

CREDIT OPINION

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New Issue

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City of Austin Water and Wastewater System, TX

New Issue - Moody's Assigns Aa2 and Revises Outlook on Austin, TX's Water/Sewer Bonds to Stable from Negative

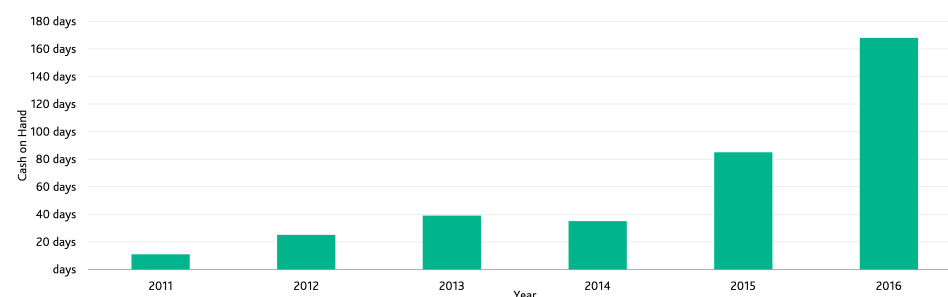
Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to the City of Austin, TX's \$251.8 million Water and Wastewater System Revenue Refunding Bonds, Series 2016. At the same time we affirm the Aa1 rating on prior first lien debt outstanding and the Aa2 ratings on prior subordinate lien and parity separate lien debt outstanding. Concurrently we change the outlook to stable from negative.

The Aa2 rating on the system's separate lien (open lien) reflects strong system characteristics, improving cash and financial metrics bolstered by recent rate increases, and strong rate management and capital planning. The rating also takes into consideration a manageable debt profile and adequate legal provisions for the bonds, with the lack of an established debt service reserve.

Exhibit 1

Significant Improvement in Liquidity Driver Behind Stable Outlook



*Fiscal 2016 year-end cash position estimates based on year-to-date trends.
 Source: Audited Financial Statements

Credit Strengths

- » Expanding service area and customer base
- » Recent rate increases
- » Satisfactory debt service coverage by pledged revenues
- » Improving days cash on hand

Credit Challenges

- » Below average liquidity
- » Historically declining water consumption

Rating Outlook

The stable outlook reflects rate increases that have resulted in a marked improvement in the system's financial performance in 2015 and year to date in 2016, boosting reserves and liquidity to healthier levels than in years past.

Factors that Could Lead to an Upgrade

- » Sustained trend of healthy operating surpluses leading to improved liquidity and debt service coverage
- » Decline in system debt profile
- » Improvement in legal provisions for the bonds

Factors that Could Lead to a Downgrade

- » Poor financial performance leading to a decline or prolonged weakness in reserve levels
- » Weak debt service coverage
- » Significant increase in debt profile

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

Austin Water and Wastewater System, TX

System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	31 years				
System Size - O&M (in \$000s)	221,724				
Service Area Wealth: MFI % of US median	101.6%				
Legal Provisions					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	None for Series 2016 Bonds				
Financial Strength					
	2011	2012	2013	2014	2015
Operating Revenue (\$000)	470,497	446,486	476,869	472,675	522,033
O&M (\$000)	177,474	190,987	216,369	226,349	221,724
Long Term debt ("non-current")	1,905,573	2,236,125	2,309,787	2,466,238	2,374,264
Total Annual Debt Service Coverage (x)	1.88	1.64	1.49	1.26	1.44
Cash on Hand not including Water Reserve Fund	11 days	25 days	39 days	35 days	85 days
Debt to Operating Revenues (x)	4.1x	5.0x	4.8x	5.2x	4.5x

Source: Audited Financial Statements and Moody's Investors Service

Detailed Rating Considerations

Service Area and System Characteristics: Strong system characteristics and growing customer base credit positives for system

The water and wastewater system predominately serves the [City of Austin](#) (GOLT Aaa stable) as well as additional areas in [Travis](#) (Aaa stable) and [Williamson](#) (Aa1 stable) Counties. Lake Travis and Buchanan are the city's two major water supply storage reservoirs and are managed by the Lower Colorado River Authority (LCRA). Combined lake storage is currently at 99%, which is significant when compared to 38% in May of 2015. Heavy rains throughout Texas in the springs months of 2015 helped restore depleted levels. The system owns and operates three water treatment plants and storage and transportation infrastructure. The city has two main wastewater treatment plants with a total combined permitted capacity of 150 million gallons per day.

