

Control Number: 42946



Item Number: 19

Addendum StartPage: 0

House Bill (HB) 1600 and Senate Bill (SB) 567 83<sup>rd</sup>  
Legislature, Regular Session, transferred the functions  
relating to the economic regulation of water and sewer  
utilities from the TCEQ to the PUC effective  
September 1, 2014.



RAPIER, WILSON & WENDLAND, P.C. Attorneys at Law

42944

John Rapier  
rapier@rapierwilson.com

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PUBLIC UTILITY COMMISSION  
FILING CLERK

May 11, 2011

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WATER DIVISION  
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Via Facsimile (512) 239-6972 and Regular Mail  
Executive Director,  
Texas Commission on Environmental Quality  
Water Supply Division  
Utilities and District Section, MC-153  
P. O. Box 13087  
Austin, Texas 78711-3087

Re: Application Nos. 36966-W and 36967-S; *Application by Providence Village Water Control & Improvement District and Mustang Special Utility District for Sale, Transfer, Merger Approval (the "STM Application")*

Dear Executive Director:

On behalf of the Mustang Special Utility District ("Mustang"), I am writing in response to the correspondence dated April 22, 2011, filed by the Town of Providence Village ("Protestant"), requesting a public hearing in connection with the above-referenced STM Application. Mustang urges the Executive Director to approve the STM Application without the necessity of a public hearing. This correspondence responds to each of the allegations raised by Protestant in its April 22 correspondence, and explains why a public hearing is neither necessary nor appropriate.

**Background**

Protestant misrepresents much of the background information relating to the STM Application. Protestant alleges that Mustang agreed to dual certification of the WCID because Mustang was "financially unable to construct the infrastructure or be the retail service provider to the new high-density development." This is nonsensical. Under Section 13.2502 of the Water Code and Mustang's service extension policies, developers must fund the infrastructure required to serve their developments. The purpose of the statute and service extension policies is to ensure that existing customers do not assume the burden and risk of financing infrastructure for a development that may or may not be successful. In this case, the developer proposed forming a special taxing entity to reimburse it for the cost of constructing the development's infrastructure. Mustang consented to the creation of a fresh water supply district (now the WCID) not because of any inability to fund infrastructure (which was not Mustang's responsibility), but in cooperation with the developer's funding requirements.

### ***Mustang Holds Water and Sewer CCNs for the Subject Lands***

Mustang already holds water and sewer CCNs for the 631.759<sup>1</sup> acres that are the subject of the STM Application. So the TCEQ has already determined that Mustang possesses the financial, managerial, and technical capability to provide continuous and adequate water and wastewater service to the lands in question. See TEX. WATER CODE § 13.241(a); 30 TAC § 291.102(a). In fact, as recently March 1, 2010, the TCEQ made a similar determination when it issued an Order amending Mustang's sewer CCN to add 2,423 acres of land slated for high density residential and commercial development along the future Dallas North Tollway corridor.<sup>2</sup>

### ***Commission Approval is Not Required***

Protestant's request for hearing fails to consider that TCEQ approval is not required for the WCID to convey its facilities to Mustang. Section 13.301 of the Water Code requires TCEQ approval for the sale, acquisition, lease, or rental of a system by a utility or water supply or sewer service corporation *that is required by law to possess a CCN*. Both Mustang and the WCID are conservation and reclamation districts organized and operating under Article XVI, Section 59, Texas Constitution, so neither entity is required by law to possess a CCN.

The sole purpose of the STM Application is to cancel the WCID's CCNs, leaving Mustang as the only certificated water and sewer provider to the 330 acres. Mustang and the WCID will complete the conveyance of assets on October 1, 2011, in accordance with the parties' contract. TCEQ approval of the STM application is only being undertaken to cancel the WCID's CCN.

It would be a tremendous waste of time, money and resources for TCEQ to conduct a public hearing with respect to a transaction that does not require TCEQ approval and that will proceed regardless of the outcome of the STM Application.

Notwithstanding these fundamental flaws in Protestant's request for hearing, the remainder of this correspondence will respond to the allegations raised by Protestant.

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<sup>1</sup> The WCID provides water and sewer service to 869.92 acres, 238.161 acres of which lie in exclusively in Mustang's water and sewer CCN.

<sup>2</sup> An Order granting the Application by the Mustang Special Utility District (SUD) to amend sewer Certificate of Convenience and Necessity No. 20930 in Denton County; TCEQ Docket No. 2007-1956-UCR; SOAH Docket No. 582-08-1318 (Application No. 35709-C).

## **Response to Allegations**

### ***Notice***

Protestant asserts that notice of the STM application was defective because it was not sent to Protestant. To the contrary, TCEQ requested that notice of the STM application be mailed to customers and adjacent utilities. TCEQ also required that notice be published. Mustang sent notice to all customers and adjacent utilities, and published notice, in accordance with TCEQ requirements.

Protestant is neither a retail public utility nor a customer of the WCID. As a result, Protestant was not entitled to notice as a matter of law, and its allegations to the contrary are without merit. Nevertheless, by its own admission, Protestant acknowledges actual notice of the STM Application and subsequent formal notice sent by Mustang to the Protestant at the request of TCEQ staff.

