

# Austin, Texas

## Revenue Bonds New Issue Report

### Ratings

#### New Issues

Water and Wastewater System Revenue Refunding Bonds, Series 2015A	AA-
Water and Wastewater System Revenue Refunding Bonds, Taxable Series 2015B	AA-

#### Outstanding Debt

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

### Rating Outlook

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

### Related Research

[Fitch Rates Austin's \(TX\) Water and Wastewater Rev Rfdg Bonds 'AA-'; Outlook Negative \(June 2015\)](#)  
[2015 Water and Sewer Medians \(December 2014\)](#)  
[2015 Outlook: Water and Sewer Sector \(December 2014\)](#)  
[Austin Energy, Texas \(November 2014\)](#)  
[Fitch Rates Austin, Texas' 2014 PIBs, Cos & PFCOs 'AAA'; Outlook Stable \(August 2014\)](#)

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### New Issue Details

**Sale Information:** Approximately \$253,090,000 Water and Wastewater System Revenue Refunding Bonds, Series 2015A, and \$36,405,000 Water and Wastewater System Revenue Refunding Bonds, Taxable Series 2015B, via negotiation the week of July 8.

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

**Purpose:** To refund portions of outstanding parity bonds (series 2005, 2005A, 2006, 2006A, 2007 and 2009A) for cost savings.

**Final Maturity:** May 15, 2043.

### Key Rating Drivers

**Weakened Financial Performance:** Maintenance of the Negative Rating Outlook reflects the increasingly weak trend in financial performance over the prior three fiscal years, resulting in cash flow and liquidity metrics that are increasingly inconsistent with the current rating.

**Eased Drought Conditions:** Significant rainfall in recent months has improved drought conditions, which could ultimately allow AWU to lift water use restrictions and avoid further declines in consumption. Easing of the drought, coupled with ongoing rate increases, improved cost recovery through rate structure changes, efforts to cut costs and more conservative financial forecasting, should help reverse the recent slide and bolster the utility's financial performance going forward.

**Strong Service Area:** AWU provides water and wastewater treatment service to a sizable service territory that includes the city (general obligation [GO] bonds rated 'AAA,' with a Stable Outlook, by Fitch) 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 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.

**Sufficient Resources:** 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 portion of the bonds that make up AWU's and Austin Energy'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.

**Rating History**

Rating	Action	Outlook/ Watch	Date
AA-	Affirmed	Negative	6/29/15
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

**Credit Profile**

AWU operates as an enterprise fund of the city of Austin, providing water treatment and distribution, primarily on a retail basis, to approximately 217,000 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 grow steadily, 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 good, and the region's ongoing drought conditions have recently abated.

Financial performance for fiscal 2014 diminished somewhat relative to the prior year, although financial results were in line with prior expectations, and modest improvement is expected going forward. The city convened a joint committee midway through 2014 that successfully identified meaningful cost savings and implemented modest rate structure changes designed to yield greater cost recovery. Fitch expects the committee's efforts, together with the implementation of an 8.1% rate increase for fiscal 2015 and the employment of more conservative forecasting, will position the utility well to improve its financial metrics and stabilize its operations. The recent end to the state's four-year long drought should also have a stabilizing impact on AWU's operating environment.

**Governance and Management**

AWU is owned and operated by the city of Austin. The city is governed by a mayor and six council members elected at large 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. The current city manager has occupied the role since January 2008. Senior management at the city and the utility are well regarded by Fitch.

Among the primary goals of the utility's management team in recent years has been the improvement of the water and sewer system's financial metrics, principally its liquidity, through rate adjustments and changes in the rate structure. Positive results have been slow to materialize as declines in consumption in five out of the prior six years have largely offset management's prudent imposition of annual rate hikes over that span.

**Service Area**

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 that of many other large metro 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 (the University of Texas System rated revenue bonds rated 'AAA', with a Stable Outlook, by Fitch), 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 also serve as economic drivers. Numerous large technology firms rank among AWU's largest customers. The city's 2014 population, estimated at roughly 847,000, has increased more than 25% since 2000. Wealth indicators for the area are comparatively high, and the city's April 2015 unemployment rate of 2.6% was exceptionally low relative to state and national averages. Accordingly, customer delinquencies are minimal, and revenue collection has been consistently strong.

**Related Criteria**

- [Revenue-Supported Rating Criteria \(June 2014\)](#)
- [U.S. Water and Sewer Revenue Bond Rating Criteria \(July 2013\)](#)
- [U.S. Public Power Rating Criteria \(March 2015\)](#)

## Customer Profile

AWU provides water and wastewater service on a retail basis to a strong service territory that includes the city of Austin and neighboring portions of Travis and Williamson counties. The system's 10 largest customers accounted for just 6% of total revenues in fiscal 2014, evidencing the utility's highly diverse customer base and related revenues.

