

# Garland, TX

## Water and Sewer System Revenue Bonds

### New Issue Summary

**Sale Date:** Week of Nov. 5, via competitive bid.

**Series:** \$48,735,000 Water and Sewer Revenue Refunding, New Series 2019A.

**Purpose:** Proceeds will be used to refund a portion of the city's outstanding bonds for debt service savings, pay a portion of the city's water and sewer system's (the system) commercial paper notes and pay costs of issuance.

**Security:** All bonds are payable from a pledge of the net revenues of the city's water and sewer system (the system). The outstanding prior lien bonds (through series 2013) are senior to the new series bonds, which are a second lien obligation. The prior lien is closed. The bank notes represent a fourth lien on system revenues and are subordinate to the outstanding prior lien bonds, the second lien new series bonds and certificates of obligation.

### Key Rating Drivers

**Adequate Financial Metrics:** Financial performance for fiscal 2018 came in as forecast with some improvement in both debt service coverage (DSC) to 1.8x on an all-in basis and cash balances. DSC net of transfers improved slight also to 1.3x.

**Moderating Wholesaler Costs:** The city's purchased water costs from North Texas Municipal Water District (NTMWD) have increased substantially over the years, pressuring management to keep pace with rate recovery. However, a recent budget methodology change adopted by NTMWD is expected to result in lower purchased water costs moving forward. The system has assured water supply through at least 2030 from its long-term, perpetual contract with NTMWD.

**Reduced Rate Flexibility:** The combined residential bill for fiscal 2020 slightly exceeds Fitch Ratings' 2.0% of median household income (MHI). Favorably, the city's wholesale provider is expecting smaller rate adjustments over the coming five years, which should provide some rate relief.

**Limited Excess Cash Flow:** The system makes annual transfers to the city's general fund totaling 11% of operating revenues (roughly \$12 million in fiscal 2018). The transfers absorb a good portion of the excess cash flow, increasing the need for debt funding of capital improvements.

**Increasing Debt Levels:** Direct system debt-per-customer levels align to the 'AA' medians but are expected to increase based on planned debt financing of NTMWD's capital improvement plan (CIP). The increasing debt levels are somewhat mitigated by the system's rapid rate of debt amortization.

**Lack of Notching:** No rating distinction is made between the senior, junior and fourth lien ratings due to the financial strength and overall credit profile of the system and minimal legal distinction/protection between liens.

### Rating Sensitivities

**Diminished Financial Cushion:** Deterioration of the system's financial metrics, as debt carrying costs are expected to rise, could negatively impact the city of Garland's water and sewer rating.

### Ratings

#### New Issues

\$48,735,000 Water and Sewer System Revenue Refunding Bonds, New Series 2019A AA

#### Outstanding Debt

Water and Sewer Revenue Bonds	
- Senior Lien	AA
Water and Sewer Revenue Bonds	
- Subordinate Lien	AA
Water and Sewer Revenue Bonds	
- Bank Notes (4th Lien)	AA

#### Rating Outlook

Stable

#### Applicable Criteria

[U.S. Water and Sewer Rating Criteria \(November 2018\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(May 2019\)](#)

#### Related Research

[Fitch Rates Garland, Texas' Water and Sewer Rev Bonds 'AA'; Outlook Stable \(October 2019\)](#)

[Fitch Ratings 2019 Outlook: U.S. Water and Sewer Sector \(December 2018\)](#)

[2019 Water and Sewer Medians \(November 2018\)](#)

[Public Sector, Revenue-Supported Entities Rating Criteria \(May 2019\)](#)

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## Credit Profile

The system serves approximately 69,000 city water customers and purchases its water on a wholesale basis under a perpetual “take-or-pay” contract from NTMWD. Existing and projected water supplies from NTMWD reportedly are sufficient to meet all customer demands through at least 2030. The system serves around 67,000 city sewer customers within the city as well as portions of five other cities, including Dallas.

### Satisfactory Financial Performance

System operations have been pressured by increasing debt service and purchased water costs, resulting in financial metrics weaker than Fitch's 'aa' category medians. From fiscal 2011 to fiscal 2018, the city's annual purchased water rate increased on average by 10%. Audited fiscal 2018 results were good, with an improved 1.8x all-in DSC, up from 1.6x the year prior. Cash balances improved to 143 DCOH after posting a weaker 107 days in fiscal 2017.

Preliminary results for fiscal 2019 point to stable financial metrics that align closely to fiscal 2018 results. Management forecasts, which include conservative assumptions of low water demand and anticipated debt to financial capital improvements, point to all-in DSC ranging from 1.5x to 1.7x.

Transfers out of the system are above average, but have been stable, averaging 11% of operating revenue over the past five fiscal years and are projected at similar levels over the forecast period. The transfers absorb most of the excess cash flow that could otherwise be used for capital projects, increasing the need for debt funding for capital improvements.

### Wholesale Methodology Revision Benefits City

For fiscal year ended 2019, NTMWD revised its budget, changing its water consumption assumption from 100% to 90%. The reduction to a 90% assumption for delivering contractual minimums results in a lower cost per 1,000 gallons to member cities. NTMWD rates had been expected to range from 5% to 10% through 2022. However, under the revised methodology, NTMWD now expects more modest increases of 2% to 6% through 2024. Purchased water costs make up 49% of fiscal 2018 water and sewer operating expenses and are expected to grow to just over 50% by 2022 due to the updated NTMWD budget methodology. Prior forecasts had indicated wholesale costs encompassing closer to 57% of operating expenses. The city's dependence on wholesale water creates cost pressure outside of the system's direct control, and the city's required minimum purchase was set when water use was significantly higher. The city's contract with NTMWD is a positive, providing for ample water demand.