### ***Franchise Agreement***

Protestant alleges that the STM Application is defective because it fails to include a franchise agreement or other "consent" of the town. As a conservation and reclamation district, Mustang is not required to secure a franchise agreement or "consent" of Protestant. The infrastructure in question was constructed long prior to Protestant's incorporation as a municipality in May of 2010. Furthermore, Section 49.220 of the Water Code specifically grants all districts rights-of-way within, along, under and across all public, state, city, town, or village roads, highway and rights of way.

### ***Financial Capabilities***

Protestant alleges that Mustang's net operating income and change in net assets for fiscal year 2010 demonstrate inadequate financial capabilities. The "negative" net asset and net operating income figures to which Protestant refers includes depreciation and amortization. In 2010, the amount of depreciation expense was \$1,115,651 and amortization expense was \$425,200. After deducting these non-cash expenses, Mustang's net revenue for fiscal year 2010 was \$1,032,194.

As a governmental entity governed by cash-needs approach to ratemaking, it would not be appropriate for Mustang to establish rates to fund its depreciation expenses. (AWWA Manual M-1). The replacement of capital facilities by governmental entities is funded through debt, not depreciation. In other words, it is contrary to established ratemaking principles for Mustang to generate revenues sufficient to fund the depreciation expenses.

Mustang's financial capabilities are further evidenced by its most recent bond rating. Standard & Poors assigned Mustang an **A+** long-term rating, and stable outlook, with regard to Mustang's most recent (Series 2009) bonds and parity revenue debt. A copy of the ratings report is attached hereto. As noted in the report, the strong rating reflects Mustang's:

- Expanding customer base with very strong wealth and income levels;
- Very strong debt service coverage; and
- Access to the Dallas-Fort Worth metropolitan statistical area's and Denton, Texas' employment centers.

According to the report, "the stable outlook reflects Standard & Poor's expectation that management will sustain its good financial position with strong [debt service coverage] and good cash reserves while addressing capital needs associated with the customer based expected expansion." For a more detailed discussion of this issue and a copy of the Standard Poors rating see Attachment A, a letter from Steven Adams, Mustang's financial advisor.

Mustang encourages the Executive Director to review Mustang's audited financial statements that were included with the STM Application. The financial statements demonstrate Mustang's strong financial capabilities:

- (i) Mustang received an unqualified opinion, the highest opinion rendered by an auditor;
- (ii) Mustang serves more than 3,600 water connections and more than 1,100 sewer connections (Audit, p. 37);
- (iii) Mustang's debt service coverage for 2010 was 1.93 (based on average annual debt service requirement of \$533,680 and net revenues of \$1,032,194);
- (iv) Mustang's net assets (assets in excess of liabilities) exceed \$20.7 million (Audit, p.18);
- (v) Mustang has more than \$4 million in current cash and investments in hand (Audit, p. 17);
- (vi) Mustang generates more than \$5 million dollars in annual revenues (Audit, p. 45); and
- (vii) Mustang has never defaulted on its debt service obligations and has cash reserves to pay its debt service requirements for the years 2011, 2012, and 2013 without adding to such reserves (Attachment B, page 2).

For a more detailed discussion of Mustang's audit, see Attachment B, a letter from Rutherford, Taylor & Company, Mustang's independent auditor.

Protestant alleges that the transfer "will increase Mustang's financial troubles" because Mustang will lose the 15% payment it receives for providing operations, maintenance, meter reading and billing services on behalf of the WCID. While Protestant misconstrues the pricing terms of the Maintenance and Operations Contract between Mustang and the WCID, suffice it to state that the net revenues to Mustang will increase as the direct provider of water and wastewater services to the customers of the WCID as opposed to being only the maintenance and operations provider.

Protestant refers to a 2009 instance in which Mustang allegedly failed to remit the correct amount of revenues to the WCID. The alleged instance took place more than two years ago, was promptly addressed, and has not re-occurred. More importantly, the Protestant cites no customer billing irregularities caused by Mustang's billing services rendered to the WCID. In addition, independent auditors found no deficiencies in Mustang's internal controls.

Protestant notes that the WCID will continue to have significant outstanding bonded indebtedness after conveying its utility assets to Mustang. The argument has no relevance whatsoever to the STM Application. The WCID's bonds are supported by an unlimited *tax* pledge, not a pledge of water and wastewater utility revenues or infrastructure. The conveyance of the utility system assets will have no impact on the WCID's tax base or its ability to pay debt service.

While the Protestant complains about the impact of the transaction on the WCID, it is meaningful to note that the WCID has not requested a hearing or corroborated the Protestant's assertions. In fact, the WCID signed the STM application to complete the current transaction.

The allegation by Protestant that Mustang lacks the financial ability to build infrastructure for the final phase of the Providence Village development is irrelevant for the reasons stated on page 1 regarding developer responsibilities.

