

## CREDIT OPINION

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New Issue

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# Albuquerque Bernalillo County Water Utility Authority (ABCWUA), NM

New Issue - Moody's Assigns Aa2 to ABCWUA, NM's \$89.5M Senior Lien Joint Water & Sewer Rfdg & Rev Bonds, Ser. 2017

## Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 to Albuquerque Bernalillo County Water Utility Authority (ABCWUA), NM's \$89.5 million Senior Lien Joint Water and Sewer System Refunding and Improvement Revenue Bonds, Series 2017. Concurrently, Moody's has affirmed the Aa2 on \$497.4 million in outstanding parity obligations and the Aa3 on \$77.6 million in outstanding subordinate lien obligations. The outlook is stable.

The Aa2 reflects the Authority's improving debt service coverage levels and healthy cash position, both a result of recent, consistent rate adjustments. The rating also incorporates the system's large and diverse customer base; aging facilities that require substantial capital investment; supply capacity that can serve the population over the long-term; adequate legal provisions; and an elevated debt burden with plans to issue in the next 24 months. The Aa3 subordinate lien rating reflects the junior nature of the pledge and weaker legal provisions.

## Credit Strengths

- » Sizable service area with substantial long-term supply
- » Stability of customer base from government and higher education institutions
- » Healthy cash position and improved debt service coverage, a result of consistent rate increases

## Credit Challenges

- » Aging assets that require significant future investment
- » Historical violation of rate covenants

## Rating Outlook

The stable outlook reflects our expectation the Authority will maintain satisfactory reserves and debt service coverage, supported by regular rate increases and a stable customer base.

## Factors that Could Lead to an Upgrade

- » Continued trend of improved debt service coverage ratios
- » Maintenance of ample unrestricted cash reserves

- » Improved asset condition

## Factors that Could Lead to a Downgrade

- » Significant reduction in days cash on hand
- » Failure to maintain debt service coverage above debt covenants

## Key Indicators

Exhibit 1

ABCWUA, NM					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	15 years				
System Size - O&M (in \$000s)	121,040				
Service Area Wealth: MFI % of US median	95.0%				
Legal Provisions					
Rate Covenant (x)	Senior 1.33x ADS / Junior 1.2x ADS				
Debt Service Reserve Requirement	No DSRF				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue (\$000)	177,055	179,678	182,350	192,312	218,128
O&M (\$000)	100,609	108,349	113,933	114,060	121,040
Long-Term Debt (\$000)	690,059	644,919	646,965	736,890	679,986
Annual Debt Service Coverage (x)	1.32	1.24	1.20	1.36	1.78
Cash on Hand	150 days	15 days	74 days	220 days	305 days
Debt to Operating Revenues (x)	3.9x	3.6x	3.5x	3.8x	3.1x

Operating Revenues exclude contributions and Operating Expenses include costs associated with capital repairs. Annual debt service coverage is based on principal and interest expense as reported in the audit.

Source: Authority's CAFRs; Moody's Investors Service; Official Statements

## Detailed Rating Considerations

### Service Area and System Characteristics: Large Service Area; System Capacity Sufficient to Serve Population

ABCWUA's customer base and service area will likely remain stable over the long-term given the essential nature of the Authority, which provides water and sewer to one-third of the state's population. Furthermore, the service area is anchored by presence of government and higher education institutions, such as [University of New Mexico](#) (Aa2 negative), [Central New Mexico Community College](#) (Aa1), Kirtland Air Force Base, and Sandia National Laboratory. The Authority was created during the 2003 State Legislative Session to provide a regional approach to water management. The system serves the [City of Albuquerque](#) (Aa1 stable) and [Bernalillo County](#) (Aaa stable), which translates to approximately 660,000 residents, or 208,000 water connections and 193,000 sewer connections (fiscal 2016). Wealth indices are average, with median family income of 95% of the US per the 2013 American Community Survey. The region's unemployment rate of 6.2% (September 2016) is slightly better than the state's 6.7%, but elevated compared to the nation's 4.8%.

