

CREDIT OPINION

16 August 2016

New Issue

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City of Las Cruces, NM

New Issue - Moody's Assigns Aa2 to Las Cruces, NM's \$14.6M in Utility Revenue Bonds, Ser. 2016

Summary Rating Rationale

Moody's Investors Service has assigned Aa2 to City of Las Cruces, NM's \$14.6 million in Joint Utility System Improvement Revenue Bonds, Series 2016. Moody's maintains the Aa2 on the outstanding parity obligations.

The Aa2 rating assignment reflects the system's sizable system assets, a stable and diverse customer base, and adequate debt service coverage. The rating also incorporates the strong system liquidity, a modest debt profile, and satisfactory legal provisions.

Credit Strengths

- » Stable customer base
- » Healthy cash reserves
- » Low debt ratio

Credit Challenges

- » Average debt service coverage for the rating category
- » Ongoing need for capital reinvestment to maintain large system
- » Below average socioeconomic profile

Rating Outlook

Moody's generally does not assign outlooks to local government credits with this amount of debt outstanding.

Factors that Could Lead to an Upgrade

- » Sustained trend of increasing debt service coverage
- » Significant increase in net working capital and unrestricted reserves

THIS REPORT WAS REPUBLISHED ON 17 AUGUST 2016 TO CORRECT AND UPDATE LANGUAGE ABOUT THE SYSTEM'S METRICS AND GOVERNANCE STRUCTURE.

Factors that Could Lead to a Downgrade

- » Declining net revenues leading to decreased debt service coverage levels
- » Deterioration of net working capital and unrestricted reserves

Key Indicators

Exhibit 1

Las Cruces, NM					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	26 years				
System Size - O&M (in \$000s)	39,502				
Service Area Wealth: MFI % of US median	76.9%				
Legal Provisions					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	DSRF funded at lesser of standard 3-prong test				
Financial Strength					
	2011	2012	2013	2014	2015
Operating Revenue (\$000)	49,896	51,128	51,635	52,410	50,012
O&M (\$000)	39,066	38,499	39,764	40,768	39,502
Long-Term Debt (\$000)	61,980	58,060	54,015	49,865	53,050
Annual Debt Service Coverage (x)	1.54	2.12	1.45	1.89	1.81
Cash on Hand	272 days	335 days	297 days	334 days	336 days
Debt to Operating Revenues (x)	1.2x	1.1x	1.0x	1.0x	1.1x

Source: City's audits; Moody's Investors Service

Detailed Rating Considerations

Service Area and System Characteristics: Water, Wastewater & Gas System Serves Southern New Mexico; Stability Stemming from University and Missile Range

The utility system benefits from a diverse and stable local economy. Las Cruces has water rights of 21,869 acre-feet per year and water is supplied by 29 wells that tap the Mesilla and Jornada del Muerto Bolsons aquifers that are interconnected with the Rio Grande stream system. Water system capacity is approximately 27.4 million gallons per day (MGD) with storage capacity of 25.4 million gallons, which is sufficient to meet average daily consumption of 15.56 million gallons per day (MGD) and peak consumption of 21.7 MGD in the summer. As the city continues expanding, officials are focused on ensuring there is enough water to meet demand. The city cannot apply for additional water rights, thus, they either have to acquire water rights from another entity or repurpose agricultural land. As such, the city plans to acquire the Jornada Water System, and its water rights to 5,961 acre-feet, with Series 2016 bond monies. The privately-owned system serves 3,500 customers inside and outside city limits on the East Mesa, Mesilla Park area and Las Alturas. After the sale, the city will acquire all of Jornada's infrastructure; however, the city is not responsible for any of the System's debt.

The wastewater system includes three treatment plants with a combined capacity of 14.9 MGD. The Jacob A. Hands wastewater treatment plant is the system's primary treatment facility with 13.5 MGD capacity. One smaller plant serves the city's West Mesa Industrial Park and a second small plant is used to collect and treat wastewater solely for use in irrigation. Officials report that the water and wastewater systems are in compliance with state and federal regulations. The gas system connects to El Paso Natural Gas Company lines located 18 miles south of the city and distributes gas to customers through over 1,000 miles of gas lines. The majority

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of natural gas supply (90%) is purchased from Shell Energy under a daily swing purchase contract and the balance is purchased from New Mexico Municipal Energy Acquisition Authority.

The joint utility system provides water, sewer, and gas service to the City of Las Cruces (Aa2), which is located about 45 miles north of City of El Paso, TX and is the second largest city in New Mexico. The local economy is anchored by New Mexico State University and White Sands Missile Range, which are the largest employers in the area with 6,500 and 4,500 employees, respectively. Growth in the area has slowed over the last three years after rapid expansion during the previous decade. Population grew a modest 2.2% between 2010 and 2015 to 101,408 after increasing 31.4% between 2000 and 2010. The city's large student population, including 16,765 students at the New Mexico State University Las Cruces campus and 8,000 students at Dona Ana Community College, contributes to below average socioeconomic indices. Median family income of \$50,327 is equal to 76.9% the U.S. median according to the 2013 American Community Survey. The unemployment rate is somewhat elevated in Las Cruces at 5.6% as of May 2016 and was essentially aligned with the state (6.0%) and above the national level (4.5%) for the same period. Despite the recent slowdown in growth and expansion, we believe that the customer base will remain stable over the near term given the high level institutional presence.

