Albuquerque Bernalillo County
Water Utility Authority

Agenda Item No. 10a

Meeting Date: September 23, 2015
Staff Contact: Stan Allred, Chief Financial Officer

TITLE: OB-15-9 – Future Debt Maturity and Revenue Implications

ACTION: None

SUMMARY:

During the discussion on the Water Authority's 10-year financial plan, Commissioner O'Malley requested an analysis of extending the term of the debt as a strategy to offset the need for future rate increases to fund the adopted increases in infrastructure spending.

RBC Capital Markets, as financial advisor to the Water Authority was requested to undertake this analysis. They evaluated the existing policy and term of 12 years as well as terms of 20, 25 and 30 years for basic capital spending. For each scenario, they identified the potential annual savings as well as the increased cost of funds and interest costs over the life of the debt. The report also identifies the criteria which is utilized by the rating agencies since any change would likely affect the Water Authority's credit rating.

The conclusion is simply that extending the term of the Water Authority's debt would have nominal savings in annual debt service. However, the increased cost of funds, increased cash reserves required and additional interest costs would out way the savings. The Water Authority's current conservative basic capital model of 12-year terms with 50% cash match requirement is a best practice and allows for rapid pay down and sustained investment in infrastructure spending.

Albuquerque Bernalillo County Water Utility Authority

August 19, 2015

Future Debt | Maturity and Revenue Implications

Overview of Water Authority Financial Policies

- On average, and at a minimum, cash fund capital projects using 50% from rate revenue (cash funded)
- On average, up to 50% of the capital projects can be funded with bonds or loans
- Amortize bonds or loans for basic needs and rehabilitation projects within 12 years and 25 years or less for special projects
- Manage financial operations to maintain the Water Authority's high investment grade credit rating

Current Ratings:	Senior Lien	Subordinate Lien	Outlook
Moody's:	Aa2	Aa3	Stable
Standard and Poor's:	AA+	AA	Stable
Fitch	AA	AA	Stable

Rate Revenue Covenant:	Board Policy	Legal Requirement
Senior Lien:	1.50x	1.33x
Subordinate Lien:	1.33x	1.25x
Super Subordinate Lien:	1.00x	1.00x

- Target $1/12^{th}$ cash reserves goal per rate ordinance

Bond Credit Rating

- The Authority and other Joint Utility issuers are rated by credit rating agencies using a four tier scale which include:
  - **System Characteristics – typically 30% of rating**
  - **Financial Strength – typically 40% of rating**
  - **Management – typically 20% of rating**
  - **Legal – typically 10% of rating**
- Issuers typically have high control over metrics such as Management and Legal.
- Issuers have less control over System Characteristics, financial performance, with the exception of asset condition which can be controlled through proper capital planning.

Summary of Scenarios

	Existing Plan (12 Years)	20 Year Amortization	25 Year Amortization	30 Year Amortization
Additional Interest Cost	**N/A**	**$454,851,000**	**$788,218,000**	**$1,092,346,000**
Average Revenue Increase (every other year) 2018 - 2027	**5.00%**	**3.55%** (1.45% Savings)	**3.50%** (1.50% Savings)	**3.45%** (1.55% Savings)
Average Revenue Increase (every other year) After 2028	**1.58%**	**3.55%** (1.97% Cost)	**3.50%** (1.92% Cost)	**3.45%** (1.87% Cost)
Capital Needs (assumes no growth)	$2,784,000,000	$2,784,000,000	$2,784,000,000	$2,784,000,000
Bonds Issued through 2045: Pay-as-you-go Capital through 2045:	$1,392,000,000 $1,392,000,000	$1,392,000,000 $1,392,000,000	$1,392,000,000 $1,392,000,000	$1,392,000,000 $1,392,000,000
Change in Debt Policy (Basic Needs):	**No Change**	TERM Longer than 12 years	TERM Longer than 12 years	TERM Longer than 12 years

