FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Austin, TX's Water and Wastewater Rev Rfdg Bonds 'AA-'; Outlook Stable

Thu 01 Oct, 2020 - 11:39 AM ET

Fitch Ratings - Austin - 01 Oct 2020: Fitch Ratings has assigned a 'AA-' rating to the following bonds issued by the city of Austin, TX (the city):

--Approximately $202.5 million water and wastewater system revenue refunding bonds series 2020C.

The bonds are scheduled to sell via negotiation on or around Oct. 20, 2020. The bond proceeds will refund outstanding tax-exempt commercial paper obligations, refund currently outstanding parity water and wastewater obligations series 2010A, and pay costs of issuance.

Fitch has also affirmed the 'AA-' rating on the following obligations:

--Approximately $2.1 billion water and wastewater system refunding bonds (prior to refunding).

Additionally, Fitch has assessed Austin Water's (AW; or the system) Standalone Credit Profile (SCP) at 'aa-'.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AA-' rating and 'aa-' SCP assessment reflect the system's moderate net leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), within the framework of very strong revenue defensibility and a very strong operating risk profile both assessed at 'aa'. Net leverage in fiscal 2019 was 8.6x, which is representative of historical performance. Additional debt financing in upcoming years will likely increase net leverage modestly but to a level that remains consistent with the current rating.

Coronavirus Considerations

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for the water and sewer sector. While the system's most recently available performance data does not indicate impairment, material changes in revenue and cost profile are occurring across the sector. In response to the coronavirus pandemic, Austin's city council approved a 10% residential water and wastewater rate decrease in April 2020. The rate decrease is expected to result in generally flat operating revenue in fiscal 2020 as compared to fiscal 2019 but not have a materially adverse effect on performance. Management reports an increase in delinquencies, but the past due balance remains less than 1% of estimated total operating revenue.

The city council approved returning rates for most residential customers to the level that was in effect prior to COVID. Rates for customer assistance program (CAP) customers will remain at the decreased level through fiscal 2021 (fiscal year end Sept. 30). Fitch's ratings are forward-looking in nature. Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks as appropriate.

CREDIT PROFILE

AW operates as an enterprise fund of the city, providing water treatment and distribution, primarily on a retail basis, to nearly 237,000 customers. Wastewater collection, treatment and disposal is also provided to over 225,000 customers. Most customers reside within the city limits, but the system also serves some portions of Travis and Williamson counties beyond the city limits. The service area covers around 544 square miles. Growth in the customer base continues at a steady pace but the system benefits from a long-term contract ensuring adequate water supply through at least 2100.

The system operates three water treatment plants with a combined treatment capacity of 335 million gallons per day (mgd), comfortably above average demand of 130 mgd seen over the last several years. AW's two wastewater treatment plants (WWTP) have a combined treatment capacity of 150 mgd; average flows in fiscal 2019 were 106 mgd. Expansion of wastewater treatment capacity is expected in the mid- to late 2020s when a 25 mgd expansion of the Walnut WWTP is anticipated. Construction of new plants is not currently contemplated as current assets could be expanded to meet projected demand and flow assumptions.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Favorable Service Area, Affordable Rates for Significant Majority

The system serves a very favorable service area with solid economic underpinnings. Fitch considers the monthly combined bill affordable for a significant majority of the population. Rate flexibility should remain strong based on current projections that show rates being held flat in most years, with around 3% increases planned in fiscals 2023 and 2025.

Operating Risks 'aa'

Very Strong Operating Risk Profile, Moderate Investment Needs

The system's operating cost burden is considered very low and healthy levels of capital expenditures (capex) have kept the lifecycle ratio low. Planned capex through fiscal 2025 is expected to continue outpacing annual depreciation costs and maintain a low lifecycle ratio.

Financial Profile 'aa'

Moderate Net Leverage, Modest Increase Likely

An uptick in net leverage is expected in upcoming years as additional debt financing is planned to support capex. In conjunction with rates remaining flat in some years, net leverage could increase to about 10.0x in Fitch's stress case, which remains at a level supported by the current rating. Liquidity cushion and coverage of full obligations (COFO) are sound and considered neutral to the rating.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained and projected net leverage that does not exceed around 8.0x in the context of 'aa' revenue defensibility and operating risks assessments.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Projected net leverage that begins to exceed 10.0x on a sustained basis, assuming stability in the revenue defensibility and operating risks assessments.

--A sustained increase in the operating cost burden to over $6,500 per million gallons would likely weaken the operating risks assessment and place pressure on the rating if not offset with lower net leverage closer to 8.0x.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

SECURITY

The water and wastewater revenue bonds are secured by net revenues of AW. The system also has prior subordinate lien obligations outstanding that are secured by a joint and several pledge of net revenues of AW and Austin Energy, 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.

