

RatingsDirect®

Summary:

Albuquerque-Bernalillo County Water Utility Authority, New Mexico; Water/Sewer

Primary Credit Analyst:

Theodore A Chapman, Farmers Branch (1) 214-871-1401; theodore.chapman@spglobal.com

Secondary Contact:

Omid Rahmani, Farmers Branch + 1 (214) 765 5880; omid.rahmani@spglobal.com

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Credit Profile

US\$86.0 mil sr lien jt wtr & swr sys imp rev bnds ser 2020 due 07/01/2030

Long Term Rating AAA/Stable New

Albuquerque (Albuquerque Jt Wtr & Swr Sys)

Long Term Rating AAA/Stable Affirmed

Preliminary Rating NR(prelim)

Albuquerque Bernalillo Cnty Wtr Util Auth jt wtr and swr sys imp rev bnds

Long Term Rating AAA/Stable Affirmed

Albuquerque Bernalillo Cnty Wtr Util Auth WTRSWR

Long Term Rating AA+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Albuquerque-Bernalillo County Water Utility Authority, N.M.'s (the authority) series 2020 senior-lien joint water and sewer system improvement revenue bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the authority's senior-lien debt outstanding, and its 'AA+' rating on the authority's series 2014B subordinate-lien bonds, the only rated subordinate-lien obligation. The outlook is stable.

We have applied our utility revenue bond criteria to determine the authority's general creditworthiness (issuer credit rating) and have applied this rating to the senior-lien issues. Because of the open nature of the senior lien, meaning additional parity debt could still be issued in the future, we continue to make a rating distinction between the two liens. We expect management will primarily use the senior lien for its capital market debt.

As of the beginning of fiscal 2020, the authority has \$507 million in senior-lien bonds (excluding this sale) and \$57 million in subordinate-lien obligations.

The rating reflects, in our opinion, the combination of extremely strong enterprise and financial risk profiles. The enterprise risk profile reflects our opinion of the authority's:

- Service area that includes the state's primary economic center, with an employment base that was resilient through the recession and continues to exhibit stability;
- Robust planning efforts that ensure that operational and financial requirements are well aligned, including resource management and sustainability; financial policies that establish strong levels of pay-as-you-go funding; and operations that reflect a long-term water supply from a mix of surface and groundwater; and
- Combined water and sewer rates that remain very affordable even with a number of recent and planned rate

adjustments.

The financial risk profile reflects our view of the system's:

- Financial performance that has seen a sustained recovery. Immediately following the introduction of a new raw water supply source and the corresponding treatment facilities, the authority's coverage and cash positions dipped measurably but have rebounded very well ever since;
- Rapid roll-off of its existing long-term debt, allowing additional debt-funding of projects without pressuring rates or financial results, and providing management the capacity to address what is still a sizable capital improvement plan; and
- Strong financial management practices and policies, which, in our view, makes it likely that recent financial performance will continue into the future.

Proceeds of the series 2020 bonds will be used for general system improvements. The bonds are secured by a first-lien pledge on the net revenues of the authority's retail waterworks and sanitary sewer system. The authority has no direct-purchase obligations or what we would deem as less traditional debt instruments that could expose it to contingent liquidity risks.

Additional senior-lien bonds may be issued so long as senior-lien debt service coverage (DSC) is at least 1.33x maximum annual debt service (MADS), whereas the test for additional subordinate-lien debt is 1.2x MADS. Debt service reserve funds (DSRFs) are established on a series-by-series basis; no DSRF is being established for the series 2020 bonds. Management generally sets its rates to achieve at least 1.5x total DSC.

The authority has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the system's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues and allows us to assign a senior-lien rating higher than that of the U.S.

Enterprise Risk

Albuquerque-Bernalillo County Water Authority serves almost 210,000 metered accounts, or an estimated 95% of the total residents of the county, although aside from annexations or other one-time system expansions, the annual growth rate has moderated greatly since the recession and subsequent recovery. The Albuquerque metropolitan statistical area (MSA) has a broad and diverse economy and is the largest economy in the state. With an estimated service area population of 681,000, employment opportunities in the MSA are led by the federal and local government, the flagship campus of the University of New Mexico, a robust health care sector, and Sandia National Laboratories. The film and entertainment industry also continues to grow, with multibillion-dollar commitments announced by both Netflix and NBC Universal over the next 10 years. In addition, financial services and technology are growth sectors, including larger new additions by Fidelity Investments and Facebook. Therefore, the November 2019 (the most recent available) unemployment rate for the MSA of 4.3% is better than the state's although slightly higher than that of the U.S. The county's median household effective buying income is roughly on par with the nation's. The authority has no concentration concerns from its principal customers relative to its total operating revenues.

The authority derives its raw water from a diverse supply that includes both ground and surface water. In 2019, surface and reclaimed water supplied 71% of the total raw water, mainly from the Rio Grande and Colorado Rivers by way of

direct water rights or firm bilateral agreements. Authority management believes that the current supply will be sufficient to support a total population of at least 1 million, given the decades of success of resource management by way of voluntary and mandatory water conservation measures. Water levels vary in the reservoirs that impound the surface water. As of January 2020 in the Rio Grande basin, Abiquiu Reservoir had 84,127 acre-feet of available water in storage, well below its maximum capacity of over 1.1 million acre-feet and its average for the past 10 years of about 152,000 acre-feet. The Heron Reservoir has also dealt with multiple consecutive years of low flows, including below-average levels for the entire upper Rio Grande basin in 2019. Still, the authority did not suffer any curtailments or other limitations in its 2019 surface water allocations, and has the option of drawing more on existing groundwater sources, including that which it has stored in recent years.

The authority's governing board in 2013 implemented additional rate increases for 2016 and 2018 with the goal of generating 5% operating revenue growth each time. Even with every-other-year rate increases since the beginning of the decade, rates, in our view, remain extremely affordable. Based on S&P Global Ratings' universal assumption of 6,000 gallons of water and sewer service, a monthly residential bill has climbed to about \$75, or about 2.1% of median household effective buying income. Management's current financial plan indicates it may next propose a 5% rate increase for fiscal 2021. The authority in recent years has implemented a water assistance fund to establish an income-based program to assist customers with bill payments, much of which is funded by employee donations, as well as a low income credit program in which dedicated funds are appropriated from the annual budget to provide assistance to 1,000 customers per year.

Based on our operational management assessment (OMA), we view the authority to be a '1' on a scale of 1-6, with '1' being the strongest. In our opinion, this indicates the strongest alignment of operations and organizational goals. The strong OMA includes a diversified and ample long-term raw water supply, aggressive and well-embedded programs for both water conservation and re-use, and a comprehensive strategic vision for all divisions of the utility that includes benchmarking and high expectations across all facets of operations. In addition to having robust water conservation measures in place for decades, the authority in 2009 began an aquifer storage and recovery project that can inject as much as 10,000 acre-feet per year as underground storage. It has also been active in non-potable water reuse, serving large irrigators and industrial customers since 2000.

In 2003, the state legislature created the Albuquerque-Bernalillo Water Utility Authority and transferred all functions, assets, and liabilities of the city of Albuquerque water and sewer system to the authority; separation of accounting functions, including audited financial statements, was completed in 2013. The authority is governed by a board consisting of three city council members, three county commissioners, the mayor of Albuquerque, and the village of Los Ranchos trustee (nonvoting). In 2005, the authority became a separate political subdivision of the state rather than a joint agency of the city and county.

Financial Risk

The authority's financial profile has historically been a strength, sustained by robust financial management policies and practices. This includes establishing rates to target a budgeted 1.5x senior-lien annual DSC, stronger than even its 1.33x senior-lien rate covenant. DSC and cash reserves. This is in part to recommit to performance that weakened for several years starting in 2010, as the authority adjusted operations to include treated surface water, as well as the related increase in annual debt service requirements. At this time, the board began implementing every-other-year rate

adjustments, typically pre-approving one future year increase at the same time as implementing one for the current budget. The authority has since rebuilt reserves substantially; as of the end of fiscal 2019, unrestricted cash stood at \$173 million, and management has committed to budgeting an additional \$2 million per year to grow its rate stabilization reserve. All-in coverage has also been maintained at what we consider extremely strong levels; for fiscal 2019 it stood at 1.50x, and management's forecast--which we view as attainable--shows coverage consistently at or near 1.6x. All-in coverage is S&P Global Ratings' adjusted debt service coverage metric that includes all recurring obligations of utility operating revenues, regardless of lien or accounting treatment. Total available cash reserves now stand at equivalent to almost 500 days of operating expenses, from as little as 12 days' cash on hand in 2010.

The authority's "decade plan" for 2020-2029 has identified capital commitments of approximately \$380 million in the first five years, through fiscal 2024. It also assumes that the authority will move closer to its long-term goal of 50:50 cash to debt funding, as over 70% of the existing long-term debt will have been repaid over that same timeline. Therefore, we agree that additional periodic use of debt could be layered on to the existing capital structure without adversely affecting financial performance. The largest single program in the capital plan is a comprehensive upgrade to the system's southside water reclamation plant.

Based on our financial management assessment (FMA), we deem the authority to be a '1' on a scale of 1-6, with '1' being the strongest. An FMA of strong indicates that practices are strong, well embedded, and likely sustainable. The authority maintains most of the best practices deemed critical to supporting credit quality and these are well embedded in its daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. This includes regularly updating the long-term financial forecast and capital improvement plan, constant budget monitoring, and a robust set of internal policies that, in our view, make it likely that the recently improved financial performance will be sustainable over time.

Outlook

The stable outlook reflects our anticipation that the rebound in financial performance is sustainable over our two-year outlook horizon and probably beyond, given the long-term view toward rate adjustments and commitment to maintaining the authority's restored reserve levels, a front-loaded repayment schedule, and a substantial level of capital spending from internally generated revenues.

Downside scenario

Although we do not expect it, downward pressure on the rating would most likely come from a precipitous drop in financial performance; for example, by way of aggressive use of debt that outstrips growth in operating revenues, perhaps driven by a new unfunded environmental regulatory mandate.

Environmental, Social and Governance

The Albuquerque MSA receives, on average, 11 inches of rainfall per year, only about 30% of the U.S. average. Therefore, efficient water usage and conservation in a desert climate has been the norm since the authority was

formed. The management team and city leadership have been so successful that annual water demand averaging 94,520 acre-feet (approximately 84 million gallons per day) from 2015-2019 has actually decreased by over 15% from about 110,000 acre feet per year 25 years ago, despite the number of metered accounts increasing from about 65,000 to the current count of more than three times that many customers. Despite the improvements, climate change impacts and variability are explicitly incorporated into the authority's water resources management strategy, and water reuse as well as aquifer storage and recovery are identified as separate water supply sources in that same plan that looks out to the year 2060 and even beyond. Renewable energy is also a core part of the authority's intentions to reduce its carbon footprint, including 6 megawatts of solar capacity at its flagship surface water treatment plant, and an existing methane capture system that can generate enough electricity to run the entire southside water reclamation plant. While we acknowledge that the upfront capital investments in many of these projects are not insignificant, the resultant operational budget savings and future capital cost avoidance have the potential to lend stability to future financial performance, which we would view as a positive for credit quality.

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