S&P Global Ratings

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Summary:

Brownsville, Texas Brownsville Public Utilities Board; Combined Utility

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Brownsville Public Utilities Board; Combined Utility

Credit Profile		
US$35.365 mil util sys rev rfdg bnds (taxable) (Brownsville Pub Util Brd) ser 2022A due 09/01/2052		
Long Term Rating	A-/Stable	New
US$16.735 mil util sys rev rfdg bnds (Brownsville Pub Util Brd) ser 2022 due 09/01/2052		
Long Term Rating	A-/Stable	New
Brownsville comb util		
Long Term Rating	A-/Stable	Outlook Revised

Rating Action

S&P Global revised its outlook to stable from negative and affirmed its 'A-' long-term rating and underlying rating (SPUR) on Brownsville, Texas' utility system revenue bonds, issued for the Brownsville Public Utilities Board (BPUB). At the same time, S&P Global Ratings assigned its 'A-' long-term rating, with a stable outlook, to BPUB's utility system revenue and refunding bonds, series 2022 and series 2022A. BPUB currently supports $306.8 million of outstanding senior-lien obligations and $535,000 of junior-lien bonds.

We revised the outlook to stable given BPUB's improved governance risk management, including new firm long-term bilateral contracts that reduce market exposure and that, in our opinion, temper its exposure to price spikes and volatility that periodically occurs in the Electric Reliability Council of Texas (ERCOT) market. The stable outlook further reflects the approved electric rate decrease, which will reduce transfers out to the rate stabilization fund (RSF) and improve rate affordability and BPUB's financial flexibility given the well-below-average incomes in the service area. The rate reduction program was approved to roll back rates implemented in 2013 to fund the Tenaska project, which was later terminated. We believe the rate reduction will improve financial flexibility and reduce historically high transfers to the RSF. The electric rate reduction in combination with the approved five-year water and wastewater rate increases is projected to result in fixed-charge coverage (FCC; S&P Global Ratings-calculated) averaging 1.4x during the next five years.

The series 2022 bonds are secured by a pledge of net revenues including electric, water, and sewer system revenues. We rate the bonds under our retail electric and gas rating methodology given the majority of net revenues comes from the electric utility system. The par amounts are about $16.7 million for the series 2022 bonds, and approximately $35.3 million for the 2022A taxable series. The proceeds will be used to refund certain outstanding commercial paper (CP) notes that were issued for capital improvements and amended to allow for taxable issuance to cover the costs of Winter Storm Uri, which took place in February 2021. Bond provisions, in our opinion, are credit neutral, and include a rate covenant set at 1.25x annual debt service (ADS) on senior obligations and 1.10x ADS for junior-lien obligations.

The additional bonds test is 1.25x maximum ADS for senior-lien obligations. The bonds will also have a debt service reserve fund that will be funded at the least of 100% of maximum ADS, 1.25x of average ADS, or 10% of the initial principal outstanding on senior-lien obligations.

Credit overview

The rating reflects our view of BPUB's efforts to reduce operational and financial risks associated with severe weather events. The utility had an ongoing short position following the retirement of coal generation in 2020 (that represented about 35% of the utility's total energy requirements). We understand that BPUB was able to sell local power into the market during Winter Storm Uri and these revenues were used to offset higher costs of operating BPUB's Silas Ray and Calpine Hidalgo plants. The net financial exposure resulted in unbudgeted costs of $34 million, for which BPUB covered by using BPUB's $100 million in CP to provide flexibility for future notes to be issued as either tax exempt or taxable. BPUB has paid all Winter Storm Uri-related costs. Since Uri, management has entered into bilateral contracts to reduce exposure to higher-than-expected peak demand. The prior short position was projected at 14% through 2022-2024, which has now been reduced to zero through 2024 and 1% exposure by 2025, based on management-projected peak demand. In our opinion, unrestricted cash and designated but legally available funds totaling about $124 million is ample given BPUB's reduced projected market exposure. In our opinion, BPUB's credit risks include the potential for peak demand above projections which could result in the need for market purchases at potentially extreme prices which could weaken liquidity. We also believe ERCOT's lack of interconnectivity to neighboring grids and BPUB's current lack of gas hedging for BPUB's assets are credit limitations.

