

CREDIT OPINION

30 April 2020

 Rate this Research

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Mesquite (City of) TX Wtrwrks & Swr Sys.

Update to credit analysis

Summary

[Mesquite Waterworks & Sewer System, TX](#)'s (Aa2) credit profile benefits from a large, diverse customer base adjacent to [Dallas](#) (A1 stable), below average resident income indices that is partially offset by affordable housing prices and an above average asset condition benefitting from regular reinvestment. The profile also incorporates healthy financial performance which will continue as the system continues to support annual rate increases for continued moderate debt issuances. Liquidity continues to be below comparable peers, but has grown materially over the past five years. The system's debt burden remains a strength of the credit, as debt is materially below comparable peers, but will be issuing debt over the next two years.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for the Mesquite Waterworks & Sewer. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Mesquite Waterworks & Sewer changes, we will update our opinion at that time.

Credit strengths

- » Large, diverse customer base in the Dallas-Ft Worth Metroplex
- » Above average asset condition
- » Low debt levels

Credit challenges

- » Below average resident income indices
- » Liquidity materially below peer averages

Rating outlook

Moody's generally does not assign outlooks to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Substantial growth in customer base and resident income indices
- » Strong operating performance bolstering liquidity and increasing debt service coverage

Factors that could lead to a downgrade

- » Violation of legal covenants
- » Diminished liquidity
- » Declining debt service coverage

Key indicators

Exhibit 1

Mesquite (City of) Waterworks & Sewer Enterprise, TX					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	26 years				
System Size - O&M (\$000)	\$53,082				
Service Area Wealth: MFI % of US median	85.40%				
Legal Provisions					
Rate Covenant (x)	1.50x				
Debt Service Reserve Requirement	DSRF funded at the lesser of the standard 3-prong test (Aa)				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aaa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue (\$000)	\$53,559	\$59,676	\$63,465	\$67,610	\$69,274
System Size - O&M (\$000)	\$37,286	\$40,805	\$42,731	\$46,704	\$53,082
Net Revenues (\$000)	\$16,391	\$19,065	\$21,146	\$21,726	\$17,437
Net Funded Debt (\$000)	\$72,382	\$70,295	\$72,134	\$73,800	\$82,339
Annual Debt Service (\$000)	\$8,032	\$8,093	\$8,198	\$8,637	\$9,065
Annual Debt Service Coverage (x)	2.0x	2.4x	2.6x	2.5x	1.9x
Cash on Hand	104 days	160 days	188 days	231 days	236 days
Debt to Operating Revenues (x)	1.4x	1.2x	1.1x	1.1x	1.2x

Source: Mesquite Waterworks & Sewer System audited financial statements

Profile

The City of Mesquite is in [Dallas County](#) (Aaa stable), just east of the City of Dallas' city limits on Interstate 20. The local economy is anchored by retail, distribution and manufacturing. In fiscal 2019, water and sewer customers totaled 40,709, and 38,972 respectively, up modestly from the prior year.

Detailed credit considerations

Service area and system characteristics: large, stable customer base with utilities provided by NTMWD

Mesquite's waterworks and sewer system will continue to benefit from a large and stable customer base which will continue to grow given ongoing economic activity and residential development. Positively, the system has ample capacity available from the water and wastewater provider, North Texas Municipal Water District (NTMWD), and its distribution assets are in good condition. The local economy is diverse, anchored by retail, distribution and manufacturing, and benefits from its favorable location near Dallas.

The city's population remained stable in 2018 with approximately 144,000 residents. Resident income indices within the city are below national levels, an estimated 85.4% (median family income), and 69.8% (per capita income) of the national median in 2018. Favorably, the median home value is 63% of the US, suggesting the city is relatively affordable. Parallel to population growth, customer

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accounts have been stable. In fiscal 2019, water customers grew 1.9% to 40,709 and sewer customers grew 2.4% to 38,972. Major utility customer concentration is moderate with the top 10 customers accounting for 9.15% of fiscal 2019 revenues.

Debt service coverage and liquidity: healthy debt service coverage;

Mesquite's waterworks and sewer system will maintain healthy financial performance given planned rate increases and conservative budgeting. The system's senior lien debt service coverage ratio declined in fiscal 2019 to 1.9x due to a \$4.5 million administrative reclassification to an expense of a prior annual transfer to the general fund. The reclassification increases expenditures, which in turn narrows debt service coverage levels. Net of the reclassification, senior lien debt service coverage would have been at 2.4x. Maximum Annual Debt Service (MADS) declined in fiscal 2019 to 1.65x from 2.06x the prior year.

In fiscal 2020, the system is projecting coverage to increase to 2.15x due to a 4.5% rate increase that is expected to boost revenues and working capital, partially offset by increases from NTMWD. The city completed a rate study in 2018 substantiated the tiered rate structure implemented several years ago and identified future rate increase needs. Following the study, the council approved a five year rate plan with annual increases of 4.5%, though the plan will be reviewed annually. Officials also anticipate completing rate studies every few years to ensure the rate structure and increases continue to support solid financial outcomes.

LIQUIDITY

In fiscal 2019, the unrestricted cash and investments totaled \$34.3 million or a healthy, though below median, 236 days cash on hand. Cash has grown in the last five years from 104 days cash on hand in fiscal 2015. The cash position is likely to remain stable based on continued rate increases planned over the next four years.

Debt and legal covenants: low debt profile supported by adequate legal coverage

The system's debt profile will remain modest and manageable with planned rate increases, although annual issuance is expected for a variety of system improvements and to expand the system to areas that are planned for residential development. Inclusive of the current issuance, the system's total revenue debt outstanding is \$85.2 million, or a favorable 1.09 times fiscal 2019 operating revenues. The city's capital improvement plan includes future debt financing of about \$34 million over the next two years, part of which will include expansions of the system to serve new residential developments.

Adequate legal covenants require rates to be imposed that will sustain a 1.5 times average annual debt service coverage, an additional bonds test of 1.5 times average annual debt service coverage, and maintenance of a debt service reserve equal to average annual debt service. The reserve requirement is largely met with sureties with [Assured Guaranty Municipal Corp.](#) (A3 stable)

DEBT STRUCTURE

The debt service schedule is descending from the maximum annual debt service of \$9.6 million scheduled for fiscal 2020. Final maturity is scheduled for 2039. Amortization is average with 61.6% of principal retired in 10 years.

DEBT-RELATED DERIVATIVES

All of the system's debt is fixed rate, and the system is not party to any derivative agreements.

PENSIONS AND OPEB

All system employees are employees of the City of Mesquite. The city is a participant in the Texas Municipal Retirement System, a multi-employer agent pension plan. Please see our report dated April 10, 2019, for more details on the city's pension plan.

ESG considerations

Environmental risks do not present a material immediate challenge to the district. The district's central Texas location puts it at medium risk for heat and extreme rainfall and high risk for water stress. These risks are mitigated by the county's economic shift away from mining and farming activity towards manufacturing and construction.

Low resident income indices present a challenge for the resident base, which is offset by the affordable housing prices. The city's proximity to Dallas provides for a strong employment base for the city's residents.

The city demonstrates good governance by annually retesting in their infrastructure and performing frequent rate studies to ensure that the system's financial performance remains healthy.

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REPORT NUMBER 1220896

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