

# RatingsDirect®

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## Summary:

## Lubbock, Texas; Water/Sewer

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## Table Of Contents

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Rating Action

Stable Outlook

Credit Opinion

## Summary:

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### Credit Profile

US\$43.85 mil wtr & wastewtr sys rev bnds ser 2020A dtd 06/01/2020 due 02/15/2040

<i>Long Term Rating</i>	AA-/Stable	New
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Lubbock wtr and wastewtr sys rev imp and rfdg bnds

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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## Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Lubbock, Texas' series 2020A water and wastewater system revenue refunding bonds. At the same time we have affirmed our 'AA' rating on the city's outstanding revenue debt. The rating reflects, in our opinion, the combination of very strong enterprise and financial risk profiles. The outlook is stable.

### Credit overview

Net revenues of the water and sewer system secure the approximately \$43.85 million series 2020A bonds. After the issuance, Lubbock will have approximately \$507.9 million in outstanding debt. Officials intend to use series 2020A bond proceeds to pay the costs of acquiring, purchasing, constructing, improving, renovating, and enlarging and equipping property, buildings, structures, facilities, and related infrastructure for the system. Lubbock indicates it has not entered into any direct-purchase bank debt. The stable outlook reflects our opinion that planned rate adjustments will allow Lubbock to maintain all-in debt service coverage (DSC) and liquidity that will keep the financial risk profile at levels we consider very strong despite some expected slowdowns as a result of anticipated economic contraction. We consider bond provisions credit neutral. In our opinion, the rating reflects very strong enterprise and financial risk profiles. Management has to date been successful in maintaining a multiyear capital improvement plan (CIP), adequate coverage levels, and an extremely strong liquidity position. We have stressed the system's economic assessment to reflect not only the potential effects of the deepening recession caused by COVID-19, but also the lower oil prices which could have an adverse effect on the local economy. Lubbock's economic base is mainly based on the presence of Texas Tech University, which we believe serves as an economic anchor. Rates here are generally affordable and looked at annually. Good conservative management practices and procedures have enabled the system to improve its financial metrics over time. The current liquidity position should enable the system to weather the current economic cycle.

The enterprise risk profile reflects our opinion of Lubbock's:

- Economic anchor of the Texas panhandle and its namesake broad and diverse metropolitan statistical area (MSA) with the presence of Texas Tech University serving as a stabilizing factor;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Generally affordable rates even with income indicators that are below average, although that reflects 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 opinion of Lubbock's:

- Overall adequate all-in DSC at roughly between 1.0x and 1.2x from fiscal years 2017-2019;
- Extremely strong unrestricted liquidity, which has grown from 298 to 303 days' cash on hand during the past three audited fiscal years;
- Moderate debt position with a debt-to-capitalization ratio of just under 50% when including the series 2020A revenue bonds; and
- Strong financial management practices and policies under our Financial Management Assessment (FMA) methodology.

### **Environmental, social, and governance factors**

Overall, we believe that management has mitigated most of its environmental, social, and governance-related risk by adopting, adhering to, and adjusting operating and financial policies and procedures. While we believe the utility's revenues may experience some declines for fiscal 2020, ultimately, our expectation is that management will continue to manage the system, whether in delaying self-funded capital projects or by developing operational efficiencies to maintain sound coverage levels. The utility also has over 300 days' cash on hand, which we believe provides a cushion against short-term disruptions. While we continue to monitor events related to COVID-19, we do not currently expect it to affect the utilities' ability to maintain budgetary balance and pay debt service costs. For more information, see our article "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector," published March 5, 2020 on RatingDirect.

## **Stable Outlook**

### **Downside scenario**

The rating could come under pressure should there be a sustained drop in the system's all-in coverage metrics below levels which we consider adequate or liquidity falling below levels which we would consider extremely strong. There could also be pressure on the rating if the economic fundamentals of the service area deteriorate as a result of the economic slowdown.

### **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, and coupled with economic stability through the recession.

## **Credit Opinion**

Bonds provisions are credit neutral and include:

- A debt service reserve, funded at maximum annual debt service (MADS);
- A rate covenant that stipulates maintaining rates at a minimum of 1.0 x annual debt service; and
- An additional bonds test that allows additional debt issuance but only if net revenue for the system is, at least, 1.25 MADS.

### **Enterprise risk**

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 distance from Oklahoma City, anchors a total population of nearly 300,000 in Lubbock, Crosby, and Lynn counties. The city is anchored by a number of higher education institutions, including Texas Tech University, Lubbock Christian University, Wayland Baptist University, and South Plains College. Undergraduate and graduate students make up nearly 20% of the total population, which acts as a stabilizing presence but also skews income indicators below average; median household effective buying income (MHHEBI) for the city is 87% that of the U.S., although the unemployment rate was low at 2.8% as of December 2019. The utility system is not dependent on any of its principal customers for operating revenues, as the 10 largest customers account for about 6.5% 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, CRMWA 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, Lubbock has relied on its owned facilities, 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 almost exclusively surface water, with the wells serving peak needs or contingencies in the event of severe drought.

For residential customers, based on the city's actual average billing rates for 5,000 gallons, the monthly combined bill is just over \$69. As a percentage of MHHEBI, the average bill is roughly 1.9%, which we consider generally affordable in relation to regional peers and local income metrics. The city maintains a comprehensive long-term and annually updated rate model with an emphasis on sustainable utility rates. The city council has the ability to raise rates whenever necessary above the suggested ratios of the rate study. The current county poverty rate for Lubbock County is low at about 19%. 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.

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**

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. We also make an adjustment to include transfer payments to the general fund for administrative costs, franchise fees, and payments in lieu of taxes 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 1.07x in fiscal 2017 to over 1.2x in fiscal 2018 and 1.05x in fiscal 2019. The decrease has been due to higher-than-expected precipitation, which reduced demand for water in fiscal 2019. We expect the coverage levels to remain in the above-mentioned range in the near future. Based on our analysis of the management's provided projections, we consider the city's coverage performance will remain at least adequate.

Liquidity is an identified strength of the system. Unrestricted cash and investments have grown from about \$44.7.8 million in fiscal 2017 to about \$53.9 million in fiscal 2019. The unrestricted cash and investments at fiscal year-end stood at the equivalent of 303 days' cash on hand. The city's internal policies require management to maintain a minimum of 25% operating expenditures as reserves. In relation to its CIP, these amounts may fluctuate slightly. However, based on management's indications, we expect the unrestricted liquidity position to remain extremely strong.

Currently, we consider the system's debt-to-capitalization ratio moderate at under 50%, with just under \$507.9 million of debt outstanding after including this issuance. The city maintains a comprehensive multiyear CIP. Its long-term CIP through 2026 calls for \$254 million for various improvement projects and expansions associated with the system, with about half of that being debt funded. It is our understanding that city also plans to issue about \$10.6 million of debt in the form of a USDA loan later on in the year. It participates in the Texas Municipal Retirement System (TMRS), which was funded at about 81% with the city making all their required contributions.

Based on our 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 a five-year CIP, which is updated on annual basis. There is a codified investment policy in place, and the 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).

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