Environmental, social, and governance

Winter Storm Uri brought into sharper focus a spectrum of environmental, social, and governance (ESG)-related risks that informs our credit analyses and ratings over the longer term. In our view, the specter of climate change weighs more heavily as a credit risk factor for Texas utilities. In light of this, we consider the adequacy of management's counterbalancing measures to plan for, mitigate, or adapt to risks associated with extreme weather conditions that have the potential to disrupt power generation and transmission, or increase costs. Among these considerations are exposures under hedging arrangements, plans relating to power plant weatherization and redundancy, and capital and liquidity sufficiency.

We believe BPUB's exposure to social factors could present elevated risk given below-average income indicators and above-average weighted average revenue per kilowatt-hour (kWh) as a percentage of the state average for which BPUB has used RSFs to manage affordability. However, we expect affordability will improve given the planned electric rate reduction and decline in transfers to the RSF, which was a part of the electric utility's way to maintain the average electric rate at $102 based on 1,000 kWh of electric consumption.

In our view, governance risk remains elevated due to operating in the ERCOT market, which requires BPUB to maintain stronger levels of liquidity, proactive planning, hedging, and financial flexibility, which comes at a cost, versus utilities in other regions where these risks are lower. Nevertheless, we recognize recent improved governance risk practices and oversight due to management entering into additional power purchase arrangements to mitigate its market price exposure and performing frequent internal financial and peak demand stress testing.

Stable Outlook

Downside scenario

We could lower the rating if actual peak summer or winter demand exceeds projections, and this results in materially higher unbudgeted power or fuels costs, reduced liquidity, and FCC.

Upside scenario

We could raise the rating if FCC outperforms projections on a sustained basis, unrestricted liquidity materially improves, and BPUB is able to weather future peak summer or winter demand without significant financial deterioration.

Credit Opinion

Enterprise risk

The rating reflects our view of BPUB's enterprise risk profile, with a primarily residential customer base, below-average income indicators, significantly above-average electric rates, and improved power supply with less market exposure since our last review. BPUB serves electric, water, and wastewater customers throughout the city of Brownsville. In 2021, the electric system served approximately 51,900 customers that accounted for about 89% of system operating revenues. Approximately 48% of retail revenue comes from residential customers, and the 10 leading customers are diverse, representing 13% of total operating revenues in fiscal 2021. In our opinion, the primarily residential revenue stream and diverse customer base provide stability. Nevertheless, income levels are significantly below the national average at 63% and unemployment is elevated at 8.4% for 2021 compared to the national average at 5.3%.

Our assessment of BPUB's market position is vulnerable, with weighted average revenue per kWh at 112% of the national average and below-average income levels. Nevertheless, we expect the rollback of electric rates will improve these metrics. In 2012, BPUB increased electric rates to cover BPUB's participation in the Tenaska Power Service project, which would have provided BPUB with 200 megawatts (MW). Due to unfavorable market conditions, the agreement was terminated. Since then, BPUB has been transferring funds to a bill reduction program to keep the average monthly residential bill at $102 based on 1,000 kWh of electric consumption. The rate rollback will take a few years, and management projects that it will reduce total electric rates by about 22%. The utility has the authority to increase its fuel and purchased energy (FP&E) charge that recovers all fuel costs on a monthly basis. We understand management is analyzing a plan to gradually increase this FP&E charge. At the same time, the board pre-approved annual rate increases for water and wastewater through 2026.

In our opinion, BPUB has reduced operational risk by adding long-term power supply to meet projected peak demand, weatherizing assets, and frequent performance of stress-testing for higher demand scenarios. Since Uri, management has added wind breaks to prevent icing, upgraded heat tracing to prevent freezing, and added a chiller system at Silas Ray. Additionally, a new natural gas interconnection was completed for the Silas Ray power plant. This new interconnection into the Valley Crossing pipeline will help support pressure and supply diversification. The board meets its power supply obligations through a combination of resources including the Silas Ray natural gas-fired plant; the Calpine/Hidalgo plant, for which BPUB has equity ownership from Duke Energy; a purchased power agreement with Sendero Wind Energy LLC; and an American Electric Power power purchase agreement. BPUB's gas supply arrangements do not currently allow for fixed price gas hedging, which we view as greater risk as gas prices have been increasing. However, BPUB is in discussion to amend that. The board has a gas transportation agreement with Texas Gas Service, a gas supply arrangement with Tenaska Marketing Ventures for service to Silas Ray, and a gas supply agreement with Calpine Energy Services for service to the Calpine/Hidalgo plant.