REVENUE DEFENSIBILITY

The system has very strong revenue defensibility, reflected in the 'aa' assessment. All revenue is derived from the monopolistic business lines of providing retail water and sewer services and the system's service area displays very favorable economic underpinnings. Customer concentration is not a concern as the top ten customers typically account for around 5% to 6% of annual operating revenue. Customer growth is strong with a five-year compound annual growth rate of 1.9%, as of fiscal 2019. Income levels are about 10% higher than the national median, while the unemployment rate trends lower than the national rate, generally just 70% of the national rate.

Rates must be approved by the city council, but rates for customers that reside outside the city limits can be appealed to the Public Utilities Commission of Texas (PUCT). In fiscal 2019, around 8% of total annual operating revenue was derived from customers that reside outside the city limits. While rates have been appealed by certain customers in the past, to date, there has not been any materially adverse effect on financial performance. A current monthly bill based on 7,500 gallons and 6,000 gallons of water and sewer usage, respectively, is around $106, which Fitch considers affordable for a significant majority of the population (about 80%). The rate flexibility subfactor is assessed at 'aa' in light of the significant amount of revenue derived from rates that require only city council approval and the fact that no action by the PUCT, to date, has adversely affected performance.

OPERATING RISKS

AW is considered to have a very strong operating risk profile, reflected by the 'aa' assessment, in consideration of the system's very low operating cost burden and low lifecycle ratio. The operating cost burden is about $5,400 per million gallons of water produced and wastewater flows, as of fiscal 2019. The metric trended upward since fiscal 2016 as a result of increasing operating costs with only modest increases in combined demand. The life cycle ratio (representing age of plant relative to remaining useful life of assets) as of fiscal 2019 is considered low at 36% and is similarly on an upward trajectory. Annual capex/depreciation is solid, averaging 103% over the last five fiscal years ending in 2019. Based on planned capex in upcoming years the lifecycle ratio should remain below 45% and continue supporting a 'aa' subfactor assessment for capital planning and management.

The current capital improvement plan (CIP) for fiscals 2020-2024 totals $943 million, and includes estimated actual spending in fiscal 2020 of around $175.4 million. Around two-thirds of the CIP is expected to be debt-financed via low-interest loans through the Texas Water Development Board or draws on commercial paper (which would be subsequently refunded with parity bond issuances). The balance of the CIP will be funded on a pay-go basis. The largest initiative in the CIP at around one-third of planned spending is related to improvements and rehabilitation and repair (R&R) work at the system's wastewater treatment plants. Another one-third of spending is devoted to R&R of the pipe network of both the water and wastewater systems. Other projects in the CIP include improvements to lift and pump stations, enhancements at water treatment plants, and various system-wide improvements.

FINANCIAL PROFILE

The system's financial profile is very strong and assessed at 'aa' and reflects moderate net leverage. As of fiscal 2019 net leverage was 8.6x, which is representative of historical performance as net leverage has ranged from 7.3x to 9.5x over the last five fiscal years (2015-2019). COFO and liquidity cushion are both sound and considered neutral to the rating. COFO has been at least 1.3x since fiscal 2015, and current days cash on hand has been around 300 since fiscal 2017.

Fitch Analytical Stress Test (FAST)

The five-year forward look provided by FAST considers the potential trend of key ratios in a base case and a stress case. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. Management's estimated fiscal 2020 results and projections for fiscals 2021-2024 provide the basis for the five-year forward look in FAST as the assumptions were considered reasonable by Fitch. Fiscal 2020 results reflect generally flat operating revenue in light a growing customer base but the effects of rate reductions implemented in April 2020 in response to COVID. Cost saving measures implemented during the year result in a 3.3% decrease in operating expenses in fiscal 2020. For fiscals 2021-2024 operating revenue increases at an average of 3.3%, mostly attributed to growth in the customer base as only one rate increase is planned over this horizon, an average 3% combined rate increase in fiscal 2023. Operating expenses will increase at an average of 4% annually in fiscal 2021-2024.

Under these assumptions net leverage peaks in fiscal 2021 in both the base and stress case at 9.9x and 10.0x, respectively. Net leverage decreases to around 9.4x in the out years of the base case and 9.6x of the stress case. Fitch also applied a moderate stress to revenue in its forward look related to the impact of the coronavirus, but the results point to net leverage that is still supported by the current rating. COFO is expected to remain near historical levels of at least 1.3x and continue to remain neutral to the rating.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

SOURCES OF INFORMATION

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

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

Julieta Seebach
Director
Secondary Rating Analyst
+1 512 215 3743

Douglas Scott
Managing Director
Committee Chairperson
+1 512 215 3725

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub. 03 Apr 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Austin (TX)	EU Endorsed

DISCLAIMER

RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

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.

US Public Finance   Infrastructure and Project Finance   North America   United States