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Ratings

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Summary:

Mustang Special Utility District, Texas; Water/Sewer

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Credit Profile		
US$32.31 mil rev rfdg and imp bnds ser 2020 due 09/01/2050		
Long Term Rating	AA/Stable	New
Mustang Spl Util Dist WS		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Mustang Special Utility District, TX's revenue refunding and improvement bonds series 2020. At the same time, S&P Global Ratings affirmed its 'AA' rating on the system's parity revenue debt outstanding. The outlook is stable.

Credit overview

Net revenues of the water and sewer system secure the approximately $32.31 million series 2020 bonds. After the issuance, Mustang Special Utility District will have just under $68.3 million in outstanding revenue. Officials intend to use series 2020 bond proceeds to construct several improvements to the system and to refund a portion of the district's outstanding debt. They indicate they have not entered into any direct-purchase bank debt in relation to the system. We consider bond provisions credit neutral. In our opinion, the rating reflects very strong enterprise and financial risk profiles. Management has to date been successful in maintaining a robust growth profile, historically extremely strong all-in coverage levels, and a very strong liquidity position.

The enterprise risk profile reflects our opinion of system's:

- A very strong service area economy with above-average income metrics, low county poverty rate, and access to the northern portions of the broad and diverse Dallas-Ft. Worth-Arlington metropolitan statistical area;
- Diverse and stable customer base with no significant concentration;
- Affordable rates in relation to regional peers; and
- Good operational management practices and policies under our Operational Management Assessment (OMA) methodology.

The financial risk profile reflects our opinion of system's:

- Historically extremely strong all-in debt service coverage (DSC);
- Very strong unrestricted liquidity, which has risen from 314 to 571 days' cash on hand during the past three audited fiscal years;

- Low debt position with a debt-to-capitalization ratio of under 34% when including the series 2020 revenue bonds; and
- Good financial management practices and policies under our Financial Management Assessment (FMA) methodology.

Environmental, social, and governance factors

We believe Mustang Special Utility District's environmental and governmental risks are commensurate with those of like peers. While long-term water supply and scarcity remains a challenge for Texas, we believe that the district will have adequate water supply to meet its future needs. We believe that the system has elevated social risk due to the COVID-19 pandemic. While we believe it's possible the utility's revenues may experience some declines for fiscal 2020, ultimately, our expectation is that management will continue to manage the system, to maintain stable coverage levels. The utility also has over 571 days' cash on hand, which we believe provides a meaningful cushion against short-term disruptions. While we continue to monitor events related to COVID-19, we do not currently expect it to affect the utilities' ability to maintain budgetary balance and pay debt service costs. For more information, see our article "The U.S. Economy Reboots, With Obstacles Ahead" (published Sept. 24, 2020, on RatingsDirect).

Stable Outlook

The stable outlook reflects S&P Global Ratings' expectation of the overall continued customer base stability and growth, coupled with maintenance of extremely strong coverage and liquidity levels, which are in line with the above-mentioned historical trends.

Downside scenario

The rating could come under pressure should there be a consistent drop in system coverage levels or liquidity below the established historical trend, we could then lower the rating. There could also be pressure on the rating if growth pressure challenges are not met, causing deterioration in the financial risk profile.

Upside scenario

While currently unlikely due to growth-related capital expenses, there could be upward pressure on the rating if the district's very strong financial risk profile is stably maintained through the growth period, coupled with the institution of more comprehensive financial management policies which are in line with other higher rated credits.

Credit Opinion

Bonds provisions are credit neutral and include:

- A debt service reserve fund to deposit either cash or an approved surety bond in an amount equal to either 1.25x average annual debt service, 10% of the par amount or the lesser of maximum annual debt service (MADS);
- A rate covenant that stipulates maintaining rates at a minimum of 1.2x annual debt service; and
- An additional bonds test that allows additional debt issuance but only if net revenues cover average annual debt service of all debt, including proposed debt, at least 1.25x annual debt service.

