



RATING ACTION COMMENTARY

Fitch Rates Lubbock, TX Ser. 2020A Water and Sewer Rev Bonds 'AA-'; Outlook Positive

Fri 24 Apr, 2020 - 5:11 PM ET

Fitch Ratings - Austin - 24 Apr 2020: Fitch Ratings has assigned a 'AA-' rating to the following Lubbock, TX (the city) revenue bonds:

--Approximately \$43.9 million water and wastewater system revenue bonds, series 2020A.

The bonds will be sold via negotiation the week of May 11. Proceeds will be used to finance the costs of acquiring, purchasing, constructing, improving, renovating, enlarging and equipping property, buildings, structures, facilities and related infrastructure for the water and wastewater system (the system) and pay issuance costs.

In addition, Fitch has affirmed the 'AA-' rating assigned to the following bonds:

--Approximately \$40.1 million outstanding water and wastewater system revenue bonds.

Fitch has also assessed the system's Standalone Credit Profile (SCP) to be 'aa-'.

The Rating Outlook has been revised to Positive from Stable.

ANALYTICAL CONCLUSION

The change in Fitch's Rating Outlook to Positive from Stable reflects the system's favorable and improving financial profile, demonstrated by relatively low leverage in the context of a strong operating risk profile and strong revenue defensibility. The rating and Outlook change also reflect the system's 'aa-' SCP assessment. Improvements in leverage are largely due to the end of a capital-intensive spending cycle, which included construction of new water and sewer treatment plants within the last ten years.

CREDIT PROFILE

The city of Lubbock (the city, Issuer Default Rating AA+/Outlook Stable) is located in northwest Texas, serving as the retail/trade, educational and healthcare hub for the surrounding, largely rural, region. The system serves a growing population of over 260,000 residents in the city and in three surrounding communities. Water sources, which are considered adequate for the long-term, are supplied from both city-owned sources and through a long-term, take-or-pay contract with the Canadian River Municipal Water Authority (CRMWA or the authority). Sewer flows are treated at two wastewater treatment plants owned by the city.

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for the Water and Sewer sector. While the system's performance through most recently available data has not indicated significant impairment, material changes in revenue and cost profiles are occurring across the sector and are likely to worsen in the coming months. Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration. Any revised expectations for future performance and assessment of key risks will be incorporated in future analyses.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Favorable Service Area; Some Affordability Pressure

The overall service area assessment is strong with very favorable customer growth and unemployment rates, but household income figures trail state and national averages. Affordability is incrementally pressured due to moderately elevated rates and the lower aforementioned income metrics. The service area is home to Texas Tech University (TTU), which adds to the region's economic stability.

Operating Risks 'aa'

Very Low Operating Cost Burden; Manageable Capital Needs

Historical system investment has been sound, as reflected by the very favorable life-cycle ratio. Operating costs are also very favorable despite purchasing around 60% of its water supplies from CRMWA.

Financial Profile 'aa'

Improving Leverage; Stable Financial Margins

The system's strong liquidity and lower projected capital spending are translating to improving net leverage metrics. Given relatively quick amortization of existing debt and decreased issuances over the next several years, leverage should continue to improve.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--The continued improvement in leverage resulting in net-debt/FADS of 6.0x or below while still sufficiently investing in system maintenance would likely lead to an upgrade within the next one-to-two years.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Increases in net leverage to a sustained level above 8.0x would likely result in moving the Outlook back to Stable;

--Sustained low levels of system investment resulting in a significantly higher life-cycle ratio could cause the Outlook to move back to Stable.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

SECURITY

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

REVENUE DEFENSIBILITY

The strong revenue defensibility assessment is derived from the fully monopolistic water and sewer services provided by the system. The service area's characteristics are very favorable with stable customer growth and low unemployment that is consistently below the state and national norms; however, due to the somewhat rural service area, income levels are below state and national averages.

The service area economy is very stable and is bolstered by TTU, agriculture production within the surrounding region as well as the city's role as the regional medical center. Rates are slightly elevated (based on Fitch's standard usage assumption of 7,500/6,000 gallons per month for water and sewer, respectively) and, when combined with the lower income metrics, results in some affordability pressure. However, the city maintains independent legal ability to raise rates and has adopted increases as necessary to support operating and capital expenses. Further, additional rate increases over the next several years are expected to be limited as the CIP ramps down, which should help to alleviate rate pressure over time.

OPERATING RISKS

The system's operating costs are considered low at around \$5,200 per million gallons of combined water production/sewer flows despite imported water costs associated with about 60% of supplies. Operating costs should remain manageable given the city's tight control of expenses and limited planned increases in passed-through from CRMWA. The system's life-cycle ratio is also considered favorable, reflecting its recent significant capital investment.

With the completion of a large sewer-system plant expansion in fiscal 2018, capital needs have declined substantially which should result in reduced capital spending over the next several years. Currently, the system's fiscal 2020-2024 capital improvement program totals \$198 million and is expected to be funded through additional borrowings (70% of total including these bonds) and a combination of surplus cash and existing proceeds.

FINANCIAL PROFILE

The system's net leverage and liquidity ratio are both considered to be strong by Fitch, and both metrics help to counter-balance the systems somewhat lower financial margins. Higher debt metrics and lower annual debt service coverage in comparison to peers historically have been constraining factors to the system's rating. Moving forward, management's forecast and CIP point to ongoing improvement in net leverage. Realization of these improvements could lead to a rating upgrade within the next one to two years.

For fiscal 2019, the system's net leverage was 6.4x. Given the system's rapid amortization of principal and decreased debt issuances, net leverage is forecast to decline to 5.1x under Fitch's Analytical Stress Tool's (FAST) base case. Fitch's rating case was developed by taking the base case and applying a capital stress that results in a 10% annual increase in planned capital expenditures. Under this scenario, net leverage shows a modest increase from the base case, ending fiscal 2024 at 5.3x. Fitch also applied a moderate stress to revenue in its forward look related to the impact of the coronavirus, but the results do not materially change Fitch's expectation of net leverage over the near term and remain consistent with Fitch's rating action.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

SOURCES OF INFORMATION

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub. 03 Apr 2020\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

Lubbock EU Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING

[READ MORE](#)

COPYRIGHT

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (in

[READ MORE](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance Infrastructure and Project Finance North America United States