### ***Participation by Town Residents in Governance***

Protestant complains of legislation authorizing Mustang to create single-member districts found in Chapter 7209 of the Special District Local Laws Code. Protestant states that the governance structure means that Mustang "does not want town residents participating in its management or overseeing its finances." To the contrary, single member district governance ensures a broad cross-representation of governance. By definition, such a governance structure gives residents of the town equal participation in governance matters as other residents within the district. More importantly, the Texas Legislature authorized single member districts within Mustang. Any concerns by

Protestant or others relating to the legislation should be raised with the Texas Legislature, not the TCEQ.

### ***Impact on Rates***

By Protestant's own admission, the WCID contractually agreed to establish rates equal to Mustang's rates. Approval of the STM Application will have no impact on the costs paid by retail customers.

### ***Fire and Sheriff Services***

Protestant argues that the loss of revenues will impact the WCID's ability to pay for fire and sheriff services. The WCID has contractually agreed to convey its assets to Mustang and has raised no such complaints with respect to the transaction. Further, the WCID will still have maintenance tax revenues to fund fire and sheriff services. Section 49.351, et. seq., of the Water Code provides additional authority for the WCID to fund fire services. Finally, Protestant may fund such services. In any event, the Protestant's concern is not relevant to any issue before the Commission in this STM Application.

### ***Public Interest***

Protestant alleges that approval of the STM Application will not serve the public interest under the statutory criteria set forth at Section 13.246(c) of the Water Code. *TCEQ has already considered such criteria and previously granted water and sewer CCNs to Mustang for the lands in question.*

Protestant cites the Austin Court of Appeal's decision in *Texas Citizens for a Safe Future & Water v. R.R. Com'n of Texas*, 254 SW3d 492, 507 (Tex.App.—Austin 2007) in support of its argument that "public interest" should be construed broadly by the TCEQ. However, the Texas Supreme Court reversed that opinion prior to the date of Protestant's request for hearing. *R.R. Com'n of Texas v. Texas Citizens for a Safe Future & Water*, 54 Tex. Sup. Ct. J. 642, 2011 WL 836827 (Tex. March 11, 2011). The Supreme Court specifically upheld the Railroad Commission's more narrow interpretation of "public interest" in lieu of the broader interpretation suggested by the Court of Appeals. In summary, Protestant cites an opinion that has been overturned by the Texas Supreme Court in relevant part.

### ***Mustang's Managerial, Technical and Operational Capabilities***

Mustang's managerial, technical and operational capabilities are demonstrated by its service record. Mustang provides direct or maintenance and operations services to more than 8,800 retail water connections and provides direct or maintenance and operations services to more than 6,300 retail sewer connections. These numbers

include the WCID's 1,725 water connections and 1,771 sewer connections for which Mustang also performs all operations, maintenance, billing and collection services for and on behalf of the WCID. In fact, the WCID employs no water or sewer operators. The high level of Mustang's managerial and technical capabilities is evidenced by the most recent TCEQ inspection reports showing no violations at Mustang or the WCID. (See Attachment "C" and Attachment "D") This is the same high level of service that the Protestant seeks to preserve, and will be preserved by approval of the STM Application.

Mustang is a participating member of the Upper Trinity Regional Water District's (UTRWD) regional water and wastewater systems so it has more than adequate capacity to meet current and future customer demand. Mustang owns and operates 10 groundwater wells with a combined capacity of 2.0 million gallons per day and has long-term supply contracts with the UTRWD for 2.8 million gallons per day of treated surface water from Lake Lewisville. Mustang purchases 730,000 gallons per day of wastewater treatment capacity at the UTRWD's Peninsula water reclamation plant and has contracted for 135,000 gallons per day of wastewater treatment in UTRWD's Riverbend water reclamation plant. When the WCID transfers its water and sewer assets to Mustang, Mustang will be the successor to the WCID's contract with the UTRWD for 2.4 million gallons per day of treated surface water and 360,000 gallons per day of wastewater treatment capacity at the UTRWD's Riverbend water reclamation plant. Therefore, Mustang has sufficient water and sewer capacity to more than double Mustang's and the WCID's customer base without adding additional capacity.

### Conclusion

A public hearing is neither necessary nor appropriate with respect to the STM Application. Mustang Special Utility District already holds water and sewer CCNs for the lands that are the subject of the application. The Commission previously considered whether certification of Mustang was in the public interest, and affirmatively found this to be the case when it issued water and sewer CCNs to Mustang for the lands that are the subject of the STM Application.

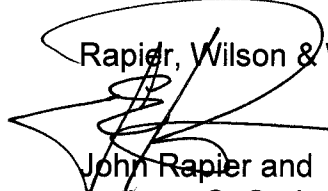
By contract, Mustang consented to dual certification of the subject lands with the WCID *for an interim period* to accommodate a developer's desire for reimbursement of its infrastructure costs with bond proceeds. The WCID contractually agreed to convey the assets to Mustang and to terminate the CCNs. The STM Application merely reflects the prior contractual agreement of Mustang and the WCID. The WCID does not oppose the transaction. Moreover, TCEQ approval of the application is not required by law. Mustang and the WCID (as political subdivisions) will transfer the assets regardless of the outcome of the STM Application. It makes no sense to conduct a public hearing under such circumstances.



