

# RatingsDirect®

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## Summary:

# Garland, Texas; Water/Sewer

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## Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

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### Credit Profile

US\$39.585 mil wtr and swr sys rev rfdg and imp bnds ser 2014 dtd 06/01/2014 due 03/01/2034

<i>Long Term Rating</i>	AA-/Stable	New
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### Garland wtr & swr

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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## Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating and stable outlook to Garland, Texas' series 2014 water and sewer system revenue refunding and improvement subordinate-lien bonds and affirmed its 'AA' rating, with a stable outlook, on the city's utility revenue senior-lien bonds.

The ratings reflect our opinion of the system's general creditworthiness, including:

- The system's stable and diverse service area economy, which participates in the Dallas-Fort Worth metropolitan area, as well as the customer base's above-average income;
- The water system's role as a distributor of North Texas Municipal Water District (NTMWD) treated water, greatly reducing operational and financial risk to the city; and
- The system's sound overall finances, evidenced by strong senior-lien debt service coverage (DSC) and strong liquidity.

We believe increasing minimum annual water costs, dry-weather conditions prompting continued water conservation measures, and additional debt needs that could lower DSC in the absence of annual rate increases somewhat offset these credit strengths.

A subordinate-lien net revenue pledge of the waterworks and sanitary sewer system secures the series 2014 bonds. Due to the sizable amount of senior-lien debt outstanding maturing over about 20 years, we believe series 2014 bondholders are materially disadvantaged; therefore, we rate the subordinate-lien bonds one notch below the senior-lien debt. The city has closed its senior-lien revenue pledge, and it has covenanted to not issue additional parity senior-lien debt. Officials intend to use series 2014 bond proceeds to refund series 2004A bonds for cost savings and finance certain water line and sewer rehab capital improvements. The system also fully self-supports roughly \$22.9 million of tax-secured debt; all transfers from the enterprise fund, however, are subordinate to revenue bond debt service.

The system provides water and sewer services to the entirety of the corporate city limits and the neighboring cities of Rowlett and Sachse. In all, the retail customer base of about 69,000 has grown relatively slowly, averaging less than 1% growth annually over the past five years; the outside-city area, however, is growing slightly faster.

Garland, with a population estimate of 231,600, is about 90% developed. We consider median household effective

buying income a good 105% of the national average. In addition, unemployment decreased to 5.9% in 2013 from 6.8% in 2012; unemployment remains below the national average.

Growth in the late-1990s in Garland and system upgrades and expansions drove the wastewater system's needs, which is where the city directed most of the system's capital improvement program funding. Garland also serves parts of Dallas, Richardson, Mesquite, and Sunnyvale; areas that have experienced rapid residential growth over the past decade.

As Garland nears residential buildout, much of its growth is now due to commercial, especially retail, development, including a mall in northern Garland and a Bass Pro Shops that anchors a major redevelopment project on Lake Ray Hubbard. The Firewheel and Bass Pro Shops areas were connected via the extension of a toll road, which led to the development of additional commercial frontage and the entry of other large retailers. Despite the presence of large industrial and manufacturing employers, we understand the system is not dependent on any of its principal water and sewer customers. The 10 leading water customers account for just 8.2% of total water usage.

In our opinion, the system's finances are sound. For fiscal 2013, fixed-charge DSC was, in our view, a good 1.3x; this ratio included \$4.2 million of self-supported general obligation debt and roughly \$22 million of minimum payments for purchased water to NTMWD before making \$10.6 million of transfers into the city's general fund. DSC of senior-lien revenue bonds only was still, in our opinion, strong at 1.94x in fiscal 2013 despite the system being in stage three of its drought management plan to reduce consumption by 10%. Pledged net revenue in fiscal 2013 provided, in our view, a strong 1.88x DSC of senior- and subordinate-lien revenue debt in fiscal 2014.

Due to dry-weather conditions and water conservation efforts, Garland's annual water usage remains below its minimum annual water purchase costs. Therefore, the city is paying for water it does not use. Water conservation efforts lowered average daily demand to 30 million gallons per day (mgd) in 2013 from 34 mgd in 2011; more importantly, annual usage decreased to 10.9 billion gallons from 12.3 billion gallons, well below Garland's minimum annual water purchase of 13.7 billion gallons. We recognize the city council consistently passes through wholesale rate increases from NTMWD onto its customers. NTMWD raised rates by 10% in October 2013 to \$1.87 per 1,000 gallons consumed; it will increase rates by 10% in 2014 and 9% in 2015 to support a major new water supply pipeline project.

System liquidity is an identified strength. Fiscal 2013 ended with roughly \$26.2 million in cash and equivalents, or 172 days' cash on hand between the water and sewer funds, compared to the city's 45-day working capital policy and 60-day target. The city's five-year financial projections estimate it will maintain at least 73 days' cash on hand. City officials remain committed to water conservation mandates, generally following NTMWD's guidelines step for step.

City officials have consistently raised rates, as necessary, over the past several years. Management intends to raise water and sewer rates by 10% and 3%, respectively, in October 2014. Management believes this will help maintain, what we consider, good DSC, which service cost increases, including NTMWD rates, would otherwise pressure. We believe rate increases will likely help support continued system investment and future debt sales. Management has identified \$119 million of capital commitments through fiscal 2018, which it plans to fund with additional subordinate-lien revenue bonds. An 8,000-gallon residential water and sewer bill is \$84.65 monthly, in-line with the regional average; in our view, this equals an affordable 2.3% of median household effective buying income.

We consider bond provisions just adequate with an additional bonds test equal to 1.25x average annual debt service and 1x maximum annual debt service, coupled with a rate covenant equal to just 1x annual debt service. A debt service reserve fund will not exist for the series 2014 subordinate-lien bonds. We, however, believe, what we consider, the system's strong liquidity mitigates the lack of a debt service reserve fund.

We expect debt, which we consider currently moderate, to increase. Following the series 2014 debt issue, the system will support \$195.8 million of senior-lien debt, \$39.5 million of subordinate-lien debt, and \$22.9 million of tax-secured debt. The system's debt-to-plant ratio was, in our view, a moderate 62% of the plant's net value in fiscal 2013. We consider principal debt amortization above average with officials planning to retire 64% over 10 years. Officials currently plan to issue \$35.2 million of additional debt in 2015 for certain water and wastewater capital improvements.

## Outlook

The stable outlook reflects Standard & Poor's opinion that Garland's largely built-out status, role as a distributor of regional water, and strong financial management will likely allow the city to sustain its financial profile. In addition, we expect Garland to continue to pass along increasing water and debt service costs to customers so it can maintain, what we view as, its historically good financial metrics. While we expect some fluctuations over time due primarily to weather effects on Garland, we do not expect to lower the rating within the next two years.

## Related Criteria And Research

### Related Criteria

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

### Ratings Detail (As Of May 12, 2014)

Garland WS		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Garland WS (AGM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Garland wtr/swr</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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