MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to City of Austin's, TX $254.79M and $36.39M Utility Rev Bonds

Global Credit Research - 25 Jun 2015

Affirms Aa1/Aa2 of outstanding utility revenue debt; Outlook remains negative

AUSTIN (CITY OF) TX
Combined Water & Sewer Enterprise
TX

Moody's Rating

ISSUE		RATING
Water and Wastewater System Revenue Refunding Bonds, Series 2015A		Aa2
Sale Amount	$254,795,000	
Expected Sale Date	07/07/15	
Rating Description	Revenue: Government Enterprise	
Water and Wastewater System Revenue Refunding Bonds, Taxable Series 2015B		Aa2
Sale Amount	$36,390,000	
Expected Sale Date	07/07/15	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook NEG

NEW YORK, June 25, 2015 --Moody's Investors Service assigns a Aa2 rating to the City of Austin's, TX, $254.79 million Water and Wastewater System Revenue Refunding Bonds Series 2015A and $36.39 million Water and Wastewater System Revenue Refunding Bonds, Taxable Series 2015B. At the same time, we have affirmed the Aa1 on prior first lien obligations, as well as the Aa2 on parity debt including the prior subordinate lien, and the separate lien obligations. The rating action affects a total of $2.26 billion.

SUMMARY RATING RATIONALE

The Aa2 rating on the system's separate lien (open lien) reflects a weak liquidity position, which is expected to improve over the near term given established and planned rate increases, as well as a rate stabilization fund. The rating also reflects the system's stable customer base and growing service area, ample water supply provided by the Lower Colorado River Authority, and adequate legal provisions with no debt service reserve established for the current issuance.

The Aa1 rating on the prior lien reflects the relatively small amount of debt outstanding under the prior lien and strong debt service coverage that will continue given that the lien is closed. The Aa2 rating on the prior subordinate lien, which is also closed, is on par with the water and sewer separate liens (working lien) given that the net revenues available to the two liens are the same on the water and sewer system.

OUTLOOK

The negative outlook reflects a weakened liquidity position at fiscal year-end 2014. Future credit reviews will focus on the impact of recent rate increases, as well as other improvements of the system's financial plan, on the overall financial health of the system and near-term improvement in liquidity.

WHAT COULD MAKE THE RATING GO UP

- Sustained trend of strong financial performance and improvement of liquidity

- Trend of improving debt service coverage

- Reduction of system debt profile

WHAT COULD MAKE THE RATING GO DOWN

- Continued narrowing of liquidity or debt service coverage

- Weak financial performance

- Significant increase in debt profile

STRENGTHS

- Recent rate increases

- Growing customer base and strong service area

- Strong management team dedicated to building liquidity

CHALLENGES

- Above average debt profile with plans for additional borrowing

- Need for ongoing rate increases

RECENT DEVELOPMENTS

Recent developments are incorporated into the Detailed Rating Rationale.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE: GROWING LOCAL ECONOMY BENEFITS CUSTOMER BASE GROWTH

We anticipate the system's customer base and service area will remain stable in the near term. The water and wastewater system of the City of Austin (GOLT rated Aaa / stable) predominately serves the residents of the city and the surrounding areas. The City of Austin is centrally located and acts as the state capital of Texas as well as the home to the University of Texas at Austin. The current population estimate for the city is 842,000 which reflects a significant 23% increase over the last ten years. A strong job market continues to attract a well-educated workforce to the area. Short term and longer term prospects for the service area remain positive. Moody's Economy.com reported in March 2015 that Austin-Round Rock's expansion will remain strong this year, led by information technology related industries and business services. In-migration of professionals will lift residential and nonresidential construction. Moody's Economy.com also noted that longer term, a well-educated labor force, high concentration of technology businesses, and fast population growth will yield above-average performance. Given the strong growth in the city, we expect significant near-term growth in the city's taxable value. The unemployment rate for the city (2.9%) in March 2015 was significantly lower than that of the state (4.2%) and nation (5.6%) for the same time period. Socioeconomic indices indicate slightly above average wealth levels for the city, evidenced by a per capita income and median family income of 111.9% and 101.6% of national levels, respectively.