A public hearing is otherwise not appropriate. Mustang serves more than 3,600 retail water connections and more than 1,100 retail sewer connections. It has operated and maintained the water and sewer utility assets referenced in the STM Application. The most recent TCEQ annual inspection identified no deficiencies with respect to the operations and facilities of both Mustang and the WCID. Mustang's independent financial audit confirms its financial capabilities.

For all of the reasons set forth above, Mustang respectfully requests that the Executive Director not refer the STM Application to public hearing. We appreciate your consideration of this response. If you have any questions, please do not hesitate to contact me at your convenience.

Very truly yours,

  
Rapier, Wilson & Wendland, P.C.

John Rapier and  
Anthony S. Corbett,  
Freeman & Corbett, L.L.P.  
Austin, Texas,  
Attorneys for Mustang  
Special Utility District

c: Brian Dickey, TCEQ (*via regular mail*)

Chris Boyd, General Manager  
Mustang Special Utility District  
7985 FM 2931  
Aubrey TX 76227



May 9, 2011

Chris Boyd, General Manager  
Mustang Special Utility District  
7985 FM 2931  
Aubrey TX 76227

Re: Request for Hearing on Application Nos. 36966-W and 36967-S from Town of Providence Village, Texas (the "Protest")

Dear Chris:

You have requested that we respond to certain allegations contained in the above referenced Protest filed by the Town of Providence Village (the "Town"). As you know, Specialized Public Finance Inc. ("SPFI") is a Texas based financial advisory firm with over 180 governmental clients in Texas. SPFI has represented Mustang Special Utility District ("Mustang") since the inception of the company in 2008. Prior to that, the principals with the firm were the financial advisors to Mustang since 1996. This letter will address the Town's financial allegations contained in the Protest in the order that they were presented.

Town Allegation 3 - "The Transferee (Mustang) lacks adequate financial capabilities."

Mustang is a financially stable utility with strong cash flows, good management and an excellent operating history. This is evidenced by Mustang's A+ (Stable Outlook) rating by Standard & Poor's Corporation (S&P) (see Attachment 1). The A+ rating is a high investment grade rating. Investment grade ratings range from BBB- to AAA. Any rating below BBB- is considered non-investment grade. Mustang is clearly within the investment grade category.

Additionally, Mustang is currently in compliance with all regulatory requirements associated with its water and sewer system operations. Mustang has sufficient capacity to serve its current customer base for at least five years, depending on the growth in its service area. Mustang, like most water utilities, requires developers to pay for infrastructure required to deliver water or wastewater service to and through their projects. As such, Mustang has and will continue to obtain retail customers without having to finance the associated infrastructure.

Town Allegation 3(A) - "Mustang's Audited Financial Statements Show Significant Losses for 2009 and 2010"

Mustang is financially strong and in compliance with all bond covenants. Any "accounting losses", as opposed to "real losses", are a result of accrual accounting requirements that impose large depreciation and accrual (non cash) expenses on a growing utility. Revenue bond covenants are cash basis covenants since bond holders are concerned about real cash income rather than accrual accounting rules. The discussion below clarifies the differences between the accrual accounting and cash accounting used to determine if Mustang complied with its Bond Order.

**Attachment A**

Currently, Mustang only has revenue bonds outstanding for its long-term debt. Mustang's revenue bonds have a typical net revenue pledge that is common among political subdivisions in Texas. Pursuant to Mustang's Bond Order, Mustang has pledged its net revenues produced by its operations.

Net revenues are based on cash accounting, not accrual accounting. The net revenues calculations based on cash accounting are used by political subdivisions to ensure compliance with Bond Ordinances. ***If a fast growing utility used accrual accounting to set rates, the rates would be higher than necessary to pay the cash expenses of the utility, repay the debt and meet coverage requirements.***

To calculate the net revenues, one must determine the operating revenues and operating and maintenance expenses of Mustang. Pursuant to the Bond Order and standard industry practice, the calculation of operating revenues is accomplished as follows:

Mustang Special Utility District Calculation of Operating Revenue		
	2010	2009
Operating Revenue		
Water/Wastewater Sales	\$ 3,338,626	\$ 3,018,990
Customer Charges/Fees	1,134,975	1,029,752
Miscellaneous Revenues	23,101	384,384
Interest Income	26,714	48,221
Total Operating Revenues	\$ 4,523,416	\$ 4,481,347

To calculate the Operating Expenses adjustments must be in accordance with the definition of Maintenance and Operating Expenses as defined in the Bond Order. That definition states that "Depreciation shall never be considered as a Maintenance and Operating Expense."

