S&P Global
Ratings

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Summary:

Gulf Coast Authority, Texas; Water/Sewer

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Credit Profile		
US$17.41 mil bayport area sys rev rfdg bnds ser 2022B due 10/01/2033		
Long Term Rating	AA-/Stable	New
US$9.1 mil bayport area sys rev bnds ser 2022A due 10/01/2042		
Long Term Rating	AA-/Stable	New
Gulf Coast Auth bayport area sys rev bnds ser 2018 due 10/01/2042		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Gulf Coast Authority (GCA), Texas' approximately $9 million series 2022A Bayport area system revenue bonds and approximately $17.5 million series 2022B Bayport area system revenue refunding 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.

Officials plan to use the series 2022A bond proceeds to finance the acquisition, construction, improvements, and extension of the system. Officials plan to use the series 2022B to refund portions of the series 2013.

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.

Credit overview

The authority serves a 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. EPA regulation also provides a national competitive advantage for the authority, providing the industrial park with the synergies from Houston's strong energy sector.

During the past two fiscal years, all-in coverage dipped from prior trends but has rebounded in fiscal 2021. S&P calculated all-in debt service coverage is expected to increase to more than 1.90x in fiscal 2021 (unaudited) from 1.69x in fiscal 2020 and 1.53x in fiscal 2019. S&P includes management fees which are excluded from bond coverage. Based on management's projections, all-in DSC is expected to be strong as a result of rate and revenue increases, projected to exceed the increasing annual debt service payment, and projected by management to be above 1.75x. As the authority's financial improvements consistently strengthened, management moved to preserve its financial integrity by maintaining liquidity at extremely strong levels to provide an additional cushion. For fiscal unaudited 2021, the Bayport system reported $28.9 million in unrestricted cash and equivalents, equivalent to roughly one year of operating expenses. We understand that management may draw on reserves to fund additional improvements, but the system's current capital plan is expected to be funded mainly from the current bond proceeds. The capital plan currently has about $113 million of identified projects through 2026, which will primarily be funded from a combination of surplus revenue and the series 2022 bond proceeds although it may need to issue additional debt in the outer years. The debt-to-capitalization ratio was moderate at 57.5% at the end of fiscal 2020, when including the new money. The authority has a defined contribution plan, which we view as credit neutral.

The stable outlook reflects our expectation that the authority's willingness to adjust rates as it deems necessary to maintain healthy financial metrics will continue to support its financial risk profile, given that the bulk of neat term capital expenditures will be addressed with this bond issuance.

Environmental, social, and governance

We view the environmental risk as elevated when related to peers based on the authority's location near the Gulf Coast which makes it susceptible to severe weather events, including tropical storms and hurricanes; however, healthy reserves are available to provide support and management emergency plans reduce damage and disruption during such emergencies. Additionally, the winter freeze in early 2021 effected both the authority's conveyance system and some of its customers' operations. The system was fully operational within a week and some customers were effect for up to five weeks. Overall, the financial impact was estimated at $3 million, however this economic loss was manageable based on the authority's unrestricted cash and emergency plans.

Overall, we consider the authority's social and governance risks in line with those of the sector. Given that its customers are primarily industrial, we view social risk is non-material. In our opinion, management has strong governance given its transparent communication with stakeholders as well as its midterm-term strategic and financial planning. Additionally, management continues to improve and update its emergency and freeze protection plans to prepare for future environmental events. Lastly, the authority has added resources to address its cybersecurity risk, including recently added a cybersecurity position, and we feel governance risk is in line with the industry and peers.

Stable Outlook

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

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 or if the capital plan stresses liquidity.

Credit Opinion

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 its 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 great recession.

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 more than two-thirds of fiscal 2021 operating revenues. They include:

- Lyondell Chemical Co. (17.4%), which emerged from Chapter 11 bankruptcy protection in 2010;
- Celanese LTD (12.8%);
- Kaneka Texas Corp. (12%); and;
- Albemarle Catalysts Co. (11.1%).

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 without the benefit of certain exemptions provided to the authority. Furthermore, in various studies GCA has demonstrated the ability to handle such operations more cost effectively. We understand that the plant's discharge permit was valid through 2022, 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 10% increase for fiscal 2022, and adopted a 9% increase in fiscal 2021. Rate increases have been higher during the past few fiscal years primarily because of corresponding commodity cost increases.

Over the longer-term the system's financial history since fiscal 2012 has been solid, reflecting strong rebounds from thin performances in 2009 and 2010. However, 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. As most of the larger customers maintain ratings in the lower investment grade category, the sector's concentration particularly emphasizes the potential risk.

Related Research

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

Ratings Detail (As Of February 8, 2022)		
Gulf Coast Waste Disp Auth (Bayport Area Sys) wtr & swr (AMBAC)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
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) wtr & swr (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		