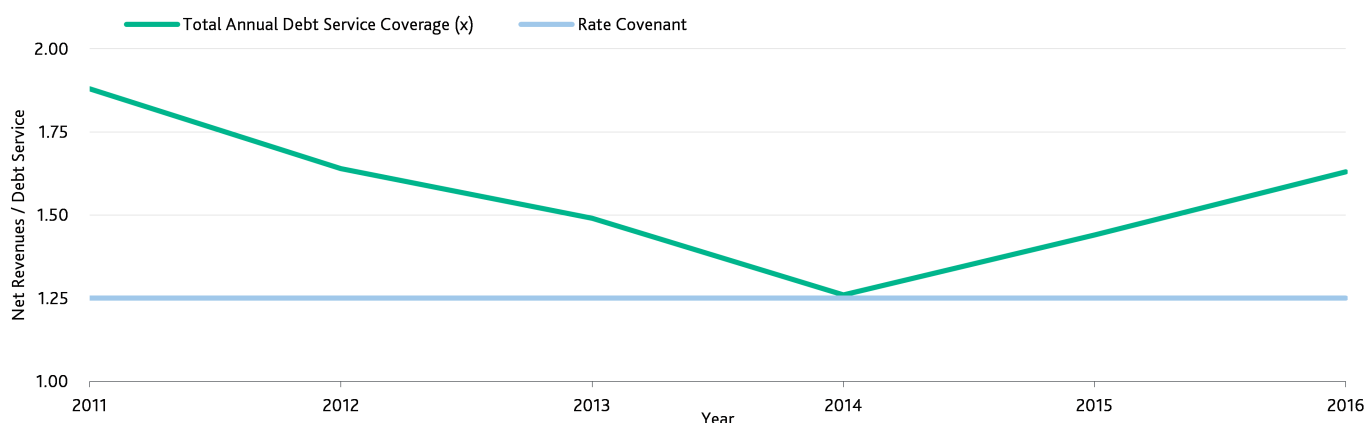
The service area continues to be a strong point for the system. The City of Austin has a growing and vibrant economy. Moody's Economy.com [reported in March 2016](#) that the area will grow at an above-average pace over the coming year. The drivers will be information technology, professional services, travel, and hospitality. In-migration of well-paid professionals will power above average gains in the housing market. Moody's Economy.com also reported that longer term, an especially well-educated labor force, high concentration of technology businesses, and fast population growth will yield above average performance in the economy. As such, we anticipate the system's customer base will remain stable and diverse for years to come. Residential retail customers make up the majority of the customer base while commercial and wholesale customers make up smaller portions. Resident wealth levels 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. [Samsung Electronics](#) Co., Ltd (A1 stable), the University of Texas at Austin, [Freescale Semiconductor](#) Inc. (Baa3), as well as various water and municipal utility districts (MUDs) make up the system's largest water customers. The system's major customers have not changed significantly in recent years and accounted for a modest 6.5% of the system's operating revenues in 2015. The number of customers has risen modestly in each of the last five years yet water consumption has been on a general decline over the past decade, which is significantly impacted by better technology that utilizes less water, and generally more conservative consumption habits.

Debt Service Coverage and Liquidity: Rate Increases Help Boost Below-Average Liquidity; Improving Financial Metrics

Rate increases aided strong financial performance and growth in liquidity in 2015 and further rate increases are expected to maintain improving trends through 2016. 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 November 1st, 2014. In fiscal 2015, operating revenues increased to \$516.9 million from \$472.5 million in the previous year (9%). Close monitoring of expenditures and a hiring freeze allowed for a decline in operating expenditures, further improving fiscal performance. Fiscal 2015 net revenues of the system increased to \$300.3 million from \$246 million, providing 1.44 times coverage of separate lien obligations. This was an improvement over 1.26 times coverage in 2014. The surplus operations also helped more than double the cash portion of the system's operating reserve.