From a bond holder's perspective, required cash expenses are most important since cash is the medium with which the bonds are repaid. Non-cash expenses such as depreciation and amortization are removed from the calculation. Non-cash expenses, while necessary to comply with governmental accounting requirements, are not important to determine if there is sufficient revenue to operate the system and pay debt. The industry standard adjustments in calculating maintenance and operating expenses are as follows:

Mustang Special Utility District  
Calculation of Maintenance and Operating Expenses

	2010	2009
Maintenance and Operating Expenses		
Payroll and Benefits	\$ 755,843	\$ 1,101,397
Water Distribution System	2,260,955	2,143,834
Other Operating Costs	214,036	225,730
Professional and Legal Fees	109,688	285,093
Insurance	150,700	261,044
Amortization	425,420	422,744
Depreciation	1,115,651	943,517
	<u>\$ 5,032,293</u>	<u>\$ 5,383,359</u>
Less:		
Amortization	425,420	422,744
Depreciation	1,115,651	943,517
	<u>\$ 1,541,071</u>	<u>\$ 1,366,261</u>
Maintenance and Operating Expenses	<u>\$ 3,491,222</u>	<u>\$ 4,017,098</u>

After the calculation of operating revenues and maintenance and operating expenses has been completed, net revenues may be calculated. Mustang's net revenues are calculated as follows:

Mustang Special Utility District  
Calculation of Net Revenues

	2010	2009
Operating Revenues	\$ 4,523,416	\$ 4,481,347
Maintenance and Operating Expenses	3,491,222	4,017,098
Net Revenues	<u>\$ 1,032,194</u>	<u>\$ 464,249</u>

Mustang's Bond Order requires that Mustang maintain certain debt coverage ratios using both annual debt service and average annual debt service amounts. For 2010 Mustang's annual and average annual debt service were as follows:

Mustang Special Utility District  
Calculation of 2010 Debt Service

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Annual Debt Service	\$	588,019
Average Annual Debt Service		533,680

Using the "Annual Debt Service Requirements" and "Average Annual Debt Service Requirements" for 2010, the calculation of the compliance with the Bond Order is as follows:

Mustang Special Utility District  
2010 Calculation of Debt Service Coverage

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Net Revenues	\$	1,032,194
Annual Debt Service Requirements		588,019
Coverage		1.76
Average Annual Debt Service Requirement		533,680
Coverage		1.93

Mustang is required to have net revenues that are 1.20 times current debt service and 1.10 times average annual debt service. As shown above, Mustang's 2010 annual debt service ratio of 1.76 and its average annual debt service ratio 1.93 far exceed the required ratios of 1.20 and 1.10 respectively. Therefore, Mustang clearly has the financial resources to continue its operations for the foreseeable future.

The Town maligned Mustang's Net Assets in great detail. To evaluate Net Assets, one must understand the economic environment in which Mustang operates and the accounting rules that are applied. Mustang operates in Denton County, Texas, which is one of the fastest growing counties in the nation. One of the most difficult financial environments for any political subdivision, whether it be a city, school district or water utility, is to operate during a time of rapid growth. These political subdivisions must make decisions on capital improvements in advance of when they are put into service. Accrual accounting assigns non-cash expenses to those capital assets in the form of depreciation. Accordingly, if a utility purchases capital assets for several years, then reduces capital expenditures to adjust to slowing growth, depreciation expenses becomes larger than capital additions. From an accounting standpoint, this means that current capital assets are "reduced" more than new assets are added, thereby reducing Net Assets. For Mustang to continue to increase Net Assets it would either be required to (i) charge onerous and unnecessarily high rates, or (ii) continue to purchase capital assets that are not needed. Neither alternative is prudent or reasonable.

Chris Boyd, General Manager  
Mustang Special Utility District

The Town alleges that Mustang "struggles to maintain an adequate debt to equity ratio." Fast growth utilities typically have higher than average debt to equity ratios. As they mature, they pay down debt and grow into capacity and the high ratios decline. This is true of cities, school districts and water utilities. It is recognized by rating agencies, bond investors and the financial community at large that the debt to equity ratio experienced by Mustang is adequate and necessary. The rating agencies and Mustang's bond holders have spoken and they hold that Mustang's debt to equity ratio is sufficient for sustained stability.

The Town criticizes Mustang for a requirement of the Texas Attorney General regarding the approval of Mustang's Series 2008 Bond issue. They state that the Attorney General said that Mustang "could not issue such indebtedness unless it paid off at least \$833,000.00 of the indebtedness incurred two years earlier in 2006." In fact, Mustang closed the Series 2008 Bonds, with the Attorney General's approval, prior to repaying the Series 2006 Revenue Notes (the "Notes"). That being said, the Attorney General and S&P required Mustang to have a plan to repay the Notes prior to their ultimate maturity in 2009. To understand the Notes requires an explanation of how they came to be initially. The Notes financed one half of the costs of a wastewater treatment plant developed by the Upper Trinity Regional Water District (UTRWD). The project was initially to be funded by Mustang and the City of Oak Point on an equal basis. Mustang initiated the project at the request of a developer who was planning a large commercial project.

It was Mustang's intent to pay its portion of the project with cash on hand. Oak Point, anticipating growth, asked UTRWD to double the size of the planning and design so they could have capacity in the plant. UTRWD completed the design and was prepared to bid the project according to the schedule when Oak Point backed out of their commitment. Mustang needed the additional capacity and decided to take over Oak Point's participation in the project. Mustang had enough cash on hand for its original one-half share of the project and it financed Oak Point's share of the project with the Notes. Mustang sold the Notes to Bank of America and completed the project. Mustang used proceeds from a previous bond issue to repay the Notes with the consent of Attorney General thus satisfying the requirements of both the Attorney General and S&P. As a result, Mustang owns sufficient wastewater treatment capacity to satisfy future development in its service area. Such capacity is paid for and has no debt associated with it. This is an example of best practices in the utility industry, not mismanagement as alleged by the Town.

Should you have questions or if we may be of additional service, please contact us.

Very truly yours,

Specialized Public Finance Inc.



By \_\_\_\_\_  
Steven A. Adams, CFA,  
Managing Director

Attachment

August 18, 2009

**Summary:**

**Mustang Special Utility District,  
Texas; Water/Sewer**

**Primary Credit Analyst:**

Scott Sagen, New York (212) 438-5126; scott\_sagen@standardandpoors.com

**Secondary Credit Analyst:**

Theodore Chapman, Dallas (1) 214-871-1401; theodore\_chapman@standardandpoors.com

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## Summary:

# Mustang Special Utility District, Texas; Water/Sewer

### Credit Profile

US\$1.22 mil rev bnds ser 2009 dtd 08/15/2009 due 09/01/2031

<i>Long Term Rating</i>	A+/Stable	New
Mustang Spl Util Dist rev bnds ser 2008		
<i>Long Term Rating</i>	A+/Stable	Affirmed

### Mustang Spl Util Dist wtr/swr

*Unenhanced Rating* A+(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating, and stable outlook, to Mustang Special Utility District, Texas' series 2009 revenue bonds and affirmed its 'A+' long-term rating and underlying (SPUR) rating, with a stable outlook, on the district's parity revenue debt.

In our opinion, the ratings reflect the district's:

- Expanding customer base with very strong wealth and income levels;
- Very strong debt service coverage (DSC); and
- Access to the Dallas-Fort Worth metropolitan statistical area's (MSA) and Denton, Texas' employment centers.

In our opinion, these strengths are mitigated by the district's growth-related additional capital needs, driven by the pace of residential development.

A first-lien net revenue pledge of the utility system secures the bonds. A debt service reserve in the amount of maximum annual debt service provides additional liquidity. The district does not have the authority to levy an ad valorem property tax. Management will use series 2009 bond proceeds and a portion of series 2008 bond proceeds to pay the district's \$2.1 million subordinate-lien revenue note due Sept. 1, 2010.

Mustang Special Utility District, created in 2002 when it converted to a special utility district from a water supply corporation, provides treated water and wastewater services to a 120-square-mile area in northeastern Denton County. District residents have easy access to employment opportunities in Denton's and Dallas' northern suburbs. The primarily rural service area consists of large-acreage ranches and moderately priced homes; and its customer base is almost entirely residential with 3,400 water customers and 900 wastewater customers. The Cross Oak Ranch subdivision, one of the leading retail customers, serves about 900 residential customers and accounts for just 0.4% of total water revenues.

Along with the construction of a state toll road along the district's eastern side, subdivision development activity is planned in the service area, which officials do not believe will be as rapid as originally estimated. Current district



projections reflect about 6,000 water connections by 2011 and 3,000 wastewater customers by 2017. The district has benefited from the residential development slowdown, which has allowed it to prepare for the growth. Denton County median household income indicators are, in our opinion, a very strong 136% of the national level.

Mustang Special Utility District's financial position is good. Pledged fiscal 2008 revenues provide a very strong 2.7x senior-lien annual DSC for fiscal 2009. In our view, system liquidity declined in fiscal 2008 to pay for capital improvements; but it remains a good 77 days' cash on hand. Management intends to maintain \$1 million of unrestricted cash, or a good 104 days' cash on hand, for fiscal 2009. The district, which reviews water rates annually, raised water rates by 5% effective November 2008. A 7,500-gallon residential water and sewer bill is \$71.34, which is, in our opinion, generally above average but in-line for a utility of this size. The district is not dependent on any of its system's principal customers.

A large \$2.1 million subordinate-lien revenue note due in 2010, however, causes combined maximum annual DSC to be, in our opinion, an inadequate 0.53x. Officials, however, intend to pay the large lump sum before 2010 with series 2008 and 2009 bond proceeds; and they plan to amortize the payment.

The district's capital improvement plan, dependent, in large part, on the pace of residential growth in the service area, has identified five new water well sites and three potential sites for wastewater plants. Officials believe developers will pay for the majority of these capital needs, and management does not currently have additional debt issuance plans. Legal provisions are adequate with an additional bonds test equal to at least 1.25x average annual debt service. In addition, the district has covenanted to maintain rates so that pledged net revenues, excluding connection fees, provide at least 1.2x annual debt service and net earnings equal at least 1.1x average annual debt service.

## Outlook

The stable outlook reflects Standard & Poor's expectation that management will sustain its good financial position with strong DSC and good cash reserves while addressing capital needs associated with the customer base's expected expansion. The stable outlook also reflects the district's direct access to the Dallas-Fort Worth MSA's expanding outer portion, which will contribute to customer base expansion. We expect the district to maintain its unrestricted cash position at good levels, but additional cash drawdowns could further pressure the rating and outlook.

## Operations

Mustang Special Utility District's water supply is more than adequate for its current needs, and officials believe infrastructure is in place to support 2% annual customer growth. Ten groundwater wells, with a combined capacity of two million gallons per day, provide the district's water supply. Mustang also has long-term contracts with Upper Trinity Regional Water District to provide 2.8 million gallons per day of treated surface water from Lake Lewisville. The district, which began providing wastewater service in fiscal 2003, currently services about 900 customers in the Cross Oak ranch subdivision. The system purchases 730,000 gallons per day of wastewater treatment capacity at Upper Trinity Regional Water District's Peninsula water reclamation plant.

## Related Research

USPF Criteria: "Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds," Sept. 15, 2008

Complete ratings information is available to RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Ratings in the left navigation bar, select Find a Rating.

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# RUTHERFORD, TAYLOR & COMPANY, P.C.

A PROFESSIONAL CORPORATION  
CERTIFIED PUBLIC ACCOUNTANTS

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FARMERSVILLE, TEXAS 75442  
972-782-7572

May 7, 2011

Mr. Chris Boyd, General Manager  
Mustang Special Utility District.  
7985 FM 2931  
Aubrey TX 76627

Re: Request for Hearing on Application Nos. 36966-W and 36967-S from Town of Providence Village, Texas (the "Protest")

Dear Mr. Boyd:

I have been requested to comment on certain aspects of the April 22, 2011, letter from McKamie Kruger, LLP concerning the financial reports of Mustang Special Utility District.

First, on page 19 of the September 30, 2010, Audited Statement of Revenues, Expenses and Changes in Fund Net Assets, the net change for the fiscal year is (\$ 1,322,967). This deficit includes as anon-cash expense amortization of \$ 425,420 and depreciation of \$ 1,115,651 for the twelve month period. If you add back these non-cash expenses, the District had excess revenue for the fiscal year of \$ 218,104.

On page 18 of the September 30, 2009, Audited Statement of Revenues, Expenses and Changes in Fund Net Asset, the net change for the fiscal year is (\$ 1,366,859). Again this deficit includes a non-cash expense amortization of \$ 422,744 and depreciation of \$ 943,517 for the twelve month period. If you add back these non-cash expenses, the District had a deficit for the fiscal year (\$ 598).

Depreciation and amortization are required to be calculated and expensed each year as to be in accordance with generally accepted accounting principles (GAAP).

GAAP requires that the cost of an asset be spread over the expected useful life of the asset in such a way as to allocate it as equitably as possible to the periods during which the use of the asset exists. It would distort the financial statements each year to expense in the year of purchase capital assets of the District.

Second, I refer to the Statement of Cash Flows for each year. The Statement of Cash Flows is to provide relevant information about the cash receipts and cash payments of an entity during the period.

As detailed on page 20, of the 2010 annual Mustang Special Utility District audit attached hereto, the District generated net cash from operating activities of \$ 1,431,898.

**Attachment B**

On page 19, of the 2009 annual Mustang Special Utility District audit attached hereto, the District generated net cash from operating activities of \$ 636,140.

The Board could have chosen to increase rates for water and sewer usage to increase positive cash flow for the District; however, the Board has made the decision to maintain the rates due to the positive cash flow as discussed above.

Third, the climate has a major impact on District's such as Mustang Special Utility District.

A review of page 45, contained within the District's annual audit for the fiscal year ended September 30, 2010, details a 5 year history of revenues and expenses for the District. During years of summer rain, the District does not sell as much water as during dry or drought years.

The District's expenses are fixed in that the District must plan and budget expenses for a dry year when increased costs are associated with providing an increased amount of water to its customers. If the season turns out to be a mild summer, then the District does not have the revenue from sales to offset the fixed costs associated with a dry year. .

Fourth, the District has in excess of three million dollars (\$ 3,000,000) in restricted assets that could be used to service debt. The debt service requirements of the District for the fiscal years ending September 30, 2011, 2012 and 2013 totals \$ 2,799,927.

The Board has in reserve the next three years debt service requirements without adding additional funds to these reserves.

Based upon my comments above, I am of the opinion that the Mustang Special Utility District is financially capable at this time.

Respectfully submitted,

Michael E. Taylor, CPA  
Rutherford, Taylor & Company, P.C.

