S&P Global
Ratings

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Brownsville, Texas; Combined Utility

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Credit Profile		
US$62.59 mil util sys rev rfdg bnds taxable ser 2020A dtd 08/01/2020 due 09/01/2045		
Long Term Rating	A+/Stable	New
US$52.255 mil util sys rev rfdg bnds ser 2020 due 09/01/2050		
Long Term Rating	A+/Stable	New
Brownsville comb util		
Long Term Rating	A+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A+' long-term rating to Brownsville, Texas' series 2020 utility system revenue refunding bonds and series 2020A utility system revenue refunding bonds (taxable). At the same time, S&P Global Ratings affirmed its 'A+' underlying rating on the city's utility system revenue bonds. The outlook is stable.

The city's first-lien pledge on the net revenue of the system's combined utility secures the bonds. The series 2020 utility system revenue refunding bonds will have a par amount of approximately $52.25 million and be used to refund certain outstanding commercial paper notes to convert short-term variable-rate obligations into long-term obligations, refund currently outstanding obligations, and pay the cost of issuance. The series 2020A utility system revenue refunding bonds have a par amount of approximately $62.59 million and will be used to refund certain outstanding obligations of the combined utility. The combined system had outstanding $237.37 million as of March 2020.

Credit overview

The ratings reflect our opinion of Brownsville Public Utility Board's (BPUB) strong enterprise risk profile and very strong financial risk profile. Brownsville is in the Rio Grande Valley, across the border from Matamoros, Mexico. The utility system provides electric, water, and sewer service to Brownsville, which has an estimated population of 189,000, including some customers outside the city limits. Each of the three systems has approximately 50,000-52,000 accounts, but the electric system is dominant, accounting for 79% of total operating revenue in fiscal 2019.

In our opinion, given the current economic conditions, we believe BPUB's system revenues might decline somewhat for fiscal 2020, though ultimately we expect that management will continue to manage expenses and capital projects to maintain sound financial metrics. As of fiscal 2019, BPUB had 111 days' cash on hand, which we believe could support short-term disruptions. In response to COVID-19, the BPUB management team has been conducting daily conference calls to evaluate the state of operations within each utility in the system and to make adjustments as needed. Current uncollectable accounts are 0.13%, and about 2% of the customer base is currently on payment plans. BPUB has implemented a program allowing eligible BPUB customers experiencing unemployment or lost income to apply for bill assistance for electric, water, and wastewater services. The program is being funded with accumulated, unspent revenues on deposit in the capital improvement fund. While we continue to monitor events related to COVID-19, we do not currently expect it to affect the BPUB's ability to maintain budgetary balance and pay debt service costs. For more information, see our article "COVID-19's Potential Effects In U.S. Public Finance Vary By

Sector" (published March 5, 2020, on RatingsDirect).

The enterprise risk profile reflects our view of the system's:

- Adequate service area economic fundamentals, reflecting a stable local service area economy and a large customer base that is diverse and not overly concentrated, although city income levels remain well below the national average (we believe that the COVID-19 pandemic and resulting recession will negatively affect economic fundamentals);
- Extremely strong industry risk relative to other industries and sectors;
- Highly vulnerable market position, with its 2018 weighted average electric system rate that is 27.6% above the state average combined with its weak income indicators, which we believe limit its revenue-raising flexibility; and
- Very strong operational and management assessment, as evidenced by a power supply that will be reliant on gas-fired generation as it plans to transition away from coal generation by 2021, and its prudent financial management policies and practices, including board-approved financial metrics targets and formal five-year financial projections and capital plan.

The financial risk profile reflects our view of the system's:

- Extremely strong coverage metrics based on historical figures, which we expect to remain so given the lack of additional debt plans;
- Strong liquidity and reserves, with about 111 days of total liquidity on hand in fiscal 2019, which we expect to stay within the range of strong; and
- Very strong debt and liabilities profile, based on our forward-looking view that as the Oklaunion coal plant is decommissioned, the utility is moving toward a hybrid utility with attributes of being both a vertically integrated and distribution-only system.

The stable outlook reflects our opinion of BPUB's financial forecast and our view that the utility will likely maintain fixed-charge coverage (FCC) at or near current levels, based on management's willingness to adjust rates when needed to maintain higher margins. Furthermore, the stable outlook reflects our view that BPUB will likely maintain its robust liquidity metrics given management's intention to keep rates at current levels, despite the change in its power supply strategy, which will no longer require additional debt that was driving the rate increases.