Financing Scenarios

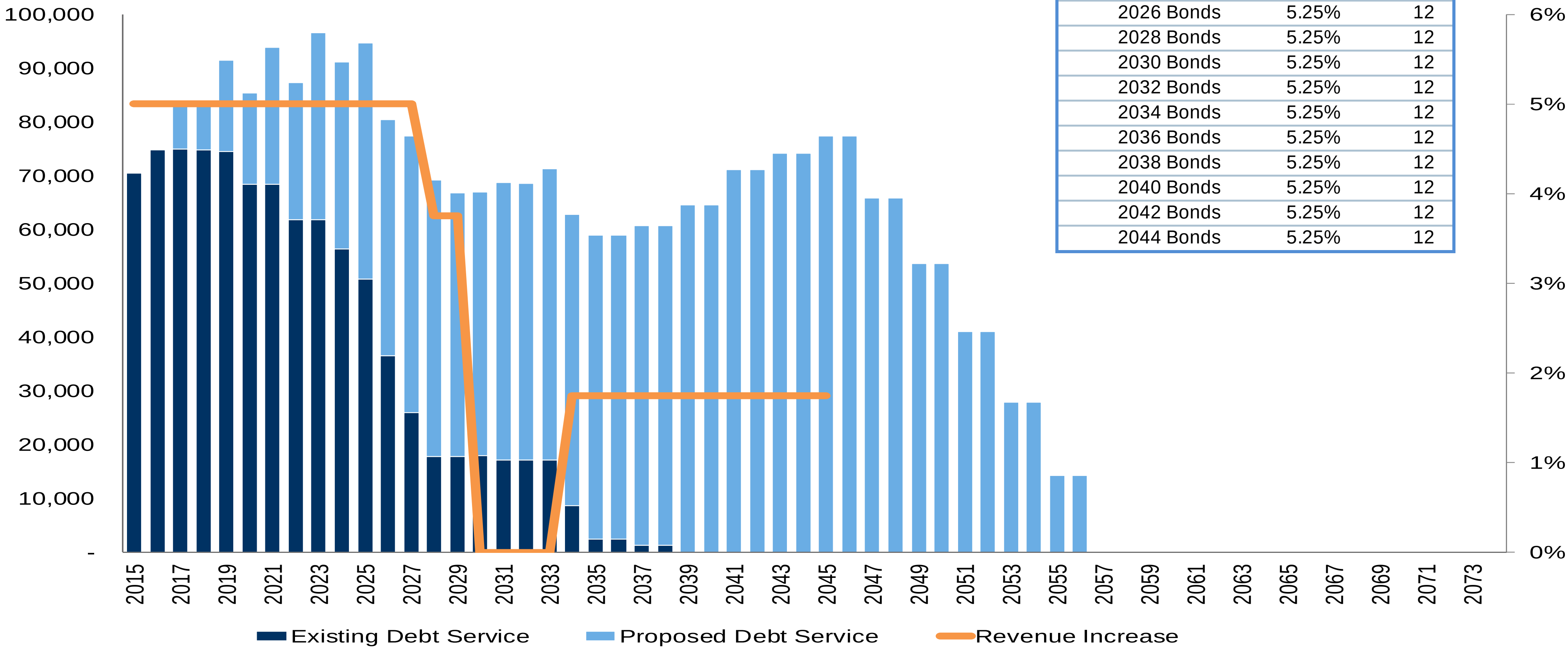
APPENDIX I

RBC Capital Markets

12 Year Scenario

- 12 Year Amortization of basic needs and rehabilitation
- Total Debt Service: $2,805,232,000