Enterprise risk

The district provides water and wastewater service to approximately 120 square miles in northeast Denton County, about 50 miles north of Dallas. The area participates in the broad and diverse Dallas-Fort Worth Metroplex. The residents have especially good access to northern employment centers, like Denton, Frisco and Plano. The economy is diversified among manufacturing, state-supported institutions, and various corporate offices. Alliance Airport, the largest industrial airport in the world, is in the county and continues to attract new transportation, distribution, and manufacturing tenants. The Texas Motor Speedway, a major NASCAR racetrack, was completed in 1997 and has had a positive effect on employment and recreational spending for the area. A major Wal-Mart distribution center in nearby Sanger is adding to the growth of the northern portion of the county. Income indicators are what we consider strong, with median household effective buying income (MHHEBI) equal to 137% of the national average. Current unemployment levels are about 5.6%, which has increased in the past year as a result of the economic downturn. However, the current rate is below the national average. UTRWD provides wholesale water and wastewater services to the district. In addition, the district operates seven groundwater wells. Mustang's water customers total approximately 8,300 and sewer customers approximately 4,900. Given the customer base's primarily residential nature, there is no concentration of water or wastewater customers.

For residential customers, based on the district's actual average billing rates, the monthly combined bill is about $156. As a percentage of MHHEBI, the average bill is about 2.6%, which we consider low in relation to regional peers and local income metrics. The district maintains an internal rate model with an emphasis on sustainable rates without weakening revenues. The board has the ability to raise rates whenever necessary.

Based on our operational management assessment (OMA), we view the water enterprise to be a '3' on a six-point scale, with '1' being the strongest. This indicates, in our view that operational and organizational policies are comprehensive and positively addressed. The OMA of good includes appropriate asset management programs for monitoring existing infrastructure, and the availability of an internal rate model, coupled with the ability to make rate adjustments and an unofficial succession plan, as well as comprehensive drought and disaster management plans, if needed.

Financial risk

The district's all-in coverage metrics are extremely strong, in our view. Historically, it has consistently produced all-in coverage metrics well over 2.0x. We consider all take-or-pay requirements to UTRWD as debt-like obligations rather than an operating expense. When considering all obligations, DSC in fiscal 2019 was, in our opinion, extremely strong at over 4.6x. Based on our analysis of internal rate plans, we believe that once expenses are normalized, the system will continue to produce all-in coverage metrics which are in line with extremely strong historical trends within the scope of this outlook.

Liquidity is a strength of the system. Unrestricted cash and investments have gone from just over $6.685 million in fiscal 2017 to just over $19.4 million in fiscal 2019. The unrestricted cash and investments at fiscal year-end stood at the equivalent of 571 days of cash on hand. In relation to the district's annual capital improvement plan (CIP), these amounts may fluctuate somewhat. However, based on management's indications, we expect the unrestricted liquidity position to remain extremely strong and continue to grow. In addition, the district's internal policies state that it will strive to maintain working capital of at least 90 days' budgeted expenditures on hand.

Currently, we consider the system's debt-to-capitalization ratio low at just under 34%, with just over $68.2 million of debt outstanding after including these issuances. The district maintains a comprehensive multiyear CIP. Management indicated that it is planning for further debt in the next year in relation to the expansion projects. We don't expect that this additional debt will have a significant effect on the system's all-in coverage metrics. The district participates in the Texas County and District Retirement System and the plan's funded ratio was 100%, with district making all of its annually required contributions.

Based on our financial management assessment (FMA), we view the district as a '3' on a six-point scale, with '1' being the strongest. We also assigned a FMA of good, indicating we consider financial practices good and somewhat comprehensive. The district maintains a conservative annual capital budget. The board receives monthly updates regarding the system's budget and any deviations from projections are analyzed. The adherence to audits that comply with generally accepted accounting principles (GAAP), as well as a detailed and codified investment and liquidity policies, are also considered credit positives. Conversely, the absence of long-term projections limits the upward potential of the FMA.

Related Research

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