Environmental, social, and governance factors

We believe BPUB's environmental and social factors (including health and safety issues related to COVID-19) do not present elevated risk and are in line with other rated utilities. The system is currently meeting all federal and state regulations. While BPUB is eliminating coal-fired generation, the utility still faces moderate environmental risk through its ownership in natural gas-fired units. BPUB plans to decommission the Oklaunion Power Station, a coal-fired steam electric generating unit, by Oct. 1, 2020. BPUB's fuel mix after the decommissioning in October 2020 will consist of natural gas, wind energy, and market purchases. S&P Global Ratings will continue to monitor BPUB's fuel mix and associated environmental impacts. There is potential for increased social risk as the pandemic continues and could potentially worsen due to higher public health and safety risks related to COVID-19. In our opinion, BPUB has strong governance factors, represented by long-range planning to ensure sufficient power supply to meet demand, frequently updated strategic plans, and annual review of the long-range capital and financial forecasting.

Stable Outlook

Downside scenario

We could lower the ratings if the utility's financial metrics fall significantly below expected levels as a result of COVID-19 and the related recession. Also, we could lower the ratings if the city experiences higher delinquent payments or an inability to raise rates, resulting in cash flow difficulties and an inability to sustain its currently strong financial performance.

Upside scenario

Due to the board's above-average electric rates, weak income levels in the service area, and management's projection of maintaining coverage and liquidity near current levels, we do not expect to raise the ratings over the two-year outlook period. In addition, uncertainty related to the COVID-19 pandemic is a credit limitation.

Credit Opinion

Enterprise Risk

Economic fundamentals: Adequate

Despite a border economy characterized by weak income levels and unemployment that has historically trended above the state and national levels, we consider the Brownsville metropolitan statistical area broad and diverse. The median household effective buying income for the city is only 67% of the U.S. level. Due to COVID-19, the city's unemployment rate for May 2020 rose to about 16.5%, compared with the nation's rate of 13.3%. Brownsville is a growing economic center for the Rio Grande Valley, which attracts retail trade and service-sector employment. The government sector is also strong, led by the Brownsville Independent School District (ISD), Cameron County, and the University of Texas Rio Grande Valley. None of the systems has any dependence on its principal customers.

We consider the customer base diverse, with the 10 leading customers accounting for approximately 15% of total revenues in fiscal 2019 and the leading customer, Brownsville ISD, accounting for 6%. Residential customers accounted for 44% of total retail revenue, followed by industrial customers at 41%, and commercial customers at 10% in fiscal 2019.

Market position: Highly vulnerable

We consider the system's most recent rates to be well above average, but the system's power cost adjustment mechanism, which is discretionary and reviewed monthly, provides timely recovery of costs. Based on the U.S. Energy Information Administration's latest available data from 2018, the system's weighted average system rate competitiveness (based on relative customer classes' revenue contributions) was 127.6% of the state average in 2018. The most recent base-rate increase occurred in October 2016 by 7% and officials do not have additional increases planned. The rate increase was implemented to fund potential debt associated with Tenaska Power Services Co. to acquire 200 megawatts (MWs) of power; however, due to delays, the agreements have been terminated. Prior to 2016, BPUB increased electric base rates by between 7% and 8% from 2013 to 2016. The BPUB uses a fuel-cost-adjustment component for its electric rates, which it reviews monthly and adjusts when necessary.

Additionally, BPUB has a fuel subaccount established in 2005, which may be utilized as a rate stabilization/competition fund to stabilize rates. As of Sept 30, 2019, the fuel subaccount had $13.3 million. The BPUB has utilized $21.5 million and $25.9 million in fiscal years ending September 2019 and 2018, respectively, to supplement actual fuel and purchased energy charge collections.

Industry risk

Consistent with our "Methodology: Industry Risk" criteria (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities, as very low, and therefore extremely strong as compared with other industries and sectors.