The ten largest customers account for a modest 10.4% of water system revenues and 6.5% of wastewater system revenues and include a mix of government and private enterprise. The Authority's current treatment capacity is expected to be sufficient for the medium to long term, with adequate well production capacity of 294 million gallons per day (MGD) and maximum historical peak day demand of

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214 MGD. Additional capacity of 90 MGD is available from the San Juan-Chama Drinking Water Project. Water loss is minimal at 6.4% in 2015, down from 10.5% in 2011. Between groundwater from the Rio Grande basin aquifer (44.2% of total consumption), and surface water from the San Juan-Chama (54.8% of total consumption), the Authority believes they can support into perpetuity a population of up to 1,000,000 utilizing 135 gallons per capita per day. The current population of 660,000 use approximately 127 gallons per capita per day. ABCWUA's 100-year water plan indicates a goal usage of 110. The lack of supply challenges is positive for the credit.

ABCWUA's wastewater treatment plant capacity is based upon 76 MGD hydraulic capacity, and existing flows are approximately 52 MGD. Officials report the chlorination and dechlorination systems have been recently decommissioned, and have been replaced with a new ultraviolet disinfection system.

The Authority's facilities are aged, with remaining useful life, as calculated by Moody's, of roughly 15 years, low compared to peers. ABCWUA's ten-year CIP outlines investment of \$600 million to \$700 million in rehab through fiscal 2025, which will be funded with excess cash (generated through biennial rate increases) and debt.

### **Debt Service Coverage and Liquidity: Improving Coverage and Liquidity Driven by Annual Rate Increases**

The Authority's financial position has improved significantly since fiscal 2011 (when in violation of rate covenants), a result of annual rate increases and modestly increasing customer counts. ABCWUA implemented 5% rate increases in fiscal 2012, 2014, 2015 and 2016, with another planned for fiscal 2018. Operating revenues increased in tandem, from \$158.5 million to \$234.8 million. As such, in fiscal 2015, net revenues of \$96.2 million (as calculated by ordinance, which includes contributions and excludes capital expenses) provided senior lien annual debt service (ADS) coverage of 1.45 times and total ADS coverage of 1.36 times. This differs from the Authority's calculations, which are based on debt service net of capitalized interest. Thus, ABCWUA reports senior lien ADS coverage of 2.03 times and total ADS coverage of 1.88 times. In fiscal 2016, revenues increased again, a result of the rate increase that effectively offset a decline in consumption. Net revenues of \$119.9 million resulted in senior lien ADS coverage of 1.96 times and total ADS coverage of 1.60 times. Per ABCWUA's calculations, senior lien ADS coverage was 2.22 times and total ADS coverage was 2.03 times. When considering revenues and debt service as reported in the audit (and presented in Exhibit 1 above), Moody's calculates ADS coverage of 1.36 in fiscal 2015 and 1.78 times in fiscal 2016.

Based on pro-forma projections from fiscal 2017 through fiscal 2021, management is assuming net revenues will result in senior lien ADS coverage of between 1.6 times and 1.8 times. Total ADS coverage, inclusive of both subordinate and super subordinate obligations, is expected to be between 1.4 times and 1.5 times. Furthermore, net revenues in the next five years should provide anywhere from 1.3 to 1.6 times maximum annual debt service (MADS) coverage.

Moody's recognizes the Authority's stabilized position, with recent coverage in excess of covenants. However, the ratios remain below average compared to peers. Future reviews will focus on ABCWUA's ability to maintain, if not strengthen, coverage levels.

### **LIQUIDITY**

Through rate increases, unrestricted cash has significantly improved since fiscal 2013 when the Authority reported \$4.4 million, or 15 days cash on hand (DCOH). Fiscal 2016 cash was a healthy \$101.2 million, or 305 DCOH. Moving forward, cash reserves may decline marginally as the Authority invests in capital. Additionally, the Authority has established and maintained a rate reserve/stabilization fund, which is included in the unrestricted cash balance. At fiscal 2016 year-end, the fund had \$6 million. Officials expect to add another \$2 million in fiscal 2017. Management has not determined a target balance as of now.

