STANDARD & POOR'S
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Austin, Texas; Combined Utility; Water/Sewer

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Credit Profile		
US$271.17 mil wtr and wastewtr sys rev rfdg bnds ser 2014 due 11/15/2044		
Long Term Rating	AA/Positive	New
Austin WS		
Long Term Rating	AA/Positive	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating and positive outlook to Austin, Texas' series 2014 water and wastewater system revenue refunding bonds. We also affirmed the 'AA' long-term rating and underlying rating (SPUR) on the system's parity separate-lien debt and the 'A+' rating on the utility's special assessment bonds. The outlook is positive on all ratings.

Last year, we revised the rating outlook to positive based on the expectation that the enhanced financial management policies adopted by the city would bolster the already-solid financial risk profile of the system, which does business as Austin Water Utility (AWU). While management had projected total debt service coverage (DSC) of all liens of at least 1.5x, recent actions have targeted improving both cash flow and cash reserves. We believe the system's financial profile continues to move in that direction. While it may take more than two years for the system's financial position to be fully in line with management's goals, a higher rating would be predicated mainly on continued progress toward that end.

The ratings reflect the system's general creditworthiness, including its:

- Service area, which has among the strongest and most diverse economies in the state and is anchored by a number of public institutions;
- Water supply agreement with the Lower Colorado River Authority (LCRA) since 1999, effectively securing a 100-year water supply at a reasonable cost, and one which has not been interrupted even during the severe and prolonged ongoing drought; and
- Five-year capital improvement plan (CIP) that includes about $840 million of capital expenditures. This level of planned improvements is roughly half of what it was just a decade ago as the system winds down from a recent capital-intensive phase.

A pledge of the water and wastewater system's net revenues secures the separate-lien system revenue bonds, which are junior to roughly $30.5 million of prior first-lien combined electric, water, and wastewater revenue bonds outstanding; these bonds also have a pledge on par with $148 million of prior subordinate-lien combined electric-water-wastewater utility revenue bonds outstanding as of May 2014, and roughly $2.3 billion of previously issued separate-lien (parity) water and wastewater revenue bonds outstanding. The utility is also standing behind two series of 2011 special assessment revenue bonds that we rate two notches below the utility's separate lien, given both the subordination and the appropriation risk if the city has to step up to fund them.

Management has already had a number of practices to support the utility's financial performance. These include a strict allocation of all combined utility revenue requirements to either AWU or to Austin Energy (AA-/stable), its municipally-owned electric counterpart. The cost allocation ensures that both utilities fully support their allocable share of combined utility debt service on both the prior first- and prior-subordinate liens.

We understand management plans to use the series 2014 bond proceeds to convert $200 million in commercial paper notes to long-term debt, as well as refund for savings the separate-lien series 1998A and 2005A water and wastewater revenue bonds.

The city maintains a liquidity target of at least 60 days' working capital, although it has established a rate stabilization reserve that will supplement cash reserves by an additional 120 days once it is fully funded in fiscal 2018, a target set by management. Similar to the strong financial management policies of the general fund, the rate stabilization reserve - funded with what is currently a 15-cent-per-1,000-gallon surcharge - can only be used in the event of a significant revenue shortfall, and no more than half of the balance can ever be used at one time. A city ordinance in place for over a decade also caps transfers to the general fund, further securing liquidity. In addition, AWU has increased revenues from fixed fees to 20% from 11% to help better manage fixed costs from cash flow, as opposed to cash on hand, thereby reducing cash flow volatility associated with seasonality and weather.

Management has identified roughly $840 million of capital expenditures through fiscal 2019, almost 40% lower than just five years prior and almost half of the rolling five-year capital plan a decade ago. While the service area remains among the most economically vibrant in the state, two large capital-intensive efforts have been completed or are nearly completed. This includes nearly $400 million of projects related to an administrative order on sanitary sewer overflows (SSO); all issues cited by the Environmental Protection Agency were satisfactorily addressed and the order closed in 2009. In addition, a fourth water treatment plant will be operational later in 2014, very close to its original budget and construction time line. The remainder of the CIP is focused on growth and rehabilitation projects. Management anticipates at this time that any increase in the CIP would be largely attributable to accelerated growth.

