S&P Global
Ratings

RatingsDirect®

Summary:

McKinney, Texas; Water/Sewer

Primary Credit Analyst:
Emily Powers, Santa Fe + 1 (312) 233 7030; emily.powers@spglobal.com

Secondary Contact:
Adriana Artola, San Francisco + 415-371-5057; Adriana.Artola@spglobal.com

Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

Summary:

McKinney, Texas; Water/Sewer

Credit Profile		
US$36.95 mil wtrwks and swr sys rev bnds ser 2023 dtd 06/01/2023 due 03/15/2043		
Long Term Rating	AA+/Negative	New
McKinney WS		
Long Term Rating	AA+/Negative	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to McKinney, Texas' approximately $37.0 million series 2023 waterworks and sewer system revenue bonds.
- At the same time, we affirmed our 'AA+' rating on the city's existing waterworks and sewer system revenue bonds.
- The outlook is negative.

Security

Net revenues of the water and sewer system secure all revenue debt. Proceeds will be used to finance various water and wastewater improvements throughout the city.

Credit overview

The 'AA+' rating reflects the system's strong and diverse economic base, located within one of the fastest-growing regions in the U.S. The negative outlook reflects our view of the city's senior-lien debt service coverage (DSC), and consequently, its all-in DSC, which has shown overall deterioration; the latter has recently leveled off at around 1.1x, well below the level of similarly rated peers. While the system's financials, particularly its liquidity, have remained strong and stable in recent years, all-in DSC, which includes fixed costs associated with the wholesale water provider North Texas Municipal Water District (NTMWD), has fluctuated, and remains low at the current rating level.

While water rates were not increased for fiscal 2022, all-in DSC increased to a level we consider adequate, at 1.2x, due to increased revenues as a result of expansion in the customer base. However, even with this improvement, all-in DSC has averaged 1.1x in in the last three fiscal years and remains well below peers at the current rating level; on a senior-lien basis, not including these fixed costs, DSC averaged 1.4x in those years, which is also below peers. A rate study completed in 2021 recommended no change to water rates until October 2023, but did recommend immediate wastewater rate adjustments to keep up with increasing costs. In response, wastewater rates were increased by 6% for fiscal 2022 and 8% for fiscal 2023, with plans for continued similar increases over the next several years. On the water side, no adjustments were implemented for fiscal year 2022, but rates were increased by 9% in fiscal 2023. The 2021 rate study was updated in August 2022 to reflect increasing costs and project increases of 9%-15% over the next several years; however, all preliminary rate adjustments are subject to modification depending on how rates are adjusted at NTMWD. Management is also in the process of completing a new full rate study later this year with the help of a consultant. Given the forecast included in the current rate study, as well as conversations with management, DSC is expected to remain in line with recent trends. If it is not improved and sustained at a level comparable with the rating level, there could be downward pressure on the rating.

Environmental, social, and governance

Overall, we believe the city mitigates most environmental, social, and governance (ESG)-related risks by adopting, adhering to, and adjusting operating and financial policies and procedures, including those that are state and federally mandated. Social risk surrounding rate affordability and governance risk surrounding rate-raising autonomy are heightened in that the systems depend on NTMWD for potable water and sewage treatment, though current affordable rates provide some cushion before affordability is likely to become a concern. Governance for the city is above average, including strong utility practices and robust state oversight, which mitigates potential operating and financial risks for both systems. Cyber security protocols are also embedded in managerial practices.

Outlook

The negative outlook reflects our view that there is a one-in-three chance that the rating could be lowered within the outlook period if management is unable to make appropriate adjustments to increase and sustain DSC at levels more comparable with the current rating level.

Downside scenario

We could lower the rating if all-in DSC is maintained at its recent levels, which are well below current comparable ratings. Rating pressure is likely should the city's revenues not be sufficient or if rates or expenditures are not sufficiently adjusted to address additional debt and capital plans.

Upside scenario

We could return the outlook back to stable if the utility's improved coverage levels are sustained beyond the most recent audited year, at a level higher than the above-mentioned historical trends, along with maintenance of the current liquidity position and an extremely strong enterprise risk profile.

Credit Opinion

Enterprise profile

McKinney provides water and wastewater services to a customer base about 30 miles north of downtown Dallas. The city, which is the seat of Collin County, is one of the fastest-growing in the U.S. and has an estimated population of more than 190,000. The systems primarily serve residences, which make up over 80% of total customers (approximately 55,000 residential water and wastewater customers) and have no major customer concentration. In addition to county government and local schools, major employers in the city include Raytheon, Torchmark, Encore, and a number of manufacturing and light-industrial firms. The city is also the owner and operator of the county's largest general aviation airport. Given the broad and diverse economic fundamentals, median household effective buying income (MHHEBI) is 142% of the national average.

McKinney is a member city of NTMWD. Because it receives all its treated water from the district and sends all its wastewater there for treatment, the city's operational requirements are limited mainly to its underground infrastructure. The NTMWD water agreement calls for a take-or-pay minimum in relation to its fixed charges amounting to $35.7 million in fiscal year 2022. However, due to a recent settlement, we expect the payment agreement between the city and the district to change over the next eight years. At the end of the transition, McKinney will pay for its use based on a five-year rolling average. The financial effects of the transition are likely to depend on several factors, including the overall increase in wholesale water use and whether pricing due to volume will be affected, as well as whether local water sources will become a more dependable resource for the city, thereby changing the mix of costs overall.

We view the city's operational management practices and policies as good, reflecting its well-embedded asset adequacy identification program and appropriate drought contingency and conservation plans, in addition to conservative management practices and policies. Rate-setting practices are also good, in our view, as rate adjustments are considered not just for the current year but through a medium-term planning horizon. Rate adjustments are passed directly through to customers from NTMWD, although management also has the ability to make further adjustments as needed. The current bill for 10,000 gallons of water usage and 5,000 gallons of wastewater is about $108.60, and represents only 1.6% of MHHEBI.

Financial profile

While the utility has historically maintained a strong financial profile, its all-in DSC has fallen in recent years, averaging 1.1x over the last four years. The system's senior-lien coverage metrics consistently remain stronger, at 1.3x or above, but when considering both calculations, DSC lags behind peers at the current rating level. In S&P Global Ratings' calculation of all-in DSC, we treat the fixed-charge requirements to NTMWD as debtlike obligations rather than as an operating expense, and we note that management's calculation is closer to 1.6x when not included for these charges. We believe that due to fixed costs associated with the service contracts, S&P Global Ratings-calculated all-in DSC of approximately 1.2x would be normal for the utility fund, if it is able to sustain DSC at this level; however, coverage has fallen below this level for several years. Dependent upon the new coverage levels achieved with planned rate increases, we could revise our outlook back to stable if the utility is able to maintain DSC more in line with historical trends. Should coverage be sustained at lower levels, there could be downward pressure on the rating.

We identify liquidity as a strength of the system, with unrestricted cash and investments totaling $45.6 million in fiscal 2022, equal to 193 days' cash on hand. This amount has remained fairly stable in recent years, and far exceeds management's requirement of 90 days. Most projects included in the city's capital improvement plan (CIP) are to be funded with revenue bonds or grants, and management has no other plans to draw down on liquidity at this time. We consider the system's debt-to-capitalization ratio low at 31%, with approximately $236 million of debt outstanding. The city maintains a comprehensive multiyear CIP that has identified approximately $200 million of additional revenue bonding over the next five years.

We believe that the city maintains robust financial policies and planning mechanisms to govern its operations, with practices we consider critical to supporting credit quality that are well embedded in its daily operations. Formal policies support many of these activities, adding to the likelihood that management will continue these practices and transcend changes in the operating environment or personnel. This includes conservative budgeting practices, monthly year-to-date and budget-to-actual updates to the city council, and regularly updating its extensive multiyear operating and capital forecasts.

Related Research

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