Fitch Rates Austin's (TX) $271MM Water and Wastewater Rev Rfdg Bonds 'AA-';
Outlook Revised
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Fitch Ratings-New York-19 May 2014: Fitch Ratings assigns an 'AA-' rating to the following Austin, Texas (the city) revenue bonds:

--Approximately $271,171,000 million water and wastewater system revenue refunding bonds, series 2014.

The series 2014 bonds are scheduled for negotiated sale the week of June 3. A portion of the 2014 bonds will retire Austin Water Utility's (AWU, or the system) outstanding commercial paper notes, while the balance of the 2014 bonds will refund outstanding water and wastewater system revenue bonds for cost savings with no extension of bond maturity dates.

In addition, Fitch affirms the following rating for the city's remaining revenue bonds:

--$30.5 million combined utility systems (prior first lien) revenue bonds at 'AA';
--$148.1 million combined utility systems (prior subordinate lien) revenue bonds at 'AA-';
--$2.3 billion water and wastewater system revenue bonds at 'AA-'.

The Rating Outlook for the series 2014 bonds and outstanding parity water and wastewater revenue bonds is revised to Negative from Stable.

The Rating Outlook remains Stable for outstanding combined utility system prior and subordinate lien bonds based on the strength of the joint and several pledge of net revenues of the combined utility systems, consisting of AWU and Austin Energy (AE).

SECURITY

The series 2014 bonds are secured by net revenues of AWU, after provision for the prior first lien obligations of the combined utility systems. The series 2014 bonds are on parity with the prior subordinate lien obligations of the combined utility systems and all outstanding water and wastewater revenue bonds. The 2014 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 revenues of the combined utility systems, consisting of AWU and AE (electric revenue bonds rated 'AA-' with a Stable Outlook by Fitch). The issuance of additional bonds secured by a joint and several pledge of net revenues 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 revenue bonds would not trigger a default on the prior first lien bonds.

KEY RATING DRIVERS

FINANCIAL RESULTS EXPECTED TO WEAKEN: The revision in Outlook to Negative from Stable on the water and wastewater bonds reflects the diminishing prospect of any material improvement in AWU's financial profile over the near term, due in part to ongoing drought conditions. Financial metrics remain weak for the rating category and further erosion in both debt service coverage (DSC) and liquidity is expected by the close of the current fiscal year based on year-to-date results.

LIMITED FLEXIBILITY: AWU's low cash levels, high rates, narrow operating margins after making transfers to the city's general fund, and susceptibility to sizeable declines in consumption limit the system's overall flexibility.

STRONG SERVICE AREA: AWU provides water and wastewater treatment service to a sizeable service territory that includes the city (general obligation bonds rated 'AAA', Stable Outlook) and neighboring areas beyond the city limits.
AWU's growing service area exhibits a deep and diverse economy, exceptionally low unemployment, above average wealth levels, and a highly diversified customer base.

LEVERAGED SYSTEM: The system's debt levels are high for the rating category, although capital needs have begun declining to a more manageable level and borrowing plans are not expected to result in a meaningful increase in current leverage.

AMPLE CAPACITY: Water supply and treatment capacity of the overall system are anticipated to be sufficient for the foreseeable future.

HIGHER RATING ON PRIOR LIEN DEBT: The 'AA' rating on the prior first lien bonds reflects the closed nature of the lien, the very modest proportion the bonds that make up AWU's and AE's (AE, 'AA-'/Stable) overall debt profile, and the strong debt service coverage provided by the pledge of the combined utilities. Coverage of prior first lien obligations should continue to strengthen given the decreasing annual debt service requirements.

RATING SENSITIVITIES

IMPROVED FINANCIAL METRICS: Additional negative rating action is likely absent a measured near-term improvement in AWU's financial profile, particularly its unrestricted cash balances, to a level more consistent with the current rating category.

CREDIT PROFILE

WEAK FINANCIAL RESULTS EXPECTED TO CONTINUE

Financial performance for fiscal 2013 resulted in a slight decline in DSC to 1.4x compared to the prior year and a modest increase in unrestricted cash to a still narrow 50 days cash on hand. Operating results fell short of healthier financial targets included in the prior year forecast, continuing AWU's trend of underperformance relative to forecasted expectations. The city continues to implement rate increases, although revenue growth has failed to materialize as forecasted due primarily to sizeable water consumption declines in four out of the prior five years. The trend in declining sales has reportedly continued into the current fiscal year, which is expected to further erode AWU's already weak financial metrics. Financial projections show DSC coverage dropping to 1.3x with a modest decline in unrestricted cash.

Similar to prior years, AWU forecasts improved DSC beginning in fiscal 2015 to about 1.6x and a meaningful increase in liquidity to a level more consistent with the current rating. AWU's forecast reasonably assumes continued growth in debt service, a sizeable rate hike in fiscal 2015 followed by more manageable rate adjustments of 3% per year. Fitch considers the assumed 1.4% rate of growth in sales incorporated into the forecast to be aggressive, particularly given the more recent trend in demand and the potential for drought conditions to remain. Fitch will continue to monitor AWU's ability to achieve its stated financial goals and respond accordingly.

STRONG SERVICE AREA

AWU provides water and wastewater service on a retail basis to a particularly strong service territory that includes the city of Austin and neighboring portions of Travis and Williamson Counties. The system's customer base is highly diverse, composed mostly of residential users, with the 10 largest customers accounting for a nominal 6% of total revenues in fiscal 2013.

Austin's economy continues to outperform that of many other large metro areas in the U.S. The city is the state capital and is home to seven colleges and universities, including the University of Texas (the University of Texas System rated revenue bonds rated 'AAA', Stable Outlook by Fitch), one of the largest public universities in the country. Wealth indicators for the area are comparatively high and the city's March 2014 unemployment rate of 3.9% is exceptionally low relative to state and national averages. Consequently, customer delinquencies are minimal and revenue collection is near perfect.

AMPLE SUPPLY AND TREATMENT CAPACITY

AWU has an ample, long-term water supply, pursuant to an agreement with the Lower Colorado River Authority (LCRA, revenue bonds rated 'A', Stable Outlook by Fitch) that runs through 2050 and is extendable through 2100 at AWU's option. The agreement, for which AWU made a $100 million up-front payment, provides the utility with up to 201,000 firm acre-feet of water per year, equal to about 55% more than AWU's average daily demand recorded in fiscal 2013. AWU does not anticipate exceeding its current allocation until at least 2050.
AWU's water treatment plants provide significant excess treatment capacity estimated to be sufficient until at least 2030 following the addition of a new facility in 2014. AWU's two wastewater treatment plants provide 150 million gallons per day (mgd) of capacity, which was sufficient to meet average daily flows of 104 mgd in fiscal 2012. Existing treatment capacity is reportedly sufficient for the foreseeable future, and discharge permits are current.

DECLINING RATE AFFORDABILITY

Fitch considers AWU's combined water and wastewater rates somewhat high relative to income levels of city residents, and in comparison to other large urban systems. Although rate hikes on a combined percentage basis have been fairly modest over the last several years, the city's total monthly residential bill currently amounts to about $88, equal to an above average 2.1% of median household income.

MANAGEABLE CAPITAL NEEDS

For the sixth consecutive year, AWU's capital needs have continued to decline to a more manageable level. Projected spending through fiscal 2019 totals $383.98 million, down nearly 18% from the prior five-year plan as larger scale projects have neared completion. The city expects to fund about two-thirds of its five-year capital program with annual borrowings through 2019. Excess cash flow is projected to cover the balance of planned expenditures. AWU's financial forecast through 2019 exhibits sufficient excess cash flow needed to meet annual pay-go targets.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria' (June 2013);
--'U.S. Water and Sewer Revenue Bond Rating Criteria' (July 2013);
--'U.S. Public Power Rating Criteria' (Dec. 2012);
--'2014 Water and Sewer Medians' (Dec. 2013);

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
U.S. Public Power Rating Criteria
2014 Water and Sewer Medians
2014 Outlook: Water and Sewer Sector
Additional Disclosure
Solicitation Status

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