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Summary:

Brazos River Authority, Texas; Water/Sewer

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Credit Profile		
US$22. mil wtr supply sys rev bnds ser 2009 due 02/15/2032		
Long Term Rating	AA/Stable	New
Brazos River Auth wtr		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Brazos River Auth wtr supply sys rev rfdg bnds ser 2001B dtd 05/01/2001 due 02/15/2002-2015		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its underlying rating (SPUR) on Brazos River Authority, Texas' water supply system revenue bonds one notch to 'AA' from 'AA-' based on the authority's maintenance of a strong and likely sustainable financial position due to its favorable position as the raw water provider of choice throughout a watershed nearly the size of Tennessee during a time when demand is increasing rapidly from both municipalities and electric power generators. The outlook is stable.

Standard & Poor's also assigned its 'AA' long-term rating, and stable outlook, to the authority's series 2009 water supply system revenue bonds.

The rating continues to reflect, in our opinion, the authority's:

- Willingness to adjust rates as necessary to maintain its financial position and fund additional capital projects;
- Competitive rates -- Even after a series of planned rate increases, management is projecting raw water to remain below $100 per acre-foot by the end of the next decade; and
- Regional nature, which has created such strong demand that historically there is often a wait list for authority water, moderating the risk of customer loss or default.

Sales to utilities that are, in general, rated at or below low investment grade preclude a higher rating.

Brazos River Authority is a conservation and reclamation district that manages a river basin roughly the size of Tennessee. The authority built, owns, and operates treated water and sanitary sewer systems throughout Texas, as well as water supply storage reservoirs and dams throughout the watershed. While the authority is a state-created agency, it operates solely on revenues from services provided to customers throughout the 42,000-square-mile service area, or about one-sixth of Texas' total land. Contracted to receive up to 660,000 acre-feet of water annually, these customers include municipalities, special districts, electric utilities, and industrial users.

Should the authority be permitted to sell additional water, the potential additional customers that are now essentially on a wait list will likely commit quickly to the authority. Because of the strong growth throughout the Brazos River watershed, however, if any existing customer were to choose to fund the infrastructure to deliver an alternate supply and, therefore, leave the authority, this wait list and the authority's low rates make its water highly attractive for remarketing purposes. It would also even further improve the water supply system's strong financial position, even if it were never approved for a permit to sell additional water. Currently, the authority has a request before the state environmental authority that, if approved, would allow it to sell an additional 420,000 acre-feet annually, nearly 65% more than the current permit, to authority customers. Historically, a large portion of water sales has been contractually committed at rates currently below the market price. These contracts also have limited rate-raising flexibility; this has led to a rate structure in which management's ability to pass through the full cost of service to all ratepayers has been limited. Any extensions of contracts with existing customers, or outright new authority customers, would include cost-of-service-based rates that are higher but still extremely competitive (about slightly less than $60 per acre-foot for fiscal 2009). While the additional demand will diversify the rate structure and, to a lesser extent, the customer base, there will remain significant concentration in Energy Futures Holding Corp. (B-/Stable/--), formerly TXU Corp., and NRG Energy Inc. (B+/Stable/B-2), which account for more than 15% of water supply system revenues combined.

Brazos River Authority's financial operations remain sound. Raw water supply system revenues, which account for half of total revenues, continue to provide a secure revenue stream and strong margins. Liquidity was also very strong with about one year's unrestricted cash on hand in fiscal 2008. Officials plan to draw down cash to fund capital improvements, and they are steadily raising system water rates to ensure continued sound coverage. Officials do not plan to issue additional parity debt until likely near the end of the next decade, at which time they will need to fund a new reservoir being jointly built with Houston. Management adopted a 50-year capital plan in early 2007, and it is projecting annual debt service coverage of 1.8x or better through fiscal 2015.

A pledge of net system raw water revenues secures the bonds, which are subordinate to the series 1972, 1975, and 1976 prior-lien bonds. Payments to federal agencies for additional contracted water storage are system operating expenses and, therefore, senior to these bonds. The authority intends to place the 2009 bonds privately with Texas Water Development Board.

Currently, about one-third of the water the authority sells is tied to the system rate, corresponding to more than half of system revenues. The authority automatically renews all expiring long-term contract-based rates at the system rate. Based on current contract rollover dates, 50% of the contracts will be at the system rate by 2016. Rapid population growth, mainly in central Texas, however, will have a two-fold benefit for the authority. Small, but rapidly, growing municipalities and special districts have already indicated the likelihood of turning to the authority to address long-term water supply and treatment needs. In addition, a number of announced or planned electric power generation projects will need the authority's water for cooling and operational purposes. Management will only enter into new water contracts at the system rate.

These factors will all serve to diversify the authority's revenues away from contracts that, by today's standards, are below market price and do not fully reflect the authority's current service costs. Yet, despite the limited ability to implement a true cost-of-service rate fully, the system rate was a very competitive $55 per acre-foot for fiscal 2008; projections have it gradually rising to just about $62 within five years. The request before the Texas Commission on Environmental Quality could allow the authority to treat the entire infrastructure as a single system rather than reservoir by reservoir and project by project.

Outlook

The stable outlook reflects Standard & Poor's expectation that, given the ongoing rapid growth in the population of the municipalities served and announced electric generation projects in the authority's service territory, the authority will be able to implement its cost-of-service-based rate structure more fully. It is Standard & Poor's expectation that this should bolster the water supply system's already-sound financial position and that management will continue as-necessary rate increases to support its ability to maintain sound financial performance and address long-term capital plan projects.

Related Research

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

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