The system also provides water and wastewater service on a wholesale basis to five municipal utility districts (MUDs), two water control and improvement district, several water supply corporations, one private utility and six neighboring towns. Three of the five area MUDs are scheduled for annexation over the next several years under approved strategic partnership agreements with the city of Austin. The increased revenue derived from the annexations is incorporated into the AWU's current financial forecast, although the added income is not expected to be significant.

The number of customers served has steadily grown over the prior 10 years, increasing by a healthy annual average of about 1.5%, including during the most recent economic recession. However, water sales have fallen in five out of the prior six years, outpacing the service territory growth and resulting in a steadily declining trend of per capita consumption.

Positively, the city's current financial forecast assumes no growth in demand through 2019, marking a favorable departure from more aggressive growth assumptions incorporated into historical projections. Despite the recent easing of drought conditions as a result of intense rains experienced in recent months, the city has prudently elected to maintain its stage two water use restrictions, limiting outdoor watering to once per week, among other curtailments.

The Austin region, similar to most of Texas, experienced severe drought conditions that began in 2010. A state-required drought contingency plan was implemented by AWU in September 2012 as a result, prompting the water use restrictions that remain in effect today.

The intensity of the drought throughout 2014 also prompted AWU to consider moving to stage three restrictions and the city council to pass an ordinance directing a joint committee headed by the city manager to devise a financial plan that balanced greater water conservation with the maintenance of AWU's financial health. The joint committee ultimately produced several recommendations that were put into practice, including the adoption of stage three and four drought rates if needed, recurring expense reductions approximating \$30 million (equal to nearly 10% of total expenditures in fiscal 2014) and modest rate structure adjustments designed to more fully recover costs.

Fitch views the city's and the committee's efforts positively and believes the measures will help put the utility on firmer financial footing going forward. Nevertheless, Fitch will continue to monitor AWU's progress should drought conditions begin developing.

## AWU Assets

### Water System

#### *Water Supply*

AWU has an ample long-term water supply, pursuant to an agreement with the Lower Colorado River Authority (LCRA) (revenue bonds rated 'A', with a Stable Outlook, by Fitch) that runs through 2050 and is extendable through 2100 at AWU's option. The agreement gives AWU independent rights to impound, divert and use water from the Colorado River and its tributaries.

These rights have been adjudicated before the Texas Commission on Environmental Quality (TCEQ).

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 66% more than AWU's average daily demand recorded in fiscal 2014. AWU does not anticipate exceeding its current allocation until at least 2030, although the city has reserved access for up to 325,000 acre-feet of water per year for additional charges.

**Treatment**

AWU's existing water treatment plants provide ample excess treatment capacity, estimated to be sufficient until 2030 following the completion of a new facility in 2014. 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 million gallons per day (mgd), comfortably above the system's five-year peak demand average of about 200 mgd. The WTP No. 4, which was recently constructed and came on line in 2014, has an initial capacity of 50 mgd but is expandable to 300 mgd. Fitch expects the system will have sufficient water treatment capacity for the foreseeable future with its current assets.

**Wastewater System**

AWU's two wastewater treatment plants provide 150 mgd of capacity, which was sufficient to meet average daily flows of 102 mgd in fiscal 2014. Existing treatment capacity is reportedly sufficient for the foreseeable future, and discharge permits are current. The TCEQ issued the city five-year discharge permits in 2009 and 2010. The system is not currently operating under any environmental judgments or consent orders.

**Annual Water Customers and Consumption**

(Fiscal Years Ended June 30)

Year	Customers	Consumption (mgd)	% Change
2006	195,042	136	13.3
2007	198,883	112	(17.6)
2008	202,057	145	29.5
2009	208,424	130	(10.3)
2010	210,225	109	(16.2)
2011	211,185	136	24.8
2012	212,466	120	(11.8)
2013	215,328	115	(4.2)
2014	216,897	105	(8.6)

mgd – Millions of gallons per day. Source: Austin Water Utility.

**Capital Plan**

Fitch expects capital needs through 2020 will remain manageable, despite a modest increase in the overall size of the AWU's capital program compared to the prior-year plan. The five-year capital spending plan is up by approximately \$23 million, or 3%, over the prior year, to accommodate plans to expand the utility's reclaimed water program, which Fitch views as a constructive development.

The nominal increase in planned spending follows a favorable trend of six consecutive years of declining five-year spending levels from a peak of almost \$1.5 billion for the 2009–2013 period to the current \$863 million program. Cost allocation is weighted primarily toward wastewater needs (52%), with the balance attributable to water-related projects (40%) and the reclaimed program (8%).

The city expects to fund about two-thirds of its capital program with annual borrowings through 2020. Excess cash flow is projected to cover the balance of planned expenditures. AWU's

financial forecast exhibits sufficient free cash flow needed to meet projected annual pay-as-you-go amounts.