The system's customer base remains stable and relatively diverse. Residential retail customers make up the majority of the customer base while commercial and wholesale customers make up smaller portions. Samsung Electronics Co., Ltd (A1 / Stable), The University of Texas at Austin, as well as various water districts and municipal utility districts (MUDs) make up the system's largest water customers. Favorably, the largest customers do not account for a significant portion of the system's revenue base. We do not expect any significant change to top customers in the near-term. The average number of water customers has risen modestly in each of the last five years. For 2014 the average number of customers totaled 216,348 which reflects roughly 0.5% growth over the previous year. Conversely, billed water consumption has declined annually since 2011 as water conservation and conservation techniques have become more prevalent. Total wastewater flow has fluctuated over the years as more system customers have come online. There is some uncertainty related to 2015 consumption given the recent historically significant rainfall the region has received as well as the typically hot summer months are ahead. Management conservatively projects flat to modestly declining annual consumption in their long term forecasting. The combined storage capacity of Lake Travis and Buchanan, the two major water supply storage reservoirs upstream of the city and managed by the Lower Colorado River Authority, is approximately 2 million acre-feet. The system is in compliance with all state and federal environmental regulations.

FINANCIAL OPERATIONS AND POSITION: WEAK LIQUIDITY AND NARROWED DEBT SERVICE COVERAGE FOR FISCAL 2014 REMAIN INFLUENCING FACTORS IN NEGATIVE OUTLOOK

The financial performance of the system remains challenged. Recent and forecasted rate increases are anticipated to impact weak liquidity and narrowed debt service coverage. For fiscal 2014, operating revenues totaled a significant $472.59 million, which was down slightly from $476.78 million in the previous year. Operating expenditures also rose roughly $10 million which contributed to a decline in net revenues available for debt service.

Fiscal 2014 net revenues of the system of $254.6 million provided a below average 1.26 times coverage of total annual debt service, which includes prior lien and separate lien debt. Given a declining debt structure and incorporating significant savings that are expected from the current issuance of refunding bonds, we anticipate fiscal 2014 net revenues will provide roughly 1.2 times coverage of maximum annual debt service (MADS) which is expected to occur in 2017. For fiscal 2014 the operating ratio for the system was a favorable 47.9%.

Officials report positive year-to-date performance which is in line with the fiscal 2015 budget and is impacted by a recent rate increase in November 2014. Despite significant rainfall in May 2015, consumption remains in line with projections and there have been no major challenges with regards to operations or any significant unforeseen expenditures. System officials conservatively estimate revenues of $522 million and adding $32.2 million to available reserves. Net revenue calculations for the 12 month period ending March 2015 indicate roughly 1.33 times coverage of separate lien obligations following prior lien obligations. Future credit reviews will focus on fiscal 2015 and future financial performance as well as the impact of recent rate increases to ensure revenue growth and financial stability.

Liquidity

The system's liquidity position remains challenged and weaker than similarly rated credits which contributes to the negative outlook. At fiscal year-end 2014, the unrestricted reserve was a thin 9.6%, measured as a percent of operating revenues.

Management has taken significant steps to increase its liquidity position. In fiscal year 2015, the system established a 13.5% rate increase for water and 2.3% rate increase for wastewater which went into effect on 01 November 2014. The average customer bill was impacted $9.79 or 12.1%. Officials are hopeful $30 million reductions in the 2015 budget will aid available reserves at year's end.

Given conservative consumption assumptions, officials anticipate annual rate increases for service in each of the next five years. The system increased the net working capital target to 60 days from 45, and changed the rate structure to reduce volatility. Officials also created a rate stabilization reserve (RSR), funded with a surcharge to all customers, which is expected to be built to 120 days of operating costs over five years ending in fiscal year 2018. The RSR can be accessed with council approval if the system experiences a revenue shortfall of 10%. Additionally, the system can only access 50% of reserves in any one year with replenishment required over the following five years. Currently the rate stabilization fund totals $15.5 million.

