San Antonio, Texas

Municipal Drainage Utility System Revenue Bonds
New Issue Report

Ratings

New Issue

Municipal Drainage Utility System Revenue Refunding Bonds, Series 2013	AA

Outstanding Debt

Municipal Drainage Utility Revenue Bonds	AA

Rating Outlook
Stable

Related Research
Fitch Rates San Antonio, TX's Drainage Revenue Bonds at 'AA'; Outlook Stable (April 2013)

Fitch Affirms San Antonio, TX Drainage Revenue Bonds at 'AA'; Outlook Stable (April 2012)

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New Issue Details

Sale Information: $74,285,000 Municipal Drainage Utility System Revenue Refunding Bonds, Series 2013, via negotiation the week of April 22.

Security: First lien on gross revenues derived from operation and ownership of the municipal drainage system, including interest income on accounts. Pledged revenues exclude drainage charges specifically provided by ordinance for contribution to the funding of future drainage system construction.

Purpose: To refund outstanding series 2003 and 2005 bonds for savings and pay issuance costs.

Final Maturity: Feb. 1, 2030.

Key Rating Drivers

Sound Financial Metrics: Financial metrics historically have been solid, featuring strong debt service coverage and ample liquidity. Operating pressures are on the horizon as the city completes large capital projects that are financed by GO bonds, but maintained and operated with the pledged stormwater fees.

Rate Flexibility: The current stormwater fee is low, lending ample flexibility for future rate hikes if needed.

Stable Revenue Stream: Stormwater fees are collected as part of the water and sewer bill, and collections are stable with limited delinquencies.

Manageable Capital Needs: Capital projects currently expected to be funded from stormwater fee revenues are limited, although some uncertainty exists as to future projects and the possible impact such projects could have on utility operations.

Adequate Legal Covenants: Legal provisions are adequate. A strong feature is the city's covenant to disconnect water service for nonpayment of drainage fees. However, the debt service reserve requirement is springing and not currently required.

Strong and Diverse Service Area: The trend of San Antonio's overall economic activity and diversification remains relatively stable, with the softening in residential building activity partially offset by steady commercial and military construction.

Rating Sensitivities

Financial Flexibility Maintained: Maintenance of adequate debt service coverage and liquidity, given the rising cost of operations, is a key credit consideration.

Rating History

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	4/18/13
AA	Affirmed	Stable	4/23/12
AA	Upgraded	Stable	5/6/10
AA–	Revised	Stable	4/30/10
A+	Affirmed	Stable	3/18/05
A+	Assigned	—	4/25/03

Credit Profile

San Antonio (GO bonds rated ‘AAA’ by Fitch) is the second largest city in the state and seventh largest in the U.S., with an estimated population of 1.4 million for 2013. The system, which covers the entire city, was created in 1997 as a public utility to provide the city with a funding source to comply with federal Environmental Protection Agency storm water quality mandates.

Historically Strong Financial Performance

Financial performance for the system has been good with net revenue coverage ranging from 1.8x–2.4x over the past five fiscal years. For fiscal 2012, net revenues provided strong 2.0x coverage on annual debt service (ADS), and liquidity remained adequate at 120 days cash on hand, although it declined from 180 days in fiscal 2011. Debt service coverage is projected to be lower with increased spending on the O&M of large capital projects financed with GO bonds. Management indicated its target net coverage is between 1.25x and 1.30x over the next five fiscal years, which is at the rate covenant level (1.25x ADS). Fitch assumes in its rating that coverage will exceed this target, as projections are based on conservative revenue and expenditure assumptions. Significant deviation from historical coverage levels of closer to 2.0x net coverage would put pressure on the current ‘AA’ rating.

Large Capital Improvement Plan Supported by GO Bonds

The city is a partner in an interlocal agreement for a regional flood control program, along with Bexar County and the San Antonio River Authority (SARA), to provide regional management of a unified flood control, drainage and stormwater quality program. Under these agreements, the county and SARA are responsible for funding regional capital projects, with the city of San Antonio taking responsibility for operations and maintenance of these assets.

Local drainage projects have been funded with proceeds from the previously issued revenue bonds and with city GO bonds. The city’s fiscal years 2013–2018 capital improvement plan (CIP) identifies $219 million in drainage projects to be funded primarily with GO debt and roughly $10.3 million in remaining unspent revenue bond proceeds from the series 2003 and series 2005 bonds.

The city does not plan to further leverage the stormwater system revenues at this time. Instead, the city voters recently approved a total of $128 million in GO bond-financed drainage and flood control projects in the May 2012 election. This was part of a larger GO bond authorization request for a total of $596 million. While funding for both local and regional drainage projects is expected to be derived from other sources, stormwater fee revenues are used to maintain and operate the capital projects. As projects are completed and placed in operation, operating costs will rise and likely pressure the system. However, Fitch expects the system’s solid financial profile will continue given the ample rate flexibility.

Good Collections and Rate Flexibility

Through an interlocal contract, the San Antonio Water System (SAWS) bills and collects the stormwater fee on behalf of the city. Each property that receives water and/or sewer service also receives a stormwater bill. Residential customers pay either $39 or $51 annually for stormwater service, depending upon lot size. Given this low annual charge, rate flexibility for future needs is a positive rating factor. The rates have remained unchanged since 2007. Management reports plans to engage an independent rate study to ensure the city maintains an adequate rate structure and rates to cover growing costs of operations. SAWS discontinues water service for nonpayment of drainage charges, thus delinquencies are minimal.

Related Criteria

Revenue-Supported Rating Criteria (June 2012)

U.S. Water and Sewer Revenue Bond Rating Criteria (August 2012)

Adequate Security Provisions

Security provisions include a rate covenant that will produce revenues equal to 1.25x ADS, O&M expenses, and any other indebtedness payable from pledged revenues. The additional bonds test (ABT) calls for gross revenues for the past completed fiscal year or for 12 consecutive months out of the immediately preceding 18 months to be at least 1.25x average annual debt service. Fitch considers the ABT to be weak and is inconsistent with the rate covenant, but derives comfort from the lack of debt issuance plans. The flow of funds, in priority order, is to debt service, O&M expenses, the reserve requirement and then to any lawful purpose. The reserve requirement is average annual debt service (AADS); however, the requirement is waived in each year that gross revenues are at least 1.75x AADS. The city also covenants to discontinue water and sewer services to a user that is delinquent in the payment of drainage charges.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

STANDARD & POOR'S
RATINGS SERVICES

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San Antonio, Texas; Water/Sewer

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Summary:

San Antonio, Texas; Water/Sewer

Credit Profile		
US$74.285 mil mun drainage util sys rev rfdg bnds ser 2013 dtd 05/01/2013 due 02/01/2030		
Long Term Rating	AA+/Stable	New
San Antonio muni drainage util sys		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating to San Antonio, Texas' municipal drainage utility system revenue refunding bonds, series 2013. At the same time, Standard & Poor's has affirmed its rating on the utility system's series 2003 and series 2005 revenue bonds, though these bonds are expected to be refunded with the series 2013 bond proceeds.

The rating reflects our assessment of the system's:

- Broad, diversified, and growing service area;
- Sound financial performance over the past several years, with strong collection rates;
- Demonstrated willingness to adjust rates, although overall rates remain low; and
- Economies of scale in the implementation of some functions of the drainage utility in conjunction with San Antonio Water System (SAWS).

A first-lien gross revenue pledge on the storm water system secures the bonds. A debt service reserve in the amount of average annual debt service provides additional security, although the reserve is not required to be funded as long as annual debt service coverage (DSC) remains at least 1.75x. While the rate covenant is a moderate 1.25x average annual debt service, annual gross DSC has been significantly higher and management projects it will remain at similar levels.

In our opinion, the storm water fund's financial position remains strong. Service rates remain low, ranging from $3.22 to $4.25 per month depending on residential square footage. Fiscal 2012 gross revenues available for debt service totaled $38.9 million, resulting in gross annual debt service coverage of more than 5.0x. Coverage over the past five years has consistently remained near this level, driven by annually steadily increasing revenues. Revenue projections for the next five years show similar gross coverage levels, because the debt service payment of approximately $6.5 million is level through 2028. The system does, however, fund drainage system maintenance and capital improvements each year. As a result, net coverage each year is much lower than gross coverage and typically near 1.0x. Accumulated cash and recurring surpluses fund these system capital and maintenance needs. The liquidity in the system, however, has remained strong with an ending fund balance of $9.2 million (fiscal 2012). This level will likely decrease and could fluctuate depending on the maintenance needs each year. Although the responsibilities for the storm water system ultimately rest with the city, SAWS provides some services as part of an interlocal agreement, including monitoring and customer billing. Because the storm water fee is included in the water and sewer bill, collection rates are extremely high. The city coordinates the development of its capital program with other jurisdictions in the area, including Bexar County and the San Antonio River Authority.

The city does not have specific plans to issue additional drainage revenue bonds in the near future, as officials will continue to use excess system revenues to address capital needs.

Outlook

The stable outlook reflects Standard & Poor's expectation for maintenance of high liquidity and strong coverage levels, though net coverage may approach thin margins in any given year. Given that revenues are not subject to weather-related fluctuations, revenue stability is likely.

Related Criteria And Research

USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.