

## **FITCH AFFIRMS BOERNE, TX'S OUTSTANDING UTILITY SYSTEM REVS AT 'A'; OUTLOOK STABLE**

Fitch Ratings-New York-28 October 2014: Fitch Ratings has affirmed the 'A' rating on the city of Boerne, Texas' outstanding \$42.1 million utility system revenue bonds, series 2006, 2009 and 2010.

The Rating Outlook is Stable.

### **SECURITY**

The bonds are secured by a first lien on the net revenues derived by the city from the operation of its electric, water and wastewater systems (collectively, the system). Net revenues include substantially all revenues and income of the system.

### **KEY RATING DRIVERS**

**SMALL, COMBINED UTILITY SYSTEM:** The city's utility system provides electric distribution, water, wastewater, gas and garbage removal services to the city and surrounding areas. Pledged revenues include the electric, water and wastewater system revenues, which account for 90% of the combined system's total.

**STABLE SERVICE AREA:** Economic indicators for the region are strong, helping to mitigate the currently above-average water and wastewater rates that are expected to increase going forward. The local economy has seen solid post-recession growth and electric load growth has been healthy, averaging 1.9% per annum over the past five years.

**LIMITED RISK POWER SUPPLY:** The system has entered into two consecutive all-requirements wholesale power supply contracts with San Antonio's City Public Service (CPS; rated 'AA+' with a Stable Outlook by Fitch), securing its power supply through Dec. 31, 2026. The utility has maintained its limited risk, distribution-only profile following the early termination of its wholesale power contract with the Lower Colorado River Authority (LCRA; revenue bonds rated 'A+') on Sept. 13, 2012. The termination of the LCRA contract remains subject to litigation.

**HIGH DEBT LEVEL:** The utility issued substantial debt in fiscal 2010 to fund a new wastewater recycling and treatment plant, which more than doubled its outstanding debt and caused Fitch-calculated debt service coverage (DSC) to weaken from historical levels. While leverage is high, DSC still compares favorably to the 'A' rating category median.

**AMPLE LIQUIDITY:** On a combined basis, the electric, water and wastewater funds maintain strong cash reserves that have been growing in recent years. Days cash on hand (DCOH) at fiscal year-end 2013 was 249 days, as compared to the median 113 days.

### **RATING SENSITIVITIES**

**STABILITY IN FINANCIAL PERFORMANCE:** A continued marked deterioration in financial metrics, especially to levels below rating category medians, would stress the rating.

**MATERIAL NEGATIVE LCRA OUTCOME:** Unanticipated pressure resulting from a material adverse decision in the LCRA contract dispute could lead to negative rating action. The utility's strong reserves provide some cushion against unexpected costs arising from the dispute.

## CREDIT PROFILE

The city of Boerne's combined utility is a municipally owned, city council-governed system that provides retail electric, water, wastewater, gas and garbage services to the city and portions of Kendall County (city is rated 'AA-', stable by Fitch). The system's gas and garbage services account for only a small portion of the combined utility system's revenues, while the pledged revenues account for 91%. The electric distribution system, the largest of the combined utilities by revenue, serves almost 5,000 customers and contributes approximately 57% of operating revenues.

## POWER SUPPLY CONTRACT DISPUTE

The utility's wholesale power was previously supplied through an all-requirements contract with LCRA that was scheduled to expire on June 24, 2016. However, Boerne terminated the contract early on Sept. 13, 2012 (along with six other LCRA customers) due to an ongoing contract dispute over pricing and accelerated debt amortization. The utility entered into a 9-month interim contract after the LCRA termination and has since transitioned to an all-requirements contract. The current contract expires June 24, 2016, at which time Boerne will transition to a different, but similar contract that extends through Dec. 31, 2026.

The all-requirement contracts retain the utility's low-risk distribution profile and favorably provide cost savings compared to the previous LCRA supply contract. However, the consequences of terminating the LCRA contract early are unclear. The 216th Judicial District Court of Kendall County, Texas and the Texas 4th Court of Appeals in San Antonio decided in favor of Boerne's claim of governmental immunity, but LCRA is appealing to the Texas Supreme Court. While any resulting pressure would be a rating factor in Fitch's future reviews, Boerne's strong liquidity position provides some cushion against a material adverse outcome.

## FINANCIALS

The system's financial metrics were historically stable but began to weaken in fiscal 2011, as anticipated, due to an increase in debt for wastewater operations. DSC has decreased from 2.83x in fiscal 2009 to 1.79x in fiscal 2013, but still compares favorably to the rating category median of 1.59x. Leverage decreased to 8.0x debt to funds available for debt service (FADS) at fiscal year-end 2013 from its high point of 9.9x after the 2010 issuance. While still high for the rating, leverage should continue to decrease as the wastewater debt amortizes, given that the system does not anticipate issuing new debt in the near term.

Liquidity has been and continues to be strong for the system, as shown by ample unrestricted reserves equal to 249 DCOH at fiscal year-end 2013. DCOH has historically averaged around 160 days, but liquidity increased substantially in 2013, in part due to the creation of a reserve related to the LCRA dispute, in which Boerne is accruing its power supply cost savings.

Fiscal 2014 is primarily on target to meet budget, as of June 30, 2014. However estimated DSC for the year is 1.49x, below previously projected DSC of 1.76x. The increased debt levels continue to have a measurable impact on coverage and leverage ratios. The maintenance of sound financial metrics, despite the increased leverage position, will be an important measure of the system's credit strength over the next several years.

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Applicable Criteria and Related Research:

- 'U.S. Public Power Peer Study -- June 2014' (June 13, 2014);
- 'U.S. Public Power Peer Study Addendum - June 2014' (June 13, 2014);
- 'U.S. Public Power Rating Criteria' (March 18, 2014);
- '2014 Outlook: U.S. Public Power and Electric Cooperative Sector' (Dec. 12, 2013).

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- U.S. Public Power Peer Study -- June 2014  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=749789](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749789)
- U.S. Public Power Peer Study Addendum - June 2014  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=750283](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750283)
- U.S. Public Power Rating Criteria  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=740841](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=740841)
- 2014 Outlook: U.S. Public Power and Electric Cooperative Sector (Calm Under Pressure)  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=725447](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=725447)

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