



Fitch Rates Lubbock, TX Ser. 2019B Water and Sewer Rev Bonds 'AA-'; Outlook Stable

Fitch Ratings-Austin-01 October 2019: Fitch Ratings has assigned a 'AA-' rating to the following Lubbock, TX (the city) revenue bonds:

--Approximately \$88.1 million water and wastewater system revenue refunding bonds, taxable series 2019B.

The bonds will be sold via negotiation the week of Oct. 7. Proceeds will be used to refund certain outstanding obligations of the city and pay issuance costs.

The Rating Outlook is Stable.

SECURITY

Bonds are payable from a first lien pledge of the net revenues of the city's water and sewer system (the system).

KEY RATING DRIVERS

STABLE FINANCIAL MARGINS: The system has consistently posted strong cash balances, finishing with over one year of cash on hand since fiscal 2014. The system's all-in debt service coverage (DSC) has ranged from 1.4x-1.7x over the past five years, despite continued increases in annual debt service requirements. While stable, these levels are notably weaker than Fitch's 'AA' median of 2.5x.

ELEVATED BUT DECLINING LEVERAGE: Substantial capital spending historically has resulted in an elevated debt profile; with debt-per-customer of approximately \$3,261 in fiscal 2018 (Fitch's AA median is \$1,731). However, over the last five years, debt metrics are declining, with funds available for debt service (FADS) now registering at 5.7x compared to Fitch's 'AA' median of 5.2x and down from 8.5x in 2015. System leverage is expected to continue to decline over the next five years as a result of rapid amortization and expected lower capital improvement plan (CIP) spending despite planned borrowing for capital investment.

STRONG OPERATING PROFILE: The system has spent extensively in its infrastructure and supply, which has contributed to the elevated debt metrics. Favorably, this investment has also resulted in a low average age of plant of just 13 years compared to Fitch's 'AA' median of 16 years.

LIMITED RATE FLEXIBILITY: Capital investment to shore up supply over the years has led to high rates, thus potentially limiting future-rate raising ability. However, further rate increases are expected to be incremental to flat.

GROWING LOCAL ECONOMY: The city of Lubbock serves as a regional hub for the Texas panhandle region and is home to Texas Tech University with enrollment of over 38,000. Local economic prospects are mostly sound with continued moderate growth and low unemployment being somewhat offset by elevated poverty rates and below-average median household income (MHI), the latter two likely due, in part, to the large student population.

RATING SENSITIVITIES

CHANGES IN LEVERAGE: Continued improvement of financial performance, coupled with declining leverage and capital spending could result in upward rating momentum over time. Conversely, acceleration of debt issuance that significantly increases the system's debt burden and weakens financial margins could pressure the rating down.

CREDIT PROFILE

The system serves a steadily growing population presently estimated at over 253,000 via approximately 88,000 water and 82,000 sewer connections. Water is supplied from both city-owned sources and through long term take-or-pay contracts with the Canadian River Municipal Water Authority (CRMWA). Sewer flows are treated at two wastewater treatment plants also owned by the city.

MIXED FINANCE RESULTS

System financial results are mixed, with strong cash balances yet below-average all-in debt service coverage (DSC) on system-supported debt. Fiscal 2018 finished higher than prior years with all-in DSC of 1.7x but still weaker than Fitch's 'AA' category median of 2.5x. Favorably, DSC has remained relatively stable despite growing debt carrying costs, averaging 1.5x over the past five years. DSC including transfers out is even lower at just 1.4x in fiscal 2018. Liquidity remains stable and strong, continuously registering at greater than one year of cash on hand for the last five years.

ABOVE AVERAGE LEVERAGE TO DECLINE

The system's debt burden as of fiscal 2018 totals over \$550 million and includes over \$440 million in COs and more than \$40 million of CRMWA contract revenue bonds. Payments made under contracts with CRMWA are paid as operating expenses of the city and paid prior to system relate debt.

Leverage metrics in fiscal 2018 were elevated compared to Fitch 'AA' medians with debt-per-customer of approximately \$3,261 vs. Fitch's 'AA' median of \$1,731, debt to net plant of 58% vs. Fitch's 'AA' median of 46%, and a slightly elevated debt to funds available for debt service of 5.7x vs. Fitch's 'AA' median of 5.2x. However, due to rapid amortization, the overall debt burden is expected to continue to improve over next five years, with debt-per-customer declining to a still elevated \$2,474.

REDUCED CAPITAL SPENDING EXPECTED

The system's 2020-2024 CIP totals about \$198 million with more than 70% of the plan dedicated to be water-related projects. It is expected that about 70% of the plan will be debt financed with water and sewer system revenue bonds. Annual CIP costs peak at over \$76.8 million in 2020 and decline rapidly thereafter. This is down measurably from annual capital spending of over \$70 million in fiscal years 2015 to 2017.

Long range capital plans could increase again in the intermediate future due to the city's participation in a water supply project with CRMWA referred to as CRMWA II, meant to increase water supply. Specific timing and financing related to CRMWA II has yet to be determined and could possibly be deferred if water demand remains moderate.

DIVERSE WATER SUPPLY; SOLID TREATMENT CAPACITY

System water is supplied from a various sources that include groundwater and surface water. Over 60% of water is supplied from CRWMA sources to primarily northern parts of the city. The city-owned sources of the Bailey County well field (ground water) and Lake Alan Henry (surface water) provide the remaining supply to the south side of the city. The city will be investing in capital projects to interconnect the northern and southern water supplies.

All water is treated locally by one of the city's two water treatment plants with total permitted capacity of 80 million gallons daily (mgd), well in excess of average demand of 34 mgd. The city owned wastewater treatment plants have permitted capacity of over 34 mgd, with sufficient capacity to treat annual flows of 19 mgd.

ELEVATED RATES

Assuming Fitch's standard usage assumption of 7,500 and 6,000 gallons per month for water and wastewater, respectively, combined customer bills are approximately \$93 per month or 2.3% of MHI. Rates are elevated among regional peers and thus could limit future rate-raising ability. However, further rate increases are expected to be incremental to flat.

REGIONAL ECONOMIC HUB

The city of Lubbock (IDR AA+) is located in northwest Texas, serving as the retail/trade, educational, and health care hub for the surrounding, largely rural, region. Health care, education, and government comprise the area's largest non-agricultural employment sectors. Local educational attainment levels are comparable to those of the U.S. due in part to the outsized presence of Texas Tech University. Unemployment rates are low, sitting slightly below state and national averages. MHI is lower than the state and nation. The lower-than-average MHI and higher poverty rates are likely driven in part by the large student population.

ESG CONSIDERATIONS

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

A January 2018 district court ruling that dismissed claims regarding payment of Puerto Rico Highways and Transportation Authority debt has raised questions about the scope of protections provided by Chapter 9 of the U.S. bankruptcy code to bonds secured by pledged special revenues. Fitch's rating criteria treat special revenue obligations as independent from the related municipality's general credit quality. The outcome of the litigation could result in modifications to Fitch's approach. For more information, see "What Investors Want to Know: The Impact of the Puerto Rico Ruling on Special Revenue Debt" available at www.fitchratings.com.

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Additional information is available on www.fitchratings.com
Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt -- Effective Feb. 26, 2018 to May 27, 2019 (pub. 26 Feb 2018)
U.S. Water and Sewer Rating Criteria (pub. 29 Nov 2018)

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