Operational Management Assessment (OMA): Very strong

The system receives power through a diverse set of assets through its ownership interest in coal-fired and gas-fired generation assets as well as power purchase contracts. Brownsville PUB owns an undivided 17.97% (124 MWs) ownership in the Oklaunion Power Station, a coal fired steam electric generating unit. On Sept. 19, 2018, the owner of this plant passed a motion to cease operations permanently and dispose of the plant no later than Oct. 1, 2020. To replace this energy requirement, the utility has signed a nine-year power purchase agreement (PPA) of 50 MWs with American Electric Power (AEP). The remaining replacement generation will be made up from increased dispatch of existing generating units owned by BPUB, and energy purchases from the Electric Reliability Council of Texas (ERCOT) market.

The system is currently long on power, with 377 MWs in total capacity to meet its 294-MW summer peak. From 2021 to 2024 management projects summer peak load will surpass available resources, and plans to supplement this shortfall by block purchases on the ERCOT market. As of fiscal 2019, 33% of the utility's power requirement was met through its ownership in Oklaunion, 29% through Hidalgo, a combined cycle power plant with 105 MWs of ownership interest), 20% from Sendero wind energy purchase (78 MWs), 3% from the board-owned Silas Ray Natural Gas fired plant, and 15% from market purchases.

We consider the utility's financial management policies and practices very strong, including monthly review of its recovery adjustment factor based on changes in fuel and purchased power costs, liquidity targets that the utility has historically exceeded, and annual updates to its formal multiyear capital planning and financial forecasts.

Financial Risk

Coverage metrics: Extremely strong

FCC was what we consider an extremely strong 1.89x in fiscal 2019, up from 1.67x in fiscal 2018. The rise in FCC in fiscal 2019 resulted from a 5.2% increase in electric and water sales outpacing only a 2.8% rise in expenses from fiscal 2018 to 2019. The system's FCC is based on S&P Global Ratings' internally adjusted debt service coverage (DSC) calculation that factors in transfers, off-balance-sheet obligations, and other long-term, recurring obligations. For the utility we include a fixed cost associated with purchased power costs associated with BPUB's purchase power agreement with Exelon Corp. In the late 1990s, droughts from past decades led the BPUB to create the Southmost Regional Water Authority (SRWA), of which it has 92.91% ownership. Obligations to the SRWA are treated as operating expenses of the BPUB system, but we consider these fixed-debt-like obligations in our FCC calculation. Transfers to the city are calculated based on adjusted gross revenue, as opposed to net income, which has allowed BPUB to have a more predictable cash flow and the general government to avoid an overreliance on transfers, helping the credit quality of both since the 2005 streamlining of transfer policies. Actual annual DSC has ranged between 3.0x and 5.4x. Based on our analysis of management-provided projections, we expect FCC to exceed 1.6x during the next five fiscal years. This assumption includes a fixed cost associated with management's projected AEP PPA for 50 MWs, which management projects will have an annual cost of about $13.5 million.

Liquidity and reserves: Strong

The BPUB's sound financial management also includes a commitment to maintain strong cash reserves across the three utility divisions. The authority maintained $51.5 million in unrestricted cash in fiscal 2018, or a strong 111 days' cash. Liquidity is strong, with year-end cash typically equivalent to three-to-four months' operating expenditures, not including various--but substantial--designated reserves that boost working capital to more than 350 days of operating expenses. Management's financial projections indicate maintaining liquidity between 90 and 100 days' cash through 2023.

Debt and liabilities: Very strong

As the Oklaunion plant is decommissioned, our forward-looking view is that the utility is moving toward a hybrid utility with attributes of being both a vertically integrated and distribution-only system, and this assessment is based on a blended analytical approach to the utility's debt and liabilities capacity. The system supported $279 million in total debt, or 41% debt-to-capitalization ratio in fiscal 2019. The system's five-year capital plan totals $226 million through 2024. BPUB plans to fund the capital plan with its commercial paper program, impact fees, and cash. The commercial paper program, authorized to issue notes in aggregate principal amount not to exceed $100 million. Liquidity support for notes issued under the commercial paper program is provided by a letter of credit issued by Bank of America N.A., which has a stated termination date of Nov. 7, 2022. BPUB currently has $50 million outstanding, which will be converted to long-term debt with this issuance.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 22, 2020)		
Brownsville comb util (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Brownsville comb util (AMBAC)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Brownsville comb util (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Brownsville util (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of July 22, 2020) (cont.)

Many issues are enhanced by bond insurance.