Exhibit 3

Rate Increases and Strong Financial Performance Favorably Impacts Debt Service Coverage



*2016 coverage estimate based on current trends.
Source: Audited Financial Statements

Year-to-date financial metrics remain strong. Following a 4.8% rate increase for water and wastewater service in November of 2015 (fiscal 2016) revenue collections and financial metrics have continued to improve, which contributes to the stable outlook. With the recent rate increase, the average customer's bill was impacted by \$4.94. Given year-to-date trends and continued close monitoring of expenditures, net revenues of the system should rise in fiscal 2016 above 2015 results. Officials anticipate additional growth in days cash on hand and improvement in debt service coverage. Management reports that refunding of outstanding debt as well as use of capital recovery fee revenues for debt defeasance should also benefit the financial performance of the system over time. Also, 2%-3% increases in water and wastewater rates are expected annually over the next five years.

LIQUIDITY

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. Given solid performance in 2015 the cash reserves of the system more than doubled to \$51.8 million from \$21.8 million in the previous year. Additional rate increases and stable revenues for 2016 indicate liquidity will strengthen by fiscal year-end 2016 if trends continue. Officials estimate available cash reserves at year-end of \$101.5 million.

Debt and Legal Covenants: Debt Profile Expected to Remain High

DEBT STRUCTURE

The system's debt profile is high yet manageable. Post-sale the system will have a sizeable \$2.32 billion in total debt outstanding. The majority of the system's debt (\$2.2B) is separate lien debt (open working lien). The system also has roughly \$29 million in Prior First Lien debt and \$137 million in Prior Subordinate Lien debt outstanding.

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.

Payout of principal outstanding is slow with only 35% of debt retired in 10 years. In fiscal 2015 the system's debt ratio was an above-average 65.1%. The system's capital improvement plan calls for \$884.4 million in capital spending over the next five years. Spending is relatively balanced between the water (\$384.4M) and wastewater (\$450.5M) systems. Significant improvements in the plan include South Austin Regional Wastewater Treatment Plant improvements (\$86.2M), Davis Water Treatment Plant improvements (\$65.6M), and infrastructure for advanced metering (\$35M). A healthy portion of the planned spending will be focused on upgrades to existing facilities versus construction of new construction.

DEBT-RELATED DERIVATIVES

System exposure to interest rate risk remains low given the modest variable rate debt amount (roughly 5% of debt profile). 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 stable) 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. In association with the 2008 bonds, the system entered into a swap agreement with Goldman Sachs Group, Inc. (A3 stable). The system pays a fixed rate of 3.6% and receives SIFMA. The mark to market for this swap was a negative \$23.4 million, as of March 31, 2016.

LEGAL PROVISIONS

We believe legal provisions for the bonds are adequate. The rate covenant established in the prior lien ordinance requires 1.25 times for prior lien and separate lien debt, and 1.1 times coverage for outstanding prior subordinate and all other debt. The system's Series 2013A, 2014, 2015A & B bonds, as well as the current issuance are not supported by a debt service reserve. The debt service reserve fund for the remaining debt outstanding is satisfied with a combination of cash and sureties. The additional bonds test on the current issuance is 1.25 times the average annual debt service requirements.

Management and Governance

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 that despite the presence of a debt service reserve, the establishment of a rate stabilization reserve is a positive influencing factor.

Legal Security

The Series 2016 Bonds are secured by a lien on and pledge of the net revenues of the water and wastewater system subordinate in nature to the system's prior first lien debt.

Use of Proceeds

Proceeds from the current debt issuance will refund certain maturities of the system's outstanding debt for a projected net present value savings, as well as take out \$190 million in commercial paper.

Obligor Profile

The City owns all the facilities of the Water and Wastewater System servicing areas in Travis and Williamson Counties. As of September 30, 2015, the Water and Wastewater System had approximately 1,149 full-time regular employees.

Methodology

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

Ratings

Exhibit 4

Austin (City of) TX Water & Wstwr Sys

Issue	Rating
Water and Wastewater System Revenue Refunding Bonds, Series 2016	Aa2
Rating Type	Underlying LT
Sale Amount	\$251,855,000
Expected Sale Date	05/05/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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