### Debt Profile

AWU's debt levels and related leverage metrics are high for the rating category. Total debt outstanding, including prior first and subordinate lien obligations allocated to the water and wastewater system, escalated by nearly 45% since fiscal 2008, principally due to growth-related needs. Consequently, the ratios of debt to equity and total leverage as a percentage of net assets remained above 21.0x and 70%, respectively, in fiscal 2014 compared with the median ratios of 3.6x and 50%. Continued growth in the service area and customer base should have a moderately positive impact on debt per customer and per capita ratios.

Annual debt service costs are also sizable, accounting for 43% of gross revenues, almost twice the median percentage for similarly rated systems. Fitch expects debt levels will continue to approximate current level for the foreseeable future as the scheduled payout of existing principal will be replaced by a like amount of additional debt currently programmed into AWU's capital plan.

The prior first- and subordinate-lien bonds outstanding totaled \$30.5 million and \$148.1 million, respectively, at the close of fiscal 2014. Outstanding debt allocated to the water and wastewater system accounts for slightly one-half of the total amounts borrowed under both liens combined. The prior first-lien obligations accounted for a nominal 1.2% of AWU's total debt outstanding, although this will continue to diminish as the lien is effectively closed and scheduled amortization occurs. The bonds mature in 2019.

AWU had just \$125.1 million of variable-rate bonds outstanding at the close of fiscal 2014, equal to a modest 4.9% of total debt obligations. The variable-rate bonds are backed by a letter of credit agreement provided by Sumitomo Mitsui Banking Corporation (A-/F1/Stable) and Bank of Tokyo-Mitsubishi UFJ, Ltd. (A/F1/[Stable]) that extends to October 2018. All additional debt is fixed rate, and the system is not currently party to any swap agreements.

The city is authorized by ordinance to issue and have outstanding at any one time a maximum of \$400 million in commercial paper (CP) notes for interim financing for capital projects of the electric and water and wastewater systems. AWU had approximately \$75 million outstanding at the close of fiscal 2012, while AE had \$140.3 million. Outstanding notes are backed by letter of credit agreements with three different providers that extend through October 2017.

### Cost Structure

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. However, the TCEQ maintains oversight of rates charged to customers residing outside the city's boundaries. Both the city council and the TCEQ reportedly have a history of being generally supportive of AWU's rate adjustment requests.

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. The latter two are fixed charges that were 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 more 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 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. The volumetric surcharge is levied to fund a water revenue stability reserve fund, which can only be drawn upon by AWU if consumption declines by 10% or greater within a certain period and the city council grants approval. The surcharge was increased in fiscal years 2014 and 2015 but will remain at its current rate until the reserve fund meets a targeted funding level of 120 days of cash on hand. AWU officials anticipate meeting the funding goal by fiscal 2018, at which time the surcharge would be dramatically reduced.

### Combined Annual Rate Increases

(Audited Fiscal Years Ended June 30)

Year	% Increase
2008	9.8
2009	7.0
2010	4.5
2011	4.5
2012	5.1
2013	5.5
2014	7.4
2015	8.1

Source: Austin Water Utility.

The size of AWU's combined water and wastewater rate increases has steadily risen over the last several years in an effort to outpace declining consumption levels driven by the drought. The average monthly residential bill, despite the escalation, remains fairly reasonable at slightly lower than 2% of median household income, in part due to lower usage patterns typical of urban areas.

Positively, the city's ability and willingness to continue raising rates appears not to have diminished given the adoption of an 8.1% rate increase for the current fiscal year and a similar adjustment planned for fiscal 2016. The remaining years of AWU's financial forecast incorporate additional but smaller rate increases.

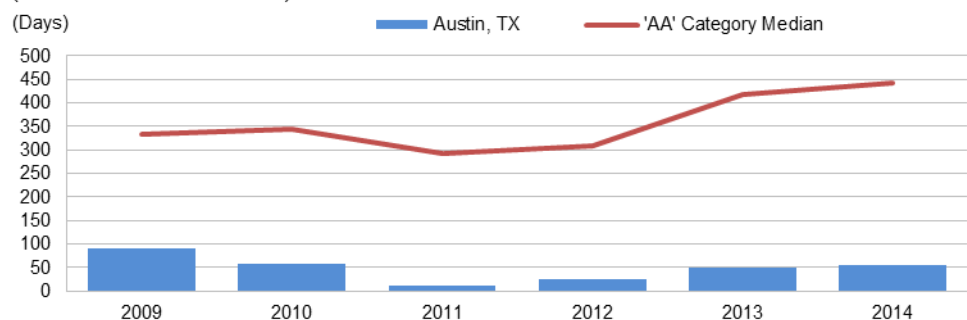
### Financial Performance

AWU's financial performance weakened in recent years, driven principally by variable weather conditions. Water restrictions invoked early in 2010 due to the onset of drought conditions were followed by heavy rainfalls that limited customers' demand requirements. Drier weather in fiscal 2011 led to a nearly 25% increase in water consumption, although the positive growth was followed by a 13% reduction in demand in fiscal 2012 as stage two restrictions were eventually put in place.

The more recent trend of falling consumption levels prompted all-in debt service coverage to deteriorate from a peak of 1.7x in fiscal 2011 to just 1.2x in fiscal 2014, well below Fitch's rating category median of 1.8x. Conversely, liquidity, which includes cash in the water revenue stability reserve fund, steadily grew over the same period, albeit incrementally. At fiscal year-end 2014, available cash and investments provided about 55 days of cash on hand, still far below the median of nearly 450 days of cash on hand.

### Days Cash on Hand

(Fiscal Years Ended June 30)



## Financial Summary

(\$000, Audited Fiscal Years Ended June 30)

	2009	2010	2011	2012	2013	2014
<b>Balance Sheet</b>						
Unrestricted Cash and Investments	42,990	27,684	5,403	13,168	28,797	33,193
Accounts Receivable	52,814	52,526	69,086	70,094	72,862	66,536
Other Current Unrestricted Assets	18,374	25,193	26,257	26,466	25,009	2,390
Current Liabilities Payable from Unrestricted Assets	(53,720)	(64,386)	(76,662)	(76,720)	(88,909)	(42,950)
Net Working Capital	60,458	41,017	24,084	33,008	37,759	59,169
Net Fixed Assets	2,444,177	2,530,961	3,036,372	3,230,035	3,389,536	3,493,744
Net Long-Term Debt Outstanding	1,943,057	2,026,539	2,184,840	2,395,827	2,415,237	2,541,238
<b>Operating Statement</b>						
Operating Revenues	391,896	360,649	448,048	442,707	476,781	472,593
Non-Operating Revenues	1,875	287	271	313	88	82
Gross Revenues	393,771	360,936	448,319	443,020	476,869	472,675
Operating Expenses (Excluding Depreciation)	(172,438)	(171,171)	(177,474)	(190,987)	(216,369)	(226,349)
Depreciation	(81,031)	(85,705)	(91,398)	(95,392)	(97,186)	(103,443)
Operating Income	140,302	104,060	179,447	156,641	163,314	142,883
Net Revenues Available for Debt Service <sup>a</sup>	221,333	189,765	270,845	252,033	260,500	246,326
Senior Lien Debt Service Requirements	33,215	46,160	46,016	44,386	30,718	8,473
Total Debt Service Requirements	147,840	156,387	163,471	178,167	189,012	204,146
<b>Financial Statistics</b>						
Senior Lien Debt Service Coverage (x)	6.7	4.1	5.9	5.7	8.5	29.1
Total Debt Service Coverage (x)	1.5	1.2	1.7	1.4	1.4	1.2
Days Cash on Hand	91.0	59.0	11.1	25.2	48.6	53.5
Days Working Capital	128	87	50	63	64	95
Debt to Net Plant (%)	79	80	72	74	71	73
Outstanding Long-Term Debt per Customer (\$)	4,801	4,970	5,326	5,774	5,778	6,033
Outstanding Long-Term Debt per Capita (\$)	2,522	2,603	2,712	2,918	2,872	2,600

<sup>a</sup>Equals gross revenues less operating expenses. Note: Numbers may not add due to rounding. Source: Austin Water Utility.

## Forecast

Year-end financial results appear reasonably forecast to improve over the prior year, largely the result of an 8.1% rate increase adopted at the outset of the fiscal year, coupled with reduced operating expenditures. Debt service coverage is projected to grow to a more acceptable 1.6x, while liquidity improves to closer to 90 days of cash on hand.

Longer term projections demonstrate continued improvement in the overall health of AWU's financial profile. With annual rate increases averaging about 4%, debt service coverage should continue to approximate 1.7x, while liquidity grows to well beyond 120 days of cash on hand. Forecast assumptions appear reasonable with level consumption, modest rate hikes and additional debt issuance. Fitch notes the current forecast does not incorporate debt service savings expected to occur as a result of the current refunding transactions, which will be structured to yield savings in each of fiscal years 2016–2019.

## Legal Provisions

The series 2015A and 2015B bonds are secured by net revenues 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 bonds currently being issued 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. 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 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 revenues. 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 revenues. CP is payable after provision for all outstanding long-term debt.

### **Rate Covenant**

Pursuant to the prior lien ordinance, gross revenues of the respective systems must be sufficient to fund operations and maintenance costs and amounts owed to all reserve funds as well as produce net revenues 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 revenues must be sufficient to fund operations and maintenance and produce net revenues 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 revenues.

### **Additional Bonds Test**

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



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