### Reduction in Purchased Water Costs Benefits Rate Payers

Adopted fiscal 2020 water and sewer rates produce a monthly bill of \$100.31 (under Fitch's standard usage assumption of 7,500 gallons per month for water and 6,000 gallons per month for sewer), above the average of municipal systems in the Dallas/Fort Worth metropolitan statistical area (DFW MSA) and registering just above Fitch's affordability threshold of 2% of MHI. Historically, the city has raised its rates in an effort to keep pace with rising purchased water costs, increasing water rates by an average 10% annually for fiscal years 2013–2017. Reflective of the reductions in expected rates from NTMWD, the city is projecting smaller water rate increases of about 4% annually through 2024. The reduced rates anticipated by NTMWD allow the city to moderate its own rate increases, preserving some rate flexibility. Sewer rate increases have been much smaller in scale, averaging closer to 2% over the last five years. Similar 2% sewer rate increases are expected through 2024.

### Stable Leverage

The system's fiscal years 2020–2024 CIP totals just under \$260 million, which will be largely debt funded, leading to elevated debt ratios compared to 'aa' rating category medians. Approximately 60% of the CIP addresses sewer system improvements that will ensure compliance with new and enhanced regulatory and operational standards while the remaining roughly 40% is for water system improvements.

Despite continued debt issuance to address capital needs, leverage metrics have trended down over the last five years.

## Rating History – All Liens

Rating	Reviewed/ Action	Outlook/ Watch	Date
AA	Affirmed	Stable	10/25/19
AA	No Action	Stable	1/30/19
AA	Affirmed	Stable	11/16/18
AA	Affirmed	Stable	5/7/18
AA	Affirmed	Stable	5/5/17
AA	Affirmed	Stable	11/7/16
AA	Affirmed	Stable	9/16/15
AA	Downgraded	Stable	7/20/15
AA+	Affirmed	Negative	5/9/14
AA+	Affirmed	Negative	4/13/14
AA+	Affirmed	Negative	4/25/13
AA+	Affirmed	Stable	5/17/12
AA+	Revised	Stable	4/30/10
AA	Affirmed	Negative	3/11/05
AA	Assigned	Stable	8/1/03

Debt to funds available for debt service has declined to 5x, down from 6.8x in fiscal 2014. Direct system debt per customer for fiscal 2018 of \$1,651 is favorable compared to the 'aa' category median of \$1,731, but debt-to-net plant is high at 51% compared to the 'aa' median of 46%. Debt per customer levels are projected to grow to over \$2,700 within five years, rising above the 'aa' median of \$1,673. Very rapid amortization is a positive, with principal payout at 72% and 99% in 10 and 20 years, respectively, compared with the category medians of 48% and 90%, respectively.

## System and Service Area

Garland (General Obligation bonds and Issuer Default Rating AAA/Rating Outlook Stable) benefits from its location within the DFW MSA. Manufacturing and distribution remain the city's primary economic engines, and the city's industrial market reportedly is the second largest in the DFW MSA. City wealth levels are slightly below state (96%) and national levels (96%). August 2019 unemployment is favorable at 3.3%, and aligns closely to the state's 3.6% and the nation's 3.8%.

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3' – ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/site/esg](http://www.fitchratings.com/site/esg).

## Financial Summary

(\$000, Audited Years Ended Sept. 30)	2014	2015	2016	2017	2018
<b>Balance Sheet</b>					
Unrestricted Cash and Investments	24,956	21,633	24,931	20,359	29,810
Other Unrestricted Current Assets	10,125	14,620	12,995	19,049	15,148
Current Liabilities Payable from Unrestricted Assets	(20,956)	(22,323)	(21,458)	(21,961)	(23,744)
<b>Net Working Capital</b>	<b>14,124</b>	<b>13,930</b>	<b>16,468</b>	<b>17,447</b>	<b>21,214</b>
Net Fixed Assets	417,375	414,773	426,165	441,040	443,616
Total Debt	244,820	234,937	226,169	228,409	225,712
<b>Operating Statement</b>					
Operating Revenues	94,154	101,147	108,458	108,306	120,542
Non-Operating Revenues Available for Debt Service	233	273	257	279	576
Connection Fees	56	104	214	563	188
<b>Total Revenues Available for Debt Service (Net RSF Transfer)</b>	<b>94,443</b>	<b>101,524</b>	<b>108,929</b>	<b>109,148</b>	<b>121,306</b>
Operating Expenditures (Excluding Depreciation)	58,668	59,972	65,017	69,301	76,124
Depreciation	19,278	19,983	20,403	20,701	21,367
<b>Net Revenues Available for Debt Service</b>	<b>35,775</b>	<b>41,552</b>	<b>43,912</b>	<b>39,847</b>	<b>45,182</b>
Senior Lien ADS	19,653	16,513	16,793	16,397	13,790
All-In ADS	24,379	25,832	26,236	25,744	25,139
<b>Financial Statistics</b>					
Senior Lien DSC (x)	1.8	2.5	2.6	2.4	3.3
All-In DSC (x)	1.5	1.6	1.7	1.6	1.8
Days Cash on Hand	155	132	140	107	143
Debt/Net Plant (%)	59	57	53	52	51
Outstanding Long-Term Debt Per Customer (\$)	1,817	1,737	1,661	1,675	1,651
Outstanding Long-Term Debt Per Capita (\$)	1,038	990	956	957	931
Free Cash/Depreciation (%)	4	24	28	21	33

Notes: Fitch may have reclassified certain financial statement items for analytical purposes. N.A. - Not available.  
Source: Fitch Ratings, Fitch Solutions, Garland, TX.

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