S&P Global
Ratings

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Summary:

Brownsville, Texas; Combined Utility

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Credit Profile		
Brownsville comb util		
Long Term Rating	A-/Stable	Affirmed

Credit Highlights

- S&P Global Ratings 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).
- The outlook is stable.

Security

As of fiscal year-end 2022, BPUB had $289 million of outstanding senior-lien obligations and $495,000 of junior-lien bonds. The 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. 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

Underpinning BPUB's credit quality (following the February 2021 winter storm known as Uri) are the utility's robust power supply stress-testing, sufficient power supply resources, winterization, and sufficient liquidity, all of which somewhat temper the utility's exposure to unbudgeted power costs from extreme weather events. The rating further reflects our view that the recent distribution of Tenaska funds, in May 2023, to BPUB customers is credit neutral because our assessment of liquidity had historically excluded this amount. However, we view the 22% electric rate decrease between 2022 and 2023, and the refund, positively as they will improve rate competitiveness and provide interim rate relief.

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 the Electric Reliability Council of Texas' (ERCOT) lack of interconnectivity to neighboring grids and BPUB's current lack of gas hedging for BPUB's assets are credit limitations.

The enterprise risk profile reflects our view of BPUB's:

- Largely residential and very diverse customer base, tempered by significantly below-average income indicators;
- Adequate electric rate competitiveness, which we project will remain around this level given the lack of planned

electric base rate increases; and

- Sufficient resources through a combination of owned and purchased power, sufficient to meet projected peak demand through 2024, with robust power supply stress-tests and long-range planning.

The financial risk profile reflects our view of BPUB's:

- Recent volatile fixed-charge coverage (FCC) ranging from above 2.0x for fiscal 2022 to below 1.0x in fiscal 2021 due to Winter Storm Uri, and projected FCC at between 1.2x and 1.3x through fiscal 2027;
- Strong unrestricted cash and investments at $41 million for fiscal 2022, equivalent to 81 days of operating expenses, and additional reserves of about $100 million (which could be used with board approval), and a $100 million commercial paper (CP) program that can be issued as taxable or tax-exempt; and
- Moderate debt-to-capitalization ratio at about 43% for fiscal 2022 given the primarily vertical nature of the utility, with planned debt during the next five years once its CP draws are between $50 million and $60 million, at which time BPUB plans to pay off its CP with long-term debt.

Environmental, social, and governance

We view BPUB's historical transparency and relationship with the city of Brownsville as weak. In our opinion, transparency and trust between the city of Brownsville and BPUB was lacking, demonstrated by the city's filing of a forensic examination in September 2022 to investigate activities related to the Tenaska natural gas-fired plant, which was eventually terminated. We also believe that the timing of the accelerated rate rollback and refund of about $31 million following the forensic report is somewhat reactionary. However, as we noted during our 2022 analysis, management indicated a five-year planned rate rollback for the Tenaska portion of the base rate decrease, which we factored into our rating at the time. Additionally, 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.

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 as a percentage of the state average, for which BPUB has used rate stabilization funds to manage affordability. However, we view the distribution of Tenaska funds as a rebate on affected BPUB customers' bills positively as the rebate provided some rate relief to customers.

Outlook

The stable outlook reflects the recent electric rate decrease, which will improve electric rate competitiveness and BPUB's financial flexibility given the well-below-average incomes in the service area. The electric rate reduction and the approved five-year water and wastewater rate increases are projected to result in FCC (S&P Global Ratings-calculated) averaging 1.2x during the next five years.

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 fuel costs, reduced liquidity, and FCC. We could additionally lower the rating if unrestricted liquidity is drawn down materially due to operational disruption or unbudgeted capital expenses.

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

Brownsville is on the southern tip of Texas. BPUB served about 52,000 electric, 53,000 water, and 54,000 sewer customers, and its customer base is primarily residential and diverse. About 46% of electric revenues come from the residential customer class, which in our opinion provides stability. The leading 10 electric customers are diverse, representing about 13% of revenues in 2022. The city's unemployment typically trends above the national rate and for March 2023 was about 6%, compared with the national rate of 3.5% for the same month.