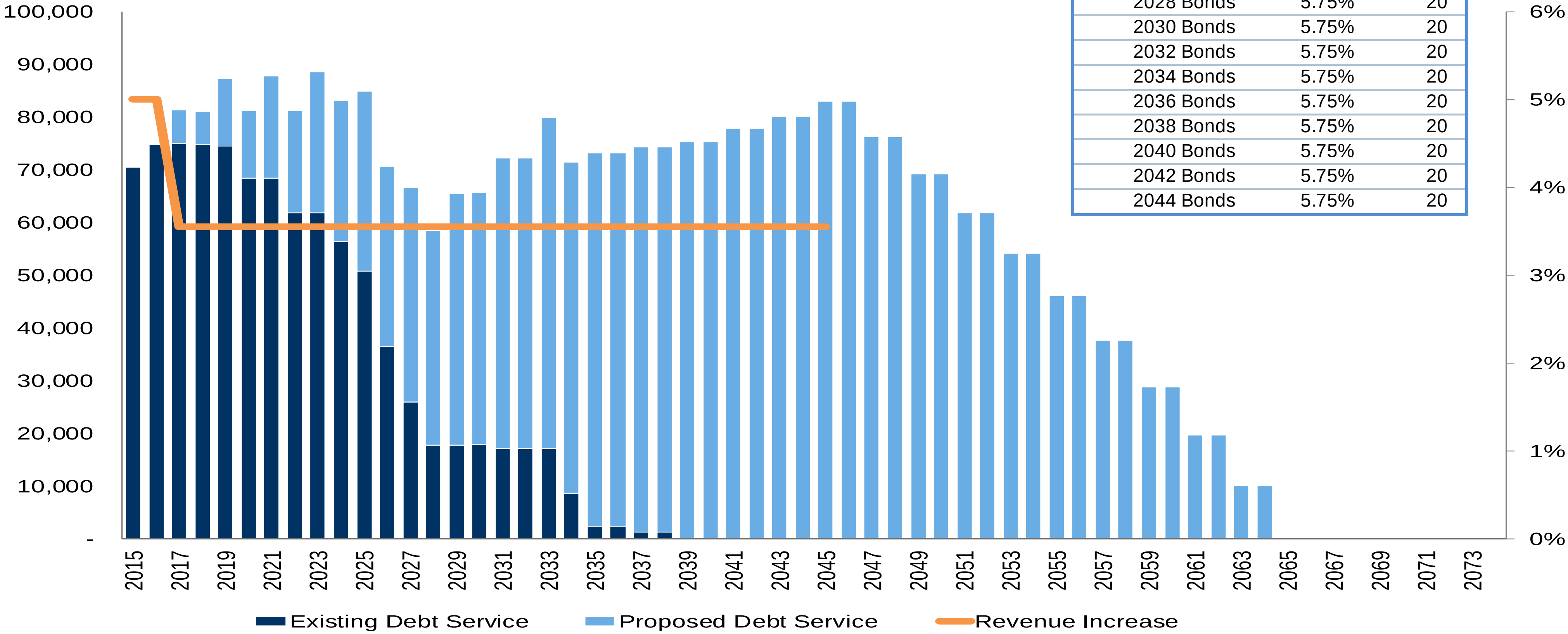
BONDS	Rate	Term
2016 Bonds	4.25%	12
2018 Bonds	4.50%	12
2020 Bonds	4.75%	12
2022 Bonds	5.00%	12
2024 Bonds	5.25%	12
2026 Bonds	5.25%	12
2028 Bonds	5.25%	12
2030 Bonds	5.25%	12
2032 Bonds	5.25%	12
2034 Bonds	5.25%	12
2036 Bonds	5.25%	12
2038 Bonds	5.25%	12
2040 Bonds	5.25%	12
2042 Bonds	5.25%	12
2044 Bonds	5.25%	12



20 Year Scenario

- Does not meet Final Term Policy
- Additional Interest Cost of $454,851,000
- Total Debt Service: $3,260,083,000