### **Debt and Legal Covenants: Elevated Debt Burden; Additional Issues Planned**

The Authority's debt profile is leveraged, with a burden of 3.1 times fiscal 2016 operating revenues (inclusive of the Series 2017 bonds) and will likely remain leverage given future borrowing plans. The next bond issuance is expected in 2019. As discussed above, the Authority anticipates capital investment of \$600 million to \$700 million through fiscal 2025. Officials expect to take advantage of ongoing principal retirement (70% in ten years), layering in new debt without ballooning the Authority's burden.

The Authority has pledged to set and maintain rates sufficient to pay operations and maintenance expenses of the System and provide coverage of annual debt service of 1.33 times senior lien and 1.20 times subordinate lien debt. Bondholder security is enhanced by an additional bonds test equal to 1.33 times senior lien and 1.20 times subordinate lien on the maximum annual debt service on all parity obligations outstanding. The authority has no surety or debt service reserve nor is there a trigger to create a debt service reserve fund. The legal covenants are considered adequate despite the lack of a debt service reserve.

**DEBT STRUCTURE**

Post-sale, the Authority will have approximately \$673 million in outstanding revenue bonds, with \$586 million considered senior, \$85.5 million considered subordinate and an expected \$1.1 million considered super subordinate. Debt service is descending, with MADS of \$83.1 million occurring on July 1, 2018 (fiscal 2019). All debt matures by July 1, 2038 (fiscal 2039).

**DEBT-RELATED DERIVATIVES**

All outstanding debt is fixed rate and the Authority is not party to any derivative agreements.

**PENSIONS AND OPEB**

The authority has a manageable employee pension burden, based on unfunded liabilities for its share of the Public Employees Retirement Association (PERA), a cost sharing plan administered by the state. In fiscal 2016, the Authority's contributions totaled \$6.4 million, which represents a nominal 5.3% of operating expenses. Moody's does not calculate an adjusted net pension liability for the Authority; however, per GASB 68, the system reported a \$38.2 million pension liability, or a manageable 0.2 times operating revenues.

**Management and Governance**

ABCWUA is managed and operated by an eight member board, consisting of three Bernalillo County Commissioners, three Albuquerque City Councilors, the Mayor of Albuquerque and a Village of Los Ranchos de Albuquerque Trustee (as an Ex Officio member). Authority management is responsible for day-to-day operations of the system, policy, system expansion, budget, rates, personnel reorganizations, unbudgeted intra-year positions, negotiation or renegotiation of labor contracts and litigation relating to the system.

Since violating covenants in 2011, the Authority has implemented several rate increases, with further adjustments planned moving forward. As such, we would consider ABCWUA's rate setting record as strong, assessed as Aa. ABCWUA can set rates independently.

ABCWUA has strong regulatory compliance and capital planning, assessed as Aa. The authority fully addressed minor compliance issues in 2015 and maintains a 10-year capital improvement plan (CIP) and 100-year water plan. Despite significant investment needed to improve aging facilities, the 10-year CIP remains manageable given future rate increases planned.

**Legal Security**

The Series 2017 bonds are secured by a senior lien on the net revenues of the system.

**Use of Proceeds**

Of the \$89.5 million being issued, \$26.4 million will be used to advance refund selected maturities of the Series 2009A-1 bonds for net present value savings of \$2 million or 7.4%. The remaining \$63.1 million will be used for basic capital needs.

**Obligor Profile**

ABCWUA is a large water and sewer utility located in Bernalillo County and serves roughly 660,000 residents in the Albuquerque metro area.

**Methodology**

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 2

### Albuquerque Bernalillo Cnty Wtr. Utl Auth, NM

Issue	Rating
Senior Lien Joint Water and Sewer System Refunding and Improvement Revenue Bonds, Series 2017	Aa2
Rating Type	Underlying LT
Sale Amount	\$89,490,000
Expected Sale Date	01/25/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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