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Contacts

Heather Correia +1.214.979.6868
Analyst
heather.correia@moodys.com

Edward (Ted) Damutz +1.212.553.6990
VP-Sr Credit Officer
edward.damutz@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Las Cruces (City of) NM Combined Enterprise

Update following assignment of initial subordinate lien rating of Aa3

Summary

Las Cruces Combined Enterprise has a stable credit profile overall. The system serves a large, diverse customer base, which is anchored by military installations and institutions of higher education. While net revenues have fluctuated historically, they have always provided debt service coverage in excess of covenants. Positively, the city plans to implement two large rate increases over the near-term, which should result in improved coverage levels and cash reserves. Legal provisions on both senior and junior lien debt provide adequate bondholder security.

Credit strengths

» Stable base; limited concentration in top five utility customers

» Water rate adjustments rolling out in fiscal 2018

Credit challenges

» Average debt service coverage for the rating category

» Below average socioeconomic profile

Rating outlook

Moody's generally does not assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

» Sustained trend of increasing debt service coverage

» Significant increase in unrestricted reserves

Factors that could lead to a downgrade

» Declining net revenues leading to decreased debt service coverage levels

» Deterioration of unrestricted reserves; further leveraging of the revenue stream

Key indicators

Exhibit 1

Las Cruces, NM Combined Enterprise					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	28 years				
System Size - O&M (in $000s)	$49,498				
Service Area Wealth: MFI % of US median	78.1%				
Legal Provisions					
Rate Covenant (x)	1.25x ADS				
Debt Service Reserve Requirement	DSRF funded at lesser of standard 3-prong test (Aa)				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2013	2014	2015	2016	2017
Operating Revenue ($000)	$51,635	$52,410	$50,012	$47,910	$59,764
System Size - O&M ($000)	$41,404	$42,485	$41,274	$40,724	$49,498
Net Revenues ($000)	$10,265	$12,953	$13,028	$11,057	$11,362
Net Funded Debt ($000)	$54,015	$49,865	$53,050	$65,445	$82,365
Annual Debt Service ($000)	$6,121	$6,104	$6,216	$6,771	$7,240
Annual Debt Service Coverage (x)	1.7x	2.1x	2.1x	1.6x	1.6x
Cash on Hand	285 days	321 days	322 days	416 days	255 days
Debt to Operating Revenues (x)	1.0x	1.0x	1.1x	1.4x	1.4x

Note: The rate covenant is for the senior lien debt; the junior lien debt provisions calls for 1.15x ADS. Likewise, annual debt service coverage is for senior lien only; junior lien debt does not come online until fiscal 2019. Days cash on hand jumped up in fiscal 2016 due to the incorrect classification of bond proceeds, and error that was corrected in fiscal 2017.
Source: City's CAFRs; Moody's Investors Service

Profile

The joint utility system provides water, sewer, and gas service to the City of Las Cruces (Issuer LT Aa2), which is located about 45 miles north of City of El Paso, TX and is the second largest city in New Mexico (Aa1 negative). The local economy is anchored by New Mexico State University (A1 stable) and White Sands Missile Range, which are the largest employers in the area with 6,500 and 4,500 employees, respectively.

Detailed credit considerations

Service area and system characteristics: joint utility system serves stable customer base in southern New Mexico

The utility system benefits from a diverse and stable local economy. Las Cruces has water rights of 21,869 acre-feet per year and water is supplied by 41 wells that tap the Mesilla and Jornada del Muerto Bolsons aquifers that are interconnected with the Rio Grande stream system. Water system capacity is approximately 27.5 million gallons per day (MGD) with storage capacity of 257.9 million gallons, which is sufficient to meet average daily consumption of 16.01 million gallons per day (MGD) and peak consumption of 20.52 MGD in the summer. As the city continues expanding, officials are focused on ensuring there is enough water to meet demand. In that vein, the city purchased Jornada Water System, and its water rights to 5,961 acre-feet, with Series 2016 bond monies. The privately-owned system serves 3,500 customers inside and outside city limits on the East Mesa, Mesilla Park area and Las Alturas. With the recent acquisition, officials report that they now have the water necessary to serve the city for the next 50 to 60 years.

The wastewater system includes three treatment plants with a combined capacity of 14.9 MGD. The Jacob A. Hands wastewater treatment plant is the system's primary treatment facility with 13.5 MGD capacity. One smaller plant serves the city's West Mesa

Industrial Park and a second small plant is used to collect and treat wastewater solely for use in irrigation. Officials report that the water and wastewater systems are in compliance with state and federal regulations. The gas system connects to El Paso Natural Gas Company lines located 18 miles south of the city and distributes gas to customers through over 1,000 miles of gas lines. The majority of natural gas supply (90%) is purchased from Shell Energy under a daily swing purchase contract and the balance is purchased from New Mexico Municipal Energy Acquisition Authority.