Through 2025, the district has less exposure to projected peak load and has performed stress testing if peak load is higher than forecast levels. Resources through 2026 total 311 MW in capacity with projected peak by 2025 of 312 MW exposing BPUB modestly to market purchases, although under severe weather events, its exposure could increase. Nevertheless, we understand management is discussing additional power supply arrangements to further reduce this exposure. Based on management-provided stress testing, the estimated potential exposure could be $16.9 million for July and August, which is the mean of projected peak load through various simulations. Based on its worst-case scenario using 10,000 simulations, its modeling predicts power costs of $30.2 million versus an expected case of a mean of $16.9 million, or a net of $13.3 million in exposure for July and August during extreme weather events. This is higher than last summer's projection at $5 million due to projected higher forward power and natural gas prices as well as higher-than-normal volatility levels for commodities, but BPUB has taken steps to maximize availability of its generation resources.

Financial risk

During Winter Storm Uri, we understand that BPUB spent $28.4 million in energy purchases in one week, significantly above the $13.5 million that was budgeted for the entire year. Given the decommissioning of the Oklaunion plant, market purchases increased to 35% during the extreme weather event from 15% in 2019. Additionally, during this severe weather event, the cost to run BPUB's Silas Ray plant was $15.9 million compared to the yearly budget of $4.1 million and $15.8 million for Calpine Hidalgo Energy Center, which had a yearly budget of $9.9 million. However, during this period, the owned generation resources were long on power for a period of time and BPUB was able to sell excess production into the market. This additional revenue was used to partially offset higher costs of operations.

Given significantly higher expenses from Winter Storm Uri, FCC declined significantly in fiscal 2021 to a figure we consider highly vulnerable of below 1.0x; however, based on management's forecast, we expect FCC will increase during the next five years to about 1.36x for fiscal 2026. We project 1.2x FCC in fiscal 2022 given the rollback of electric rates and decrease in transfers out to the RSF. After 2023, management projects the rollback to be substantially complete with no more transfers out to support the bill reduction plan. In our opinion, management-provided projections are reasonable given they were recently updated to reflect higher costs of power and include the current bond issuance, the electric rate reduction, and the water and wastewater annual rate increases.

As of fiscal 2021, unrestricted cash was strong at about $53.5 million, and when including the operating reserve of $17 million, this total increases about $70 million, equivalent to about 160 days of operating expenses, which we believe is adequate. BPUB has a $100 million CP program with $47 million remaining, which could be issued as either taxable or tax exempt. Management also indicated there are restricted funds in the capital improvement reserve and improvement fund that could be used if needed, which total $104 million, although we note this would decrease funds available for capital needs.

In our opinion, BPUB's debt-to-capitalization is moderate at about 45% as of fiscal 2021 which we expect to increase modestly with this issuance. We note a substantial decline in debt obligations by 2031, and management plans to take out the remaining CP beyond the five-year horizon. BPUB's capital plan totals about $270 million, which in our opinion is large. Management plans to fund these improvements through a combination of reserves, internally generated funds, and its CP program. Management indicates the automatic meter reading infrastructure is a priority project during the next few years. Other electric projects include those related to generation, transmission, and distribution.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of May 16, 2022)		
Brownsville comb util (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised
Brownsville comb util (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised
Brownsville comb util (AMBAC)		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised
Brownsville comb util (BAM)		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised
Brownsville util sys rev rfdg bnds ser 2020 due 09/01/2050		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised
Brownsville util sys rev rfdg bnds taxable		
Unenhanced Rating	A-(SPUR)/Stable	Outlook Revised

Many issues are enhanced by bond insurance.