DEBT AND OTHER LIABILITIES: HIGH DEBT PROFILE WITH PLANS FOR ADDITIONAL BORROWING

Post-sale the water system will have $28.1 million in prior first lien debt, $43.9 million in prior subordinate lien debt, and $2.09 billion in separate lien obligations outstanding. The system's debt ratio at fiscal year-end 2014 was a high 69.2%. Approximately $21.2 million in net present value savings is expected from the refunding issues. Moving forward, system officials report additional plans for borrowing. The system's current 5-year capital improvement plan calls for $348.5 million in water utility projects and an additional $452.3 million in wastewater projects. Management anticipates various methods for funding the projects including debt issuance and cash funding.

Debt Structure

The revenue debt of the system has a generally declining debt structure with MADS occurring in 2018 with all debt maturing in 2044.

Debt-Related Derivatives

The system has one outstanding variable rate issue (Series 2008). There is $115.7 million outstanding and the bonds are supported by a letter of credit from Citibank N.A. (A1) with an expiration date of October 15, 2018. The LOC is sized for the outstanding principal amount of the bonds plus 50 days of interest at 12%, the maximum rate applicable to the Bonds, and provides sufficient coverage while the bonds are in the weekly rate mode. For additional information related to the LOC, please see our rating report published 29 April, 2015. In association with the 2008 bonds, the system entered into a swap agreement with Goldman Sachs Group, Inc. (A3). The system pays a fixed rate of 3.6% and receives SIFMA. The mark to market for this swap was a negative $20 million, as of May 2015. The system exposes itself to some interest rate risk. However, we believe this is manageable given the modest debt amount.

Legal Provisions

We believe legal provisions for the bonds are adequate. The bonds include a satisfactory rate covenant of 1.25 times from a three year rolling coverage for prior lien, and 1.1 times for prior subordinate lien and other debt. The system's Series 2013, 2014, and 2015A & B bonds (Current issue) are not supported by a debt service reserve. The debt service reserve fund for the remaining separate lien obligations is funded at one-half average annual debt service, satisfied with a combination of cash and surety bond. The common debt service reserve fund on the prior lien and prior sub lien debt is cash funded, and equal to average annual debt service. The additional bonds test on the separate lien is 1.25 times the average annual debt service requirements.

MANAGEMENT AND GOVERNANCE: ADEQUATE LEGAL PROVISIONS FOR THE BONDS; MANAGEMENT TAKES STEPS TO ENSURE STABLE FINANCIAL PERFORMANCE

We believe management of the city's water and wastewater system will remain stable, demonstrated by appropriate and timely rate setting measures, prudent and conservative budgeting and forecasting of revenues, as well as maintenance of multiyear planning. Moody's notes the establishment of a rate stabilization reserve and more stringent reserve policies are positive influencing factors. Current stable system performance is in part the result of recent management influence which we anticipate will continue in the near-term. Future credit reviews will focus on the impact implemented changes will have on the overall financial performance of the system.

KEY STATISTICS

- Asset Condition: 34 years

- System Size (O&M in 000s): $226,349

- Service Area Wealth (MFI) as a % of US: 101.6%

- Annual Debt Service Coverage: 1.26x

- Days Cash on Hand: 35 days

- Debt to Operating Revenues: 5.43x

- Rate Covenant: 1.25x

- Debt Service Reserve Requirement: No debt service reserve established for current issuance

OBLIGOR PROFILE

The city's owns and operates a water and wastewater system which provides the city, adjoining areas of Travis County (Aaa / Stable outlook) and certain areas of Williamson County (Aa1 / Stable) with water and wastewater services. The city owns and operates all of the facilities. The defined service area totals approximately 544 square miles. For fiscal year 2014 to 2015, the water and wastewater system has approximately 1,147 full-time regular employees.

LEGAL SECURITY

The bonds are secured by a lien on and pledge of the Net Revenues of the Water and Wastewater system.

USE OF PROCEEDS

Proceeds from the sale of Series 2015A and 2015B Bonds will refund certain maturities of the system's outstanding debt for a projected net present value savings in excess of 6.7% with no extension of the final maturity on the bonds.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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