The joint utility system provides water, sewer, and gas service to the City of Las Cruces (Issuer LT Aa2), which is located about 45 miles north of City of El Paso, TX and is the second largest city in New Mexico. The local economy is anchored by New Mexico State University and White Sands Missile Range, which are the largest employers in the area with 6,500 and 4,500 employees, respectively. Income indices are below average, in part due to the large student population, with median family income of 78.1% of the US (2015 ACS). Likewise, the October 2017 unemployment rate is somewhat elevated at 6% compared to the nation’s 3.9%.

Given institutional presence, the city's customer base will likely remain stable over the mid-term. The joint utility system has a total of 35,099 water customers, 34,048 sewer customers, and 40,391 gas customers. Modest customer growth continues in region, with year-over-year growth of 3.3% across the system. The customer base is diverse with the largest customers representing only a small portion of total revenues. The gas system has the highest customer concentration with the top five customers accounting for a still modest 6.9% of total fiscal 2017 revenues (unaudited). The top five customers of the water and sewer systems each made up less than 1% of fiscal 2017 total system revenues (unaudited).

Debt service coverage and liquidity: average coverage and liquidity metrics

The city's debt service coverage and liquidity levels are expected to remain stable, if not improve, over the near-term with the implementation of rate increases. In fiscal 2017, the city purchased the Jornada Water System, which resulted in increased operating revenues (additional customers) and expenditures (additional personnel). Net revenues of the system, including water, sewer and gas, as calculated by Ordinance, were $11.4 million, which provided 1.57 times senior lien annual debt service (ADS) and 1.42 times maximum annual debt service (MADS). While the system is in compliance with its covenants, coverage is average compared to Aa2-peers.

The fiscal 2018 budget anticipates net revenues to increase to $12.2 million, driven by additional revenues from the Jornada Water System. If realized, senior lien ADS coverage will decline slightly to 1.55 times, but MADS coverage will improve to 1.52 times.

In fiscal 2019, the city plans to implement a water rate adjustment of around 24%, which will generate an additional $3.8 million in annual revenues. As such, net revenues are expected to increase to $16 million, which will provide 1.99 times senior lien ADS and MADS coverages. In addition, fiscal 2019 is the first year of junior lien debt service. Considering total ADS of $8.5 million and total MADS of $9.6 million, net revenues will provide 1.88 times and 1.66 times coverage, respectively.

Officials report that the city is currently engaged in a wastewater rate study, which is expected to go into effect in fiscal 2020. Outside of these larger base-rate adjustments, the city utilizes annual “rate riders” to ensure maintenance of coverage levels. Officials prudently set rates to include debt service coverage and reinvestment in the system at annual depreciation levels, as well as the standard utility basis rate of return (3.5%). Given these policies, Moody's anticipates that coverage of both senior and total debt service to remain stable over the mid-term.

LIQUIDITY

The system's net cash position is adequate for the rating category. In fiscal 2017, unrestricted cash totaled $34.6 million, or 255 days cash on hand (DCOH). Cash has declined slightly from its peak of 322 DCOH (fiscal 2015), which officials attribute to one-time capital investment. It is expected that with the upcoming rate adjustments, the city will add to its cash reserves.

Debt and legal covenants: slightly leveraged revenue stream; subordinate lien legal provisions are adequate, if weaker than senior

The system's debt burden will likely remain manageable over the mid-term given limited borrowing plans coupled with average payout. Including the junior lien bonds, total debt to operating revenues is around 1.75 times. The city maintains a five-year capital improvement plan, and expects to fund future infrastructure with cash reserves and bond proceeds. Management is considering another borrowing in late 2018 or 2019, but the amount and lien is undetermined at this time.

Legal provisions are adequate. Specific to the senior lien obligations, the rate covenant requires 1.25 times coverage of annual debt service. A debt service reserve will be funded with a surety reserve at the lesser of 125% of average annual debt service, maximum annual debt service, or 10% of par. The additional bonds test requires that historical net revenues provide at least 1.25 times coverage of maximum annual debt service on outstanding and proposed. Legal provisions of the subordinate lien obligations are similar to the senior, if slightly weaker. The rate covenant requires 1.15 times coverage of annual debt service. A debt service reserve will be funded with a surety reserve at the lesser of 125% of average annual debt service, maximum annual debt service, or 10% of par. The additional bonds test requires that historical net revenues provide at least 1.15 times coverage of maximum annual debt service on outstanding and proposed debt.

DEBT STRUCTURE

The system has $104.9 million of outstanding revenue bonds, $82.4 million in senior a d $22.5 million in junior. Total ten year payout is average at around 62%. All debt retires by fiscal 2038.

DEBT-RELATED DERIVATIVES

All debt outstanding debt is fixed rate and the system is not party to any interest rate derivatives.

PENSIONS AND OPEB

Moody's does not maintain an ANPL for the system. In fiscal 2017, the city allocated $13.2 million of its pension liability to its utility enterprise, which represents an elevated 22% of total operating revenues of the system.

Management and governance: city has sole-rate setting authority

The joint utility is managed by an independent seven-member board. This board is authorized to develop strategic policy and make rate recommendations, which are considered by the City Council for adoption, and can be remanded to the board for strategic guidance. Water, gas and sewer rates are reviewed periodically, and management anticipates water rate adjustments to be implemented in fiscal 2019. A wastewater rate study is underway.

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