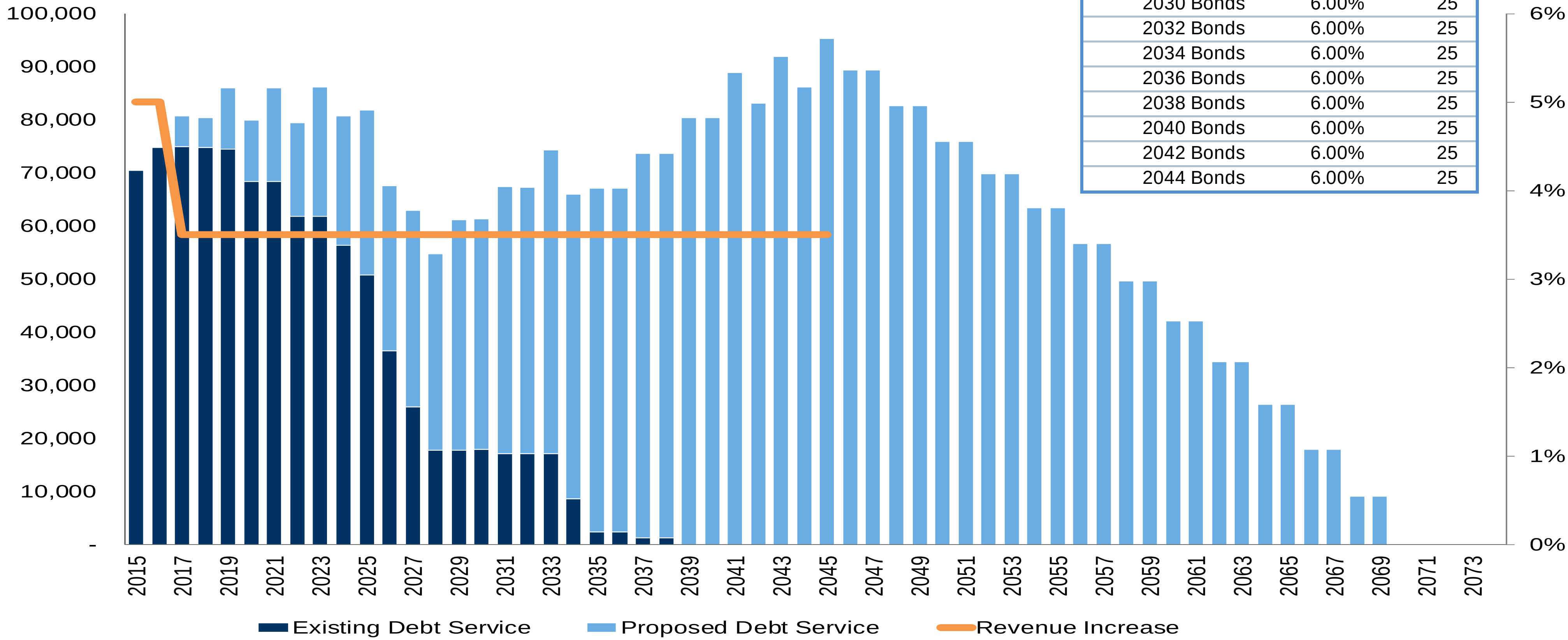
BONDS	Rate	Term
2016 Bonds	4.75%	20
2018 Bonds	5.00%	20
2020 Bonds	5.25%	20
2022 Bonds	5.50%	20
2024 Bonds	5.75%	20
2026 Bonds	5.75%	20
2028 Bonds	5.75%	20
2030 Bonds	5.75%	20
2032 Bonds	5.75%	20
2034 Bonds	5.75%	20
2036 Bonds	5.75%	20
2038 Bonds	5.75%	20
2040 Bonds	5.75%	20
2042 Bonds	5.75%	20
2044 Bonds	5.75%	20



25 Year Scenario

- Does not meet Final Term Policy
- Additional Interest Cost of $788,218,000
- Total Debt Service: $3,593,450,000