The joint utility system has a total of 32,653 water customers, 33,518 sewer customers, and 39,846 gas customers. Modest customer growth continues in region but has been particularly strong within the gas system, which absorbed 6,700 customers from Rio Grande Gas Company in fiscal 2011. The customer base is diverse with the largest customers representing only a small portion of total revenues. The gas system has the highest customer concentration with the top five customers accounting for a still modest 7% of total fiscal 2016 revenues (unaudited). The top five customers of the water and sewer systems each made up less than 2% of fiscal 2016 total system revenues (unaudited).

Debt Service Coverage and Liquidity: Adequate Debt Service Coverage; Strong Cash Levels

Debt service coverage will remain adequate over the near-term as the city adjusts utility rates to offset additional leveraging from Series 2016 bonds. Fiscal 2015 net revenues provided 1.81 times annual debt service coverage and 1.41 times maximum annual debt service coverage (MADS). When excluding an annual payment in lieu of taxes (PILOT) to the city from expenditures, the system's debt service coverage increases to 2.10 times annual and 1.99 times MADS.

Fiscal 2016 unaudited results indicate a decline in operating revenues of approximately \$2 million. Officials attribute the loss to reductions in gas and water usage, as well as \$1.4 million in one-time expenses. As such, the city anticipates annual debt service coverage to fall to 1.39 times; excluding PILOT payments, annual coverage improves to a healthier 1.64 times. Positively, the system is currently engaged in a long-term rate study, and has plans to make rate adjustments to its water, wastewater and gas enterprises in calendar year 2016. Additionally, the board has implemented a new policy that requires annual coverage of at least 1.6 times, inclusive of PILOT payments. Furthermore, under the new policy, the city can increase rates as necessary to reach that target. Outside of annual rate adjustments, the city utilizes "rate riders" to service additional debt. Officials prudently set rates to include debt service coverage and reinvestment in the system at annual depreciation levels as well as the standard utility basis rate of return (3.5%).

With the acquisition of Jornada Water System, Las Cruces will absorb 3,500 customers, equating to an additional \$1.5 million in annual operating revenues and \$500,000 in operating expenses. Based on fiscal 2017 projections, the city is anticipating net revenues of \$10.6 million, which would provide 1.44 times annual debt service and 1.36 times MADS. Excluding PILOT payments, coverage improves to 1.69 for annual and 1.60 for MADS.

LIQUIDITY

Unrestricted reserves are healthy, with fiscal 2015 cash of \$36.4 million representing 336 days cash on hand. These levels are expected to remain stable for the foreseeable future. The commission has a formal policy to hold reserves equal to at least two months of operating expenditures for the water and wastewater systems and one month of operating expenditures for the gas system. Aside from the annual PILOT and charges for administrative services, the joint utility system does not transfer revenues to the general government. We expect the system to maintain healthy financial operations going forward.

Debt and Legal Covenants: Manageable Debt Profile

The system's debt burden will remain manageable over the near-term given above average principal payout and no major borrowing plans. Inclusive of the new sale, the system will have \$80.1 million outstanding in revenue bonds, which represents 1.6 times operating

revenues. Management does not anticipate further issuances over the medium term, with a majority of capital improvement funded through rate increases, grants, and impact fees.

DEBT STRUCTURE

Principal amortization is rapid with 73.3% repaid within ten years. All revenue debt matures in fiscal 2036.

DEBT-RELATED DERIVATIVES

All debt outstanding debt is fixed rate and the system is not party to any interest rate derivatives.

LEGAL PROVISIONS

The legal provisions provide adequate bondholder security. The rate covenant requires 1.25 times coverage of annual debt service. A debt service reserve will be funded with a surety reserve at the lesser of 125% of average annual debt service, maximum annual debt service, or 10% of par. The additional bonds test requires that historical net revenues provide 1.25 times coverage of outstanding and proposed debt service requirements or that the city obtain a certificate from a consulting engineer showing that historical net revenues provide 1.15 times coverage of outstanding debt service, that the city will remain in compliance with the rate covenant through completion of the project being financed, and that net revenues will remain at least 1.25 times debt service including the proposed bonds for three years after project completion.

Management and Governance

The joint utility is managed by an independent seven-member board. This board is authorized to develop strategic policy and make rate recommendations, which are considered by the City Council for adoption, and can be remanded to the board for strategic guidance. Water, gas and sewer rates are reviewed periodically, and management anticipates water rate adjustments to be implemented in 2016. Gas rates include pass-through charges that pass gas supply costs along to consumers.

Legal Security

The Series 2016 bonds are payable from and secured by an irrevocable first lien (but not necessarily an exclusive first lien) upon the net revenues. Net revenues consist of all income and revenues directly or indirectly derived from the operation and use of the city's joint water, wastewater and natural gas utility systems, less Operation and Maintenance Expenses.

Use of Proceeds

Proceeds from the Series 2016 bonds will be used to purchase the Jornada Water System, including system assets and water rights.

Obligor Profile

The joint utility system provides water, sewer, and gas service to the City of Las Cruces (Issuer LT Aa2), which is located about 45 miles north of City of El Paso, TX and is the second largest city in New Mexico. The local economy is anchored by New Mexico State University and White Sands Missile Range, which are the largest employers in the area with 6,500 and 4,500 employees, respectively.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Ratings Methodologies page on www.moody.com for a copy of this methodology.

Ratings

Exhibit 2

Las Cruces (City of) NM

Issue	Rating
Joint Utility System Improvement Revenue Bonds Series 2016	Aa2
Rating Type	Underlying LT
Sale Amount	\$14,635,000
Expected Sale Date	08/24/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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