



TO: Mayor and Council Members

FROM: Elaine Hart, Chief Financial Officer, Financial Services Department

DATE: May 19, 2014

SUBJECT: Austin Water Utility (AWU) Refunding Bonds, Series 2014

Elaine Hart

City Council's May 22 agenda includes an item to approve an ordinance authorizing the issuance of **City of Austin, Texas, Water and Wastewater System Revenue Refunding Bonds, Series 2014, in an amount not to exceed \$310,000,000**. The bond sale includes:

- **Refunding tax-exempt commercial paper.** About \$200,000,000 revenue refunding bonds will be issued to refund outstanding tax-exempt commercial paper. This refunding will take advantage of currently favorable market conditions and restore available capacity under the commercial paper program for future borrowing needs.
- **Refunding for debt service savings.** About \$102,945,000 will be issued to refund \$105,780,000 of City of Austin Water and Wastewater System Revenue Refunding Bonds, Series 2005A and \$9,725,000 of City of Austin Combined Utility System Subordinate Revenue Refunding Bonds, Series 1998A to take advantage of currently favorable market conditions and generate savings.

The City's Financial Policies set a target of present value savings of at least 4.25% of the principal amount of the refunded bonds. As of May 16, 2014, the proposed refunding for debt service savings produced about \$10.67 million savings or 9.23% of the refunded bonds, which exceeds the policy target of 4.25%. The refunding bonds do not exceed the life of the bonds being refunded.

The proposed refunding transaction is a "**parameter**" bond sale, that is, the bond sale will take place subsequent to the date Council authorizes the transaction in accordance with parameters specified in the bond ordinance. In order to provide the City the flexibility to quickly respond to changing market conditions, the proposed ordinance delegates authority to the City Manager or Chief Financial Officer ("the Pricing Officer") to complete the refunding bond sale transaction. This delegated authority shall be exercised in accordance with parameters outlined in the proposed ordinance including:

- aggregate original principal amount not to exceed \$310,000,000 for the Series 2014 bonds,
- bonds shall bear interest at a rate not greater than 15.0% per annum and net effective interest rate shall not exceed 15.0%,
- with respect to the bonds issued for debt service savings, refunding bonds must produce net present value savings of at least 4.25%,
- maximum maturity shall not extend beyond November 15, 2045 for the Series 2014 bonds, and
- this delegation shall expire if not exercised by the Pricing Officer on or prior to January 31, 2015.

This “parameter” bond sale is posted on the consent agenda, instead of time certain at 2:00 p.m. which is typical for general obligation bond sales, since the actual bond sale will take place at a later date. The City has completed parameter bond sales several times in the past. The most recent were the November 2012 Austin Energy Revenue Refunding Bonds (\$268 million Series 2012A and \$108 million Taxable Series 2012B) and June 2012 AWU Revenue Refunding Bonds (\$375 million).

AWU Bond Ratings. All current ratings on the Austin Water Utility separate lien revenue bonds were affirmed, however, Moody’s Investors Service and Fitch Ratings revised their Outlook from “Stable” to “Negative”. Standard & Poor’s outlook remains at “Positive”. The Outlook horizon is generally up to two years. It is possible that AWU’s rating could return to “Stable” by Moody’s Investors Service and Fitch Ratings within that timeframe should the financial metrics improve. Current ratings and those as of September 30, 2013 and 2012 are presented below with current changes highlighted in yellow.

Debt	Moody’s Investors Service, Inc.			Standard and Poor’s			Fitch, Inc.		
	Current	2013	2012	Current	2013	2012	Current	2013	2012
Utility revenue bonds – prior lien	Aa1	Aa1	Aa1	AA Positive	AA Positive	AA	AA	AA	AA-
Utility revenue bonds – subordinate lien	Aa2	Aa2	Aa2	AA Positive	AA Positive	AA	AA	AA	AA-
Utility revenue bonds – Water separate lien	Aa2 Negative	Aa2 Stable	Aa2 Stable	AA Positive	AA Positive	AA Stable	AA Negative	AA Stable	AA-Stable

Excerpts from Moody’s Investors Service Report: *“...The negative outlook reflects a historically challenged financial profile that is expected to decrease materially at fiscal year end 2014. Future credit reviews will focus on the system’s ability to execute rate increases sufficient to improve the liquidity position, as well as effectively implement the other aspects of its financial plan. Inability to improve the current liquidity levels will likely result in downward rating action...”*

“The Aa2 rating on the system’s separate lien (open lien) reflects a historically challenged liquidity position, much weaker than similarly rated credits, which is expected to improve over the near term given planned rate increases, as well as the already established rate stabilization fund. The rating also reflects the utility’s strong demand supported by a vibrant and growing service area, ample water supply provided by the Lower Colorado River Authority, and adequate legal provisions. Also incorporated is a manageable capital plan with needs expected to be addressed by future debt issuance, as well as, cash reserves...”

Excerpts from Fitch Ratings Report. *“FINANCIAL RESULTS EXPECTED TO WEAKEN: The revision in Outlook to Negative from Stable on the water and wastewater bonds reflects the diminishing prospect of any material improvement in AWU’s financial profile over the near term, due in part to ongoing drought conditions. Financial metrics remain weak for the rating category and further erosion in both debt service coverage (DSC) and liquidity is expected by the close of the current fiscal year based on year-to-date results.*

Standard & Poor’s (S&P) Report. As of Friday, May 16, S&P indicated they will affirm the ‘AA’ rating and maintain the ‘positive outlook’; however, the rating report has not been released at this date.

The Outlook revisions by Moody’s and Fitch Ratings from stable to negative are not expected to have a significant impact on interest rates on these refunding bonds, when sold. AWU’s forecasted rate increases, as planned, should improve the utility’s financial metrics. Strong ratings signal better credit quality and will allow the utility to issue debt at the lower interest rates, thus reducing future debt service costs.

If you have any questions, please contact me or Art Alfaro, City Treasurer.

xc: Marc A. Ott, City Manager
Michael McDonald, Deputy City Manager
Robert Goode, Assistant City Manager
Assistant City Managers
Greg Meszaros, Director, Austin Water Utility
David Anders, Assistant Director, Austin Water Utility
Larry Weis, General Manager, Austin Energy
Greg Canally, Deputy Chief Financial Officer
Ed Van Eenoo, Deputy Chief Financial Officer
Art Alfaro, City Treasurer
Georgia Sanchez, Assistant Treasurer
Dennis Waley, Public Financial Management, City's Financial Advisors