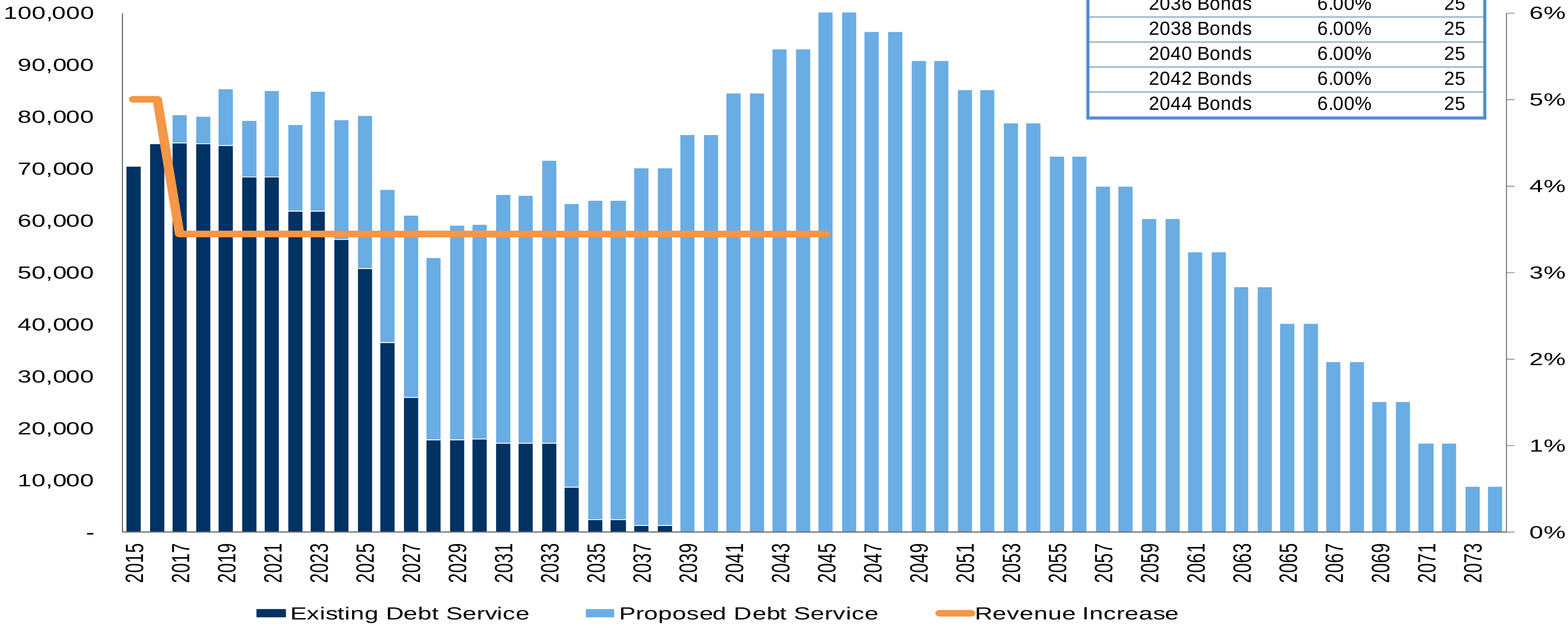
BONDS	Rate	Term
2016 Bonds	5.00%	25
2018 Bonds	5.25%	25
2020 Bonds	5.50%	25
2022 Bonds	5.75%	25
2024 Bonds	6.00%	25
2026 Bonds	6.00%	25
2028 Bonds	6.00%	25
2030 Bonds	6.00%	25
2032 Bonds	6.00%	25
2034 Bonds	6.00%	25
2036 Bonds	6.00%	25
2038 Bonds	6.00%	25
2040 Bonds	6.00%	25
2042 Bonds	6.00%	25
2044 Bonds	6.00%	25



30 Year Scenario

- Does not meet Final Term Policy
- Additional Interest Cost of $1,092,346,000
- Total Debt Service: $3,897,578,000