Electric rates are slightly above the state average at 101.6% which is adequate, but income indicators are only 63% of the national average, limiting rate-raising flexibility. Between 2022 and 2023, the electric base rate was decreased by 22%, and in May 2023, BPUB provided credits to over 34,300 active electric accounts and refund checks to over 26,400 former customers. The refund went to all BPUB customers who were customers during the Tenaska rate increases. In addition, BPUB and the city of Brownsville pooled their refunds to ensure all still-active Tenaska time frame customers received at least $48.90. In our view, this provides electric customers with interim rate relief, which we view positively.

In our opinion, BPUB has reduced operational risk by adding long-term power supply to meet projected peak demand, weatherizing assets, and frequently performing stress testing for higher-demand scenarios. 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 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.

Based on management-provided stress testing, the estimated potential exposure in July, under its worst case scenario, is $6.9 million, and we believe management has sufficient reserves (including its $100 million CP program) to cover this cost.

Financial risk

FCC has been volatile the past few years, ranging from below 1.0x in fiscal 2021 to above 2.0x in fiscal 2022, which we consider extremely strong. We project FCC will decrease to 1.2x-1.3x through 2027 because the series 2022 bonds will refund BPUB's CP. During Winter Storm Uri in 2021, 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 event from 15% in 2019. Additionally, during this event, the cost to run BPUB's Silas Ray plant was $15.9 million (compared with the yearly budget of $4.1 million) and the cost to run the Calpine Hidalgo Energy Center was $15.8 million (compared with the 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. BPUB used this additional revenue to partially offset higher costs of operations.

As of fiscal 2022, unrestricted cash was strong at about $41.3 million, equivalent to 81 days of operating expenses, with an additional approximately $100 million of designated restricted funds that could be used for operations upon board approval. In our opinion, the liquidity position is sufficient, but we believe utilities operating in ERCOT need to have a higher level of liquidity given the lack of interconnectivity to other electric grids, which can lead to insufficient resources and volatile electric price swings. BPUB has a $100 million CP program, which could be issued as either taxable or tax exempt.

In our opinion, BPUB's debt-to-capitalization is moderate at about 43% as of fiscal 2022, which we expect will increase with the series 2022 bonds but remain manageable. BPUB's capital plan (electric, water, and wastewater) totals about $235 million, which in our opinion is large. About 40% of the capital plan is for electric system projects that include an airport substation upgrade, advanced metering infrastructure, Hidalgo improvements, and renewal and replacement projects. Management plans to fund these improvements through a combination of reserves, internally generated funds, and its CP program.

Brownsville Public Utilities Board, Texas--key credit metrics			
	--Fiscal year ended Sept. 30--		
	2022	**2021**	**2020**
Operational metrics			
Electric customer accounts	52,410	51,912	51,406
% of electric retail revenues from residential customers	46	48	45
Top 10 electric customers' revenues as % of total electric operating revenue	13	13	13
Service area median household effective buying income as % of U.S.	63	63	63
Weighted average retail electric rate as % of state	102	102	112

Brownsville Public Utilities Board, Texas--key credit metrics (cont.)			
	--Fiscal year ended Sept. 30--		
	2022	2021	2020
Financial metrics			
Gross revenues ($000s)	271,544	315,521	201,131
Total operating expenses less depreciation and amortization ($000s)	186,017	283,757	141,806
Debt service ($000s)	28,145	27,187	25,943
Debt service coverage (x)	3.0	1.2	2.3
Fixed-charge coverage (x)	2.0	0.6	1.5
Total available liquidity ($000s)*	41,388	53,545	55,371
Days' liquidity	81	69	143
Total on-balance-sheet debt ($000s)	344,477	359,255	334,779
Debt-to-capitalization (%)	43	45	41

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy).

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 June 29, 2023)		
Brownsville comb util (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
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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 sys rev rfdg bnds ser 2020 due 09/01/2050		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Brownsville util sys rev rfdg bnds taxable		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Brownsville util (BAM)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Brownsville util (BAM)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed