

RatingsDirect®

Summary:

Gulf Coast Authority, Texas; Water/Sewer

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Summary:

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Credit Profile

US\$34.255 mil bayport area sys rev bnds ser 2018 due 10/01/2042

Long Term Rating AA-/Stable New

Gulf Coast Waste Disp Auth (Bayport Area Sys) wtr & swr (AGM)

Unenhanced Rating AA-(SPUR)/Stable Affirmed

Gulf Coast Waste Disp Auth (Bayport Area Sys)

Unenhanced Rating AA-(SPUR)/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Gulf Coast Authority (GCA), Texas' series 2018 Bayport area system revenue bonds. At the same time, we affirmed our 'AA-' rating on the GCA's (formerly known as the Gulf Coast Waste Disposal Authority) existing system revenue bonds. The rating reflects, in our opinion, the combination of the GCA's very strong enterprise and financial risk profiles. The outlook is stable.

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

- Service area participation in the broad and diverse Houston-The Woodlands-Sugar Land metropolitan statistical area (MSA) economy, one that, in our opinion, remains strong;
- Unique service territory that, while concentrated among 70 industrial and two municipal customers, has significant barriers for a customer that might want to choose to provide its own treatment services;
- Very low industry risk as a monopolistic service provider of an essential public utility; and
- Good operational management assessment (OMA).

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

- Improved debt service coverage (DSC), which we expect to be sustainable even as growth and rehabilitation needs continue to generate the system's capital improvement;
- Extremely strong liquidity and reserves, which is strengthened by the management's willingness to adjust rates to maintain recent operating results;
- Moderate leverage position characterized by a debt-to capitalization ratio of about 68% at the end of fiscal 2017 and no immediate plans for additional debt beyond the series 2018 bonds; and
- Good financial management practices and policies.

Officials plan to use the series 2018 bond proceeds to finance the acquisition, construction, improvements, and extension of the system.

A first-lien net revenue pledge of the Bayport area wastewater treatment system secures the bonds. Bond provisions in general are considered credit neutral and include a rate covenant of 1.25x annual debt service and a debt service reserve equivalent to average annual debt service payments on all parity bonds outstanding and provide additional bondholder liquidity.

Enterprise risk

Created in 1969, GCA is a political subdivision of the state charged with providing sanitary, sewer, conservation, reclamation, and environmental stewardship services in Harris, Galveston, and Chambers counties. A separate and discrete enterprise fund of the authority exists to provide treated wastewater services to an industrial development in Bayport, just outside of Houston city limits. The massive 12-square-mile industrial district includes deepwater ports and channel facilities, intermodal transportation hubs, and barge docks. The authority provides wastewater treatment to 70 industrial customers in the service area as well as wholesale service to the cities of La Porte and Shore Acres. Nearly all of the industrial customers are centered on petrochemicals and petrochemical-related intermediate-use industrial products and support services. Several customers have begun or announced expansion of operations at their Bayport facilities, and existing facilities have recovered from the effects of the recent recession. Major expansions include projects by Air Liquide, Kaneka, Celanese, and several large joint ventures. Much of the growth reflects low natural gas prices, given the energy-intensive processes of refineries, chemical plants, and heavy industry.

While the underlying economy is strong, the authority's small customer base results in a highly concentrated revenue stream. The 10 leading waste disposal customers accounted for over two-thirds of fiscal 2017 operating revenues. They include:

- Lyondell Chemical Co. (15.28%), which emerged from Chapter 11 bankruptcy protection in 2010;
- Celanese LTD (12.03%);
- Kaneka Texas Corp. (11.7%); and;
- Albemarle Catalysts Co. (11.6%).

Consistent with "Methodology: Industry Risk" (published Nov. 19, 2013, on RatingsDirect), we consider industry risk for the system very low, the most favorable assessment possible on a six-point scale, where '1' was the best.

The good OMA reflects the system's very adequate water supply and good rate-setting practices. The system's wastewater treatment plant facility is currently permitted for an average flow of 25 million gallons per day (mgd) and a maximum flow of 30 mgd, which is adequate for its current average daily flow and peak daily flow of 21 mgd and 30 mgd, respectively. The current capital improvements are targeted at expansion of the capacity.

The authority's treatment plant is unique because of its ability to handle industrial waste; otherwise, Bayport customers would have to find the capital and physical space on their own respective properties to build the facilities. Ownership and operation of waste treatment facilities would also put those customers under state and federal environmental regulations of which GCA retains certain exemptions, and GCA has in various studies demonstrated the ability to handle such operations more cost effectively. We understand that the plant's discharge permit was valid through 2017, and that it has complied with the renewal process and has submitted its application. The plant's management will run under the permit specifications until the they receive the renewal. The plant remains fully compliant with all

environmental requirements. The authority introduced a new rate structure in 2012 with a separate pass-through component to rates that recoups certain of its variable costs such as energy, chemicals, and commodities every month, in full. Management reviews its rate model at least annually and implements rate adjustments as necessary, including a 4% increase for fiscal 2015, and adopted a 1% increase in fiscal 2017 and most recently raised rates in January 2018 by 2% and 3%, for Biosan and clean stream customers, respectively.

Financial risk

The system's financial history since fiscal 2012 has been solid, reflecting strong rebounds from thin performances in 2009 and 2010. Between fiscal years 2008 and 2010, actual annual DSC was not much more than 1.0x, and actually slipped below 1.0x in fiscal 2009 due primarily to a collection system line breach and a key customer filing for Chapter 11 bankruptcy protection. The authority's board has adjusted rates multiple times since 2010 and by fiscal 2011, all-in DSC bounced back to 1.20x. In the past three fiscal years, all-in coverage has improved from an extremely strong 1.92x in fiscal 2014 to 1.89x in fiscal 2016. Based on management's projections, all-in DSC is expected to be strong as a result of rate and revenue increases, is projected to exceed the increasing annual debt service payment, and is projected by management to be above 2.00x.

As the improvement in finances became consistently stronger, management has preserved financial integrity with liquidity remaining extremely strong and providing additional cushion. For fiscal 2016, the Bayport system reported \$28.1 million in unrestricted cash and equivalents, equivalent to more than one year of operating expenses. We understand that management may draw on reserves to fund additional system improvements, but the system's current capital plan is expected to be funded mainly from current bond proceeds. The capital plan currently has about \$96.85 million of identified project through 2022, which will primarily be funded by the series 2018 bond proceeds and roughly \$40 million of the capital improvement plan (CIP) can be pushed back if growth is not driving the improvements. No additional use of debt is currently anticipated. The debt-to-capitalization ratio is a moderate at 67.9% at the end of fiscal 2017. The authority has a defined contribution plan, which we view as credit neutral.

Our good financial management assessment (FMA) highlights include a formal investment policy and quarterly review of the budget-to-actual results by the authority's board. Management has also indicated that it will set rates to target total cash reserves of at least six months of operations, a level we consider strong.

Outlook

The stable outlook reflects our opinion the authority will maintain its improved all-in DSC at least 1.4x through the two-year outlook horizon and sustain its extremely strong liquidity, given that the bulk of capital expenditures will be addressed with this bond issuance.

Upside scenario

Due to concentration in the system's customer base, which we do not expect to abate in the near term, we do not expect any upward rating movement in the outlook period. The key to a higher rating is continued financial improvement, coupled with significant economic diversification and expansion that that would improve our view of the underlying service base.

Downside scenario

If rising debt service attributed to this issuance debt issuance stresses all-in DSC or the capital plan stresses liquidity, we could lower the rating. Additionally, we could lower the rating if operating revenues become more vulnerable due to the authority's significant customer base concentration in the event of a prolonged downturn in the petrochemical sector.

Ratings Detail (As Of March 12, 2018)

Gulf Coast Waste Disp Auth (Bayport Area Sys) wtr & swr (AGM)

Unenhanced Rating

AA-(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 to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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