BONDS	Rate	Term
2016 Bonds	5.00%	25
2018 Bonds	5.25%	25
2020 Bonds	5.50%	25
2022 Bonds	5.75%	25
2024 Bonds	6.00%	25
2026 Bonds	6.00%	25
2028 Bonds	6.00%	25
2030 Bonds	6.00%	25
2032 Bonds	6.00%	25
2034 Bonds	6.00%	25
2036 Bonds	6.00%	25
2038 Bonds	6.00%	25
2040 Bonds	6.00%	25
2042 Bonds	6.00%	25
2044 Bonds	6.00%	25



Credit Rating Overviews

APPENDIX II

RBC Capital Markets

Ratings Defined

Moody's	Standard and Poor's	Fitch	
Aaa	AAA	AAA	Highest possible rating - principal and interest payments considered extremely secure.
Aa1/Aa2/Aa3	AA+/AA/AA-	AA+/AA/AA-	High quality - differs from highest rating only in the degree of protection provided bondholders.
A1/A2/A3	A-/A/A+	A-/A/A+	Good ability to pay principal and interest although more susceptible to adverse effects due to changing conditions.
Baa1/Baa2/Baa3	BBB-/BBB/BBB+	BBB-/BBB/BBB+	Adequate ability to make principal and interest payments -- adverse changes are more likely to affect the ability to service debt.

Current Ratings:	Senior Lien	Subordinate Lien	Outlook
Moody's:	Aa2	Aa3	Stable
Standard and Poor's:	AA+	AA	Stable
Fitch	AA	AA	Stable

Bond Ratings – Moody’s (Aa2 (Senior Lien) Aa3 (Subordinate Lien) Stable Outlook)

- What Could Make the Rating Go Up
  - Trend of improved debt service coverage ratios
  - Significantly improved liquidity

- What Could Make the Rating Go Down
  - Additional deterioration of liquidity
  - Failure to increase and maintain debt service coverage above debt covenants

- Strengths
  - Sizable service area with adequate future capacity
  - Stability of customer base from government and higher education institutions
  - **Rapid pay down of debt (71.5% within ten years) helping to keep elevated debt burden manageable**

- Challenges
  - Limited debt service coverage ratios
  - Narrow liquidity position in comparison to similarly rated entities

Bond Ratings – Standard and Poor's (AA+ (Senior Lien) AA (Subordinate Lien) Stable Outlook)

- Strengths
  - Service area that includes the state's primary economic center, with an employment base that was resilient through the recession;
  - Robust planning efforts that ensures that operational and financial requirements are well-aligned, including resource management and sustainability, financial policies that establish aggressive levels of pay-as-you-go funding and operations that reflect a long-term water supply from a mix of both surface and groundwater; and,
  - **Combined water and sewer rates that remain very affordable even with a number of recent and planned upcoming rate adjustments.**
- Challenges
  - Service system's financial risk profile that continues to rebound from several consecutive years of weakened performance.
  - The financial profile is still thin for the rating and will be further challenged as the Authority becomes more aggressive in addressing its system rehabilitation needs, whether on a prioritized basis or as a result of unfunded regulatory mandates. However, strong financial and operational planning – including identification of critical system needs and overall risk management – should temper any pressure downward pressure on the rating.

Bond Ratings – Fitch (AA (Senior Lien) AA (Subordinate Lien) Stable Outlook)

- Strengths
  - Service area that includes the state's primary economic center,
  - Moderately high debt burden to fall due to rapid debt amortization
  - Ample water supply
  - Improved financing reporting capability as the Authority no longer operates as a component unit of the city of Albuquerque
  - Improved financial metrics expected
  - Capital needs slowing down
  - Rate flexibility

- Challenges
  - Weak debt service coverage in recent years but has begun to strengthen with recent rate increases
  - **Authority's financial metrics are below average for the rating category, improvement in the metrics is expected over the medium term due to its declining capital needs and debt amortization**
  - Financial reporting delays hindered management