The city has a long record of rate adjustments - typically annually - to support the continued system investment. The most recent adjustment was implemented in November 2013 and included a 5.1% water rate increase and a 1.9% sewer rate increase. Forecasts have similar rate adjustments necessary for each of the next five years. The continued adjustment to rates that are already above those of comparable utilities in the state does create a challenge for elected officials. However, the rates are not unreasonable because of the water supply agreements already in place and that other very large capital programs are already completed or at least fully funded.

We expect annual DSC to remain steady, even if periodically affected by weather; fiscal 2013 coverage of all system obligations was about 1.5x by Standard & Poor's calculation. Fiscal 2014 DSC is expected to still be in line with the 1.5x in the forecast. Management indicates projected annual DSC of all liens of between 1.5x and 1.6x through 2019.

Austin Water Utility serves about 216,000 water customers and about 204,000 wastewater customers. The customer base grew more than 3% annually during the economic expansion's peak prior to the Great Recession. While the growth in metered accounts is still steady, it has been more measured; officials are projecting growth of between 1% and 2% for the next five years. The system obtains water from the Colorado River through the city's own water rights and purchases it from Lower Colorado River Authority. The system then treats the water at three treatment plants. In

1999, city officials secured a long-term water supply through an amendment to the water agreement with LCRA that put a 50-year water supply in place with an option to renew for an additional 50 years. The city is a priority customer of LCRA; as the authority has dealt with the profound drought, it has curtailed certain interruptible customers in favor of its obligation to Austin. Still, the city has had for many years an aggressive water conservation and drought management program, including inclining block rates, public education, and environmentally-sensitive practices.

Outlook

The positive outlook reflects Standard & Poor's expectation that recently adopted financial management policies and supporting rate adjustments will bolster the system's financial risk profile over our two-year horizon, especially its working capital levels, which would result in an upgrade. When combined with large projects that have been completed or are nearing completion, moderating the capital improvement program, we believe management's projections are realistically sustainable. A return to a stable outlook would be based on an unexpected and unfavorable shift in the economic fundamentals or inability to achieve the forecasted financial performance, especially improved cash reserves.

Operations: The Biggest Initiatives Are Already Funded

The city's source of supply is entirely surface water, via a series of reservoirs along the Colorado River. While some of the assets are owned and operated by the city, others are LCRA facilities. Because central Texas remains in a prolonged drought, the two largest LCRA reservoirs are a combined 36% full as of May 2014. However, in 1999, the city and LCRA reached an agreement which essentially guarantees the city has senior rights for up to 325,000 acre-feet per year of LCRA water through 2050, with an additional 50-year option. The city also prepaid the actual volume charges on the first 150,000 acre-feet per year of that water; water delivered above 150,000 acre-feet would be subject to additional volume charges. However, city management believes that due to aggressive water conservation practices and public education, it may not be until 2030 before the city might reach that next level of water delivery. The senior water rights position has benefited the city in recent years, as each year since 2012 LCRA has had to interrupt downstream irrigation customers because of hydrological conditions.

The supply certainty was an important factor in allowing the city to complete the oft-delayed fourth water treatment plant at a site along Lake Travis. The plant, which was built on time and within budget, is expected to go into service in mid-2014. The roughly $500 million plant will initially have a capacity of 50 million gallons per day (mgd) with sufficient land space and core infrastructure to expand to 300 mgd. The plant will not only replace capacity from a decommissioned - and now razed - water treatment facility downtown, but should also be sufficient to accommodate growth in demand for many years.

The city in 2009 also closed out a decade-long regulatory mandate on SSO remediation. The administrative order caused the city to spend almost $400 million, mainly on collection line replacements and pumping rehabilitation. The efforts reduced SSOs by more than 95%.

While all of these projects did affect the city's rates, we believe they place the city's somewhat high rates in context.

Currently, a monthly residential bill is more than $110, or 3.2% of median household effective buying income, based on Standard & Poor's assumption of 8,000 gallons of both water and sewer service. This includes the revenue stability reserve fund surcharge, currently at 15 cents per 1,000 gallons of billed water.

Related Criteria And Research

Related Criteria

USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Ratings Detail (As Of May 21, 2014)		
Austin WS (wrap of insured) (AGM & BHAC) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
Austin (Indian Hills Pub Imp Dist) WS		
Long Term Rating	A+/Positive	Affirmed
Austin (Whisper Vy Pub Imp Dist) WS		
Long Term Rating	A+/Positive	Affirmed
Austin		
Long Term Rating	AA/Positive	Affirmed
AustinWS		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed
Austin WS		
Unenhanced Rating	AA(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.