support planned pay-go capex. Failure to generate sufficient FCF that results in leverage metrics increasing beyond current expectations would likely place downward pressure on the rating. The rating is unlikely to move higher in the intermediate term based on thinner DSC as compared to peer systems, and the elevated leverage profile.

CREDIT PROFILE

AW operates as an enterprise fund of the city, providing water treatment and distribution, primarily on a retail basis, to nearly 233,000 customers. Wastewater collection and treatment is also provided to about 217,000 customers. The combined customer base has grown by an average of 1.4% annually since 2014. There is no meaningful customer concentration as the top ten customers account for just 6% of operating revenues annually. AW benefits from a strong service area that includes the city of Austin and neighboring portions of Travis and Williamson counties. The city's unemployment rate of 2.4% (Sept. 2019) is lower than both the state and national rate (both 3.3%).

STABLE FINANCIAL RESULTS EXPECTED TO CONTINUE

AW's financial margins stabilized in the last several years, reflecting DSC and liquidity levels more commensurate with the rating category. Fitch-calculated all-in DSC was 1.6x in both fiscals 2017 and 2018, while liquidity remained over 250 DCOH both years. DSC after incorporating the utility's annual transfer to the city's general fund was slightly weaker at 1.4x in both years. The annual transfer is subordinate to all other obligations and is limited to 8.2% of total revenues averaged over the prior three fiscal years.

Management's forecast reflects a slight decrease in revenue in fiscal 2019 driven by reduced demand during a wet spring and early summer. Regardless, Fitch expects DSC will remain acceptable at 1.5x in fiscal 2019. Future years of the forecast (2020-2023) assume customer growth between 1% and 2% annually and a rate increase of just 3% in fiscal 2022. Operating expenses increase an average of 3.1% annually. Under these assumptions, which Fitch considers reasonable, all-in DSC is generally expected at 1.6x, or 1.4x net of transfers.

The forecast also reflects healthy FCF that supports most planned pay-go capex, which should allow liquidity to remain largely intact over the upcoming years, but unrestricted cash balances are not expected to increase much higher than 250 DCOH. Unrestricted cash balances do not include AW's additional revenue stability fund, which can be used whenever water revenue shortfalls of 10% or more occur in a given fiscal year, with a maximum use of 50% of the balance permitted in any one year. Use of the restricted reserve requires city council approval. The fund is expected to have about $47 million at fiscal 2019 year-end, which would equate to 123 days water operating expenses meeting AW's 120 day goal.

INCREASING CAPITAL PROGRAM SHOULD REMAIN MANAGEABLE

The system's current CIP (2020-2024) totals $975.2 million and is up from the last plan reviewed by Fitch (2017-2021) that totaled $890.4 million. Increased spending is expected in upcoming years on the wastewater system. Treatment capacity is expected to be expanded from 75 million gallons per day (mgd) to 100 mgd at the Walnut Creek wastewater treatment plant (WWTP). Over the current five-year horizon spending on the wastewater system accounts for a little over half of planned capex. Water spending accounts for nearly 45% of the CIP, and the balance is dedicated to the reclaimed water system. The system recently obtained low-interest Texas Water Development Board state revolving fund (SRF) loans totaling $120.8 million that will fund a portion of the CIP. Additional debt issuances are expected over the next five years, but the timing and size will ultimately depend on the level of actual capex. Debt financing (inclusive of the recent SRF loans) will account for between one-half to two-thirds of the CIP. The balance will be funded on a pay-go basis.

ELEVATED LEVERAGE METRICS

The system's leverage profile is higher than similarly rated systems, but is expected to remain acceptable for the current rating. Debt/customer is expected to continue its gradual downward trajectory, down to about $5,100 within five years, despite additional debt issuances during that time period. The declining metric is largely driven by the steadily growing customer base. The debt burden as measured by cash flow is expected to remain generally stable. Debt/FADS registered 7.5x in fiscal 2018, which is higher than the 'AA' category median of 4.1x. Fitch's internal projection reflects debt/FADS remaining near its current level and should continue to support the current rating. A sustained increase to highs seen in fiscal 2014 (over 10x) would likely place downward pressure on the rating.

AMPLE WATER SUPPLY AND TREATMENT CAPACITY

The system has an ample, long-term water supply, pursuant to an agreement with the Lower Colorado River Authority (LCRA; revenue bonds rated AA-/Stable) that runs through 2050 and is extendable through 2100 at AW's option. The agreement was executed in 1999 and paid for up-front by AW and provides for 325,000 acre feet (af) of water annually, well exceeding current demand around 150,000 af. While the agreement calls for annual payments to LCRA once annual demand exceeds 201,000 af for two consecutive years, management does not expect this level of demand to occur until at least 2030, and likely later. Existing treatment capacity of 335 mgd is also sufficient for the foreseeable future.

LOCAL RATE SENSITIVITY

Previous rate increases and restructuring in response to a historic drought earlier in the decade resulted in a combined monthly bill that was previously as high as 2.3% of MHI, based on Fitch's standard usage metrics of 7,500 gallons and 6,000 gallons of water and wastewater, respectively. After a modest rate decrease in May 2018 and holding rates flat in fiscals 2019 and 2020, the current monthly combined bill is now slightly less than 2% of MHI. An affordability study was completed in December 2018 and improving affordability metrics is a component of the system's long-term plan. Fitch notes that the steadily growing customer base has allowed the system to decrease and/or freeze rates, while still allowing for increasing FADS, typically. Should the rate of customer growth slow Fitch would expect rate increases beyond those currently planned would be needed to support planned pay-go capex and to maintain adequate debt/FADS.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of Environmental, Social and Governance (ESG) credit relevance is a score of 3. This signals that ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Austin (TX) [Water, Sewer]			
Austin (TX) /Water & Sewer Revenues/1 LT	LT AA- ⊙ Affirmed		AA- ⊙

Additional information is available on www.fitchratings.com

FITCH RATINGS ANALYSTS

Primary Rating Analyst
Audra Dickinson
Director
+1 512 813 5701
Fitch Ratings, Inc.
111 Congress Avenue Suite 2010
Austin 78701

Secondary Rating Analyst
Kathy Masterson
Senior Director
+1 512 215 3730

Committee Chairperson
Douglas Scott
Managing Director
+1 512 215 3725

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Applicable Criteria

U.S. Water and Sewer Rating Criteria (pub. 29 Nov 2018)
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 07 Nov 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

DISCLAIMER

COPYRIGHT

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy