

RatingsDirect®

Summary:

Lubbock, Texas; Water/Sewer

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Summary:

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Credit Profile		
US\$88.07 mil wtr & wastewtr sys rev rfdg bnds ser 2019B dtd 10/15/2019 due 02/15/2034		
<i>Long Term Rating</i>	AA-/Stable	New
Lubbock wtr and wastewtr sys rev imp and rfdg bnds		
<i>Long Term Rating</i>	AA-/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Lubbock, Texas' series 2019B water and wastewater system revenue refunding bonds. The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and a strong financial risk profile. The outlook is stable.

The enterprise risk profile reflects our view of the system's:

- Location in the economic anchor of the Texas Panhandle and an engine of its namesake's broad and diverse metropolitan statistical area (MSA);
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable rates even with income indicators that are below average, although that reflect a very large student populace and
- Good operational management practices which include a comprehensive long-term water management plan.

The financial risk profile reflects our view of the utility system's:

- Overall adequate all-in debt service coverage (DSC);
- Extremely strong liquidity and reserves;
- Moderate debt levels in relation to regional peers with approximately \$466 million debt outstanding when including this issuance; and
- Strong financial management practices.

Proceeds from the series 2019B bonds will be used to refund a portion of the utility system's outstanding debt and paying for the cost of issuance.

The system's first-lien pledge of net revenues generated from water and sewer system operations secure the bonds. We believe bond provision are adequate, with a rate covenant equal to 1x annual parity debt service (maximum annual debt service [MADS]) and an additional bonds test equal to 1.25x maximum annual parity debt service. A debt service reserve funded at MADS will provide additional liquidity for the bonds.

Enterprise risk

Our assessment of the utility system's enterprise risk profile is very strong, reflecting our view of its affordable rates even with income indicators that are below average, although that reflect a very large student populace, as well as the city serving as an economic anchor of the Texas Panhandle and engine of its broad and diverse MSA and good operational management framework.

Lubbock provides retail drinking water and sanitary sewer service to about 85,000 mostly residential metered accounts, as well as outside-city, wholesale, and emergency interconnect services to a number of small surrounding communities. The city, about 300 miles west of Dallas and about the same to Oklahoma City, anchors a total population in Lubbock, Crosby, and Lynn counties of nearly 300,000. It is anchored by a number of higher education institutions, including Texas Tech University, Lubbock Christian University, Wayland Baptist University, and South Plains College. Nearly 20% of the total population are undergraduate and graduate students, which acts as a stabilizing presence but also skews income indicators below average; median household effective buying income (MHHEBI) for the city is 85% that of the U.S., although the unemployment rate is extremely low at 2.8% as of December 2018. The utility system does not depend on any of its principal customers for operating revenues, as the 10 largest customers account for about 5% of total operating revenues.

The city has a diverse raw water supply that includes both groundwater and surface water, and both city-owned facilities and access to the Canadian River Municipal Water Authority (CRMWA), of which Lubbock is a member city and has an allocable share of 37%. CRMWA's Lake Meredith has been particularly susceptible to the persistent drought in recent years. Earlier in the decade, the authority made a substantial purchase in Roberts County to secure a long-term groundwater supply, although the delivery infrastructure is not planned to be in place until the next decade. Until then, the city has relied on its owned facilities and groundwater from Bailey County and Lake Alan Henry. It also recently brought online a 15-million gallon-per-day advanced secondary wastewater treatment plant, effluent from which will eventually be used to supply a planned city-owned lake for which Lubbock has already sited. Management's long-term goal is to use surface water almost exclusively, with the wells serving peak needs or contingencies in the event of severe drought.

Lubbock has had in place robust drought management and water conservation plans for years, as well as a rate structure that encourages water conservation with pricing signals. Currently, the average water and sewer bill for city residents is about \$92, based on an average household consumption of 7,000 gallons monthly. The rates are reviewed annually based on recommendations rooted in a comprehensive external rate study, and the management conducts internal rate reviews every fiscal year. The rates are affordable even with income indicators that are below average, although that reflect a very large student populace. The average water and sewer bill constitutes about 2.7% of the MHHEBI level.

Based on our operational management assessment, we view the water system as a '2' on a six-point scale with '1' being the strongest. An assessment of good, in our view, implies that the system's operational practices and policies are good and primarily comprehensive. The city has an informal succession plan in place. There are also state-approved and comprehensive drought and disaster management plans in place. The city conducts periodic external rate studies which are used in rate considerations during budgeting.

Financial risk

Our assessment of the utility system's financial risk profile as very strong reflects our view of the city's extremely strong liquidity position, strong financial management framework, and strong coverage levels, coupled with debt levels which we view as moderate in relation to those of regional peers.

All-in coverage is S&P Global Ratings' adjusted DSC metric that treats certain recurring financial obligations as if they were debt; in Lubbock's case, we incorporate the water and sewers portion of the city's general obligation (GO) debt and capital leases. We also make an adjustment to include transfer payments to the general fund for administrative costs, franchise fees, and payments in lieu of taxes (PILOTs) since we view them as a recurring use of utility revenues and exclude the transfers for the capitalization of equipping them. We also include the city's minimum payments to CRMWA as a fixed-cost expense of the utility. All-in coverage for Lubbock has risen from about 1.02x in fiscal 2016 to 1.22x in fiscal 2018. The increase has been due to the management of rates on the part of the system. We expect the coverage levels to remain in the above-mentioned range in the near future. We consider the city's current coverage performance adequate.

Liquidity is another identified strength of the system. In the previous three audited fiscal years, unrestricted cash and investment have climbed from \$44.1 million in fiscal 2016 to just under \$50.4 million in fiscal 2018; the current unrestricted cash position is equivalent to about 298 days' cash on hand. The city's internal policies require management to maintain a minimum of 25% operating expenditures as reserves.

The city has approximately \$466 million of debt outstanding when including this issuance, consisting of revenue and GO bonds allocated to the water and sewer fund. The debt-to-capitalization ratio was just under 48%. The city participates in the hybrid defined-benefit pension plan administered by the Texas Municipal Retirement System. The funding ratio of the plan was about 81.5% for year 2017.

Based on our financial management assessment (FMA), we view the city as a '2' on a six-point scale, with '1' being the strongest. An FMA of good indicates our view that practices are good, well embedded, and likely sustainable. Management reports monthly financial activities to the city council. A five-year financial forecast is updated annually as a part of the budget development process. The city prepares five-year capital improvement plan, which is updated on annual basis. There is a codified investment policy in place, and city maintains a minimum of 25% operating expenditures as reserves. In addition, it maintains a codified and detailed debt management policy. Management also produces annual audited financial statements that comply with generally accepted accounting principles (GAAP).

Outlook

The stable outlook reflects our expectation that coverage of both revenue bond and self-supporting GO debt service will remain adequate as Lubbock addresses its capital needs, coupled with our expectation that its role as a strong regional economic center and favorable operational profile will continue. A willingness to increase rates and maintenance of extremely strong liquidity also support the outlook.

Upside scenario

The key to a higher rating, in our view, would be maintaining the steady improvement to the system's all-in DSC and liquidity. Generally, peer 'AA' or higher ratings demonstrate sustained all-in DSC of around 1.4x or better and available reserves equivalent to four-to-five months of operating expenses, all other things being equal.

Downside scenario

Although unlikely given the overflow initiative already in place with the state, downward pressure on the rating would realistically most likely come from some kind of unfunded mandate or massive upsizing to the CIP that usually also comes with a very large increase in both the use of debt and rates, that can often weaken the overall financial profile.

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