MET/ny

MUSTANG SPECIAL UTILITY DISTRICT  
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS  
YEAR ENDED SEPTEMBER 30, 2009

	Enterprise Fund Water Utilities
Cash Flows from Operating Activities:	
Cash Received from Customers	\$ 4,433,126
Cash Payments for Goods and Services	(2,695,589)
Cash Payments to Employees	(1,101,397)
Net Cash Provided by (Used for) Operating Activities	<u>\$ 636,140</u>
Cash Flows from Capital and Other Related Financing Activities:	
Acquisition and Construction of Capital Assets	\$ (1,534,853)
Equity Buy-in Fees / Bond Issuance Costs Capitalized	(136,959)
Escrow for Land Easements Received	10,225
Proceeds Received on Bond and Notes	4,613,603
Premium Proceeds related to Bond Issuance	55,004
Principal Paid on Bonds and Notes	(1,260,958)
Interest Paid on Bonds and Notes	(459,808)
Wastewater Capacity Fee Received from Developers	61,875
Net Cash Provided by (Used for) Capital and Other Related Financing Activities	<u>\$ 1,348,129</u>
Cash Flows from Noncapital Financing Activities:	
Increase (Decrease) in Customer Deposits	\$ 42,385
Net Cash Provided by (Used for) Noncapital Financing Activities	<u>\$ 42,385</u>
Cash Flows from Investing Activities:	
Interest Income	\$ 48,221
Net Cash Provided by (Used for) Investing Activities	<u>\$ 48,221</u>
Net Increase (Decrease) in Cash and Investments	\$ 2,074,875
Cash and Investments - Beginning (October 1)	<u>3,649,947</u>
Cash and Investments - Ending (September 30)	<u><u>\$ 5,724,822</u></u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>	
Operating Income (Loss)	\$ (950,233)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	943,517
Amortization	422,744
Change in Assets and Liabilities:	
(Increase) Decrease in Accounts Receivable	775,636
(Increase) Decrease in Prepaid Expenses, Supplies and Materials	(15,855)
Increase (Decrease) in Accounts Payable	(320,302)
Increase (Decrease) in Other Payables	(262,180)
Increase (Decrease) in Due to Other Districts	55,635
Increase (Decrease) in Bulk Water Deposits Payable	(12,822)
Net Cash Provided by (Used for) Operating Activities	<u><u>\$ 636,140</u></u>

The accompanying notes are an integral part of this statement.

MUSTANG SPECIAL UTILITY DISTRICT  
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS  
YEAR ENDED SEPTEMBER 30, 2010

	Enterprise Fund
	Water Utilities
<b>Cash Flows from Operating Activities:</b>	
Cash Received from Customers	\$ 4,830,938
Cash Payments for Goods and Services	(2,641,047)
Cash Payments to Employees	(757,993)
<b>Net Cash Provided by (Used for) Operating Activities</b>	<b>\$ 1,431,898</b>
<b>Cash Flows from Capital and Other Related Financing Activities:</b>	
Escrow for Land Easements Received	\$ 276
Principal Paid on Bonds and Notes	(1,445,952)
Interest Paid on Bonds and Notes	(643,035)
Wastewater Capacity Fee Received from Developers	5,000
<b>Net Cash Provided by (Used for) Capital and Other Related Financing Activities</b>	<b>\$ (2,083,711)</b>
<b>Cash Flows from Noncapital Financing Activities:</b>	
Increase (Decrease) in Customer Deposits	\$ 36,316
<b>Net Cash Provided by (Used for) Noncapital Financing Activities</b>	<b>\$ 36,316</b>
<b>Cash Flows from Investing Activities:</b>	
Acquisition and Construction of Capital Assets	\$ (398,985)
Interest Received	18,268
<b>Net Cash Provided by (Used for) Investing Activities</b>	<b>\$ (380,717)</b>
<b>Net Increase (Decrease) in Cash and Investments</b>	<b>\$ (996,214)</b>
Cash and Investments - Beginning (October 1)	5,724,822
<b>Cash and Investments - Ending (September 30)</b>	<b>\$ 4,728,608</b>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>	
Operating Income (Loss)	\$ (536,591)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	1,115,651
Amortization	425,420
Change in Assets and Liabilities:	
(Increase) Decrease in Accounts Receivable	230,754
(Increase) Decrease in Prepaid Expenses, Supplies and Materials	43,619
Increase (Decrease) in Accounts Payable	46,478
Increase (Decrease) in Other Payables	3,085
Increase (Decrease) in Due to Other Districts	103,482
<b>Net Cash Provided by (Used for) Operating Activities</b>	<b>\$ 1,431,898</b>

The accompanying notes are an integral part of this statement.

Kathleen Hartnett White, *Chairman*  
R. B. "Raiph" Marquez, *Commissioner*  
Larry R. Soward, *Commissioner*  
Glenn Shankle, *Executive Director*



## TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

*Protecting Texas by Reducing and Preventing Pollution*

March 28, 2006

Ms. Angela Stepherson, P.C.  
District Attorney  
Denton County FWSD #9  
3100 McKinnon St. Ste. 950  
Dallas, TX 75201

Re: Comprehensive Compliance Investigation at:  
Denton County FWSD #9, 809 Oakcrest Dr., Denton County, Texas  
PWS ID No.: 0610244

COPY

Dear Ms. Stepherson:

On February 21, 2006, Mr. Brandon Cooper of the Texas Commission on Environmental Quality (TCEQ), D/FW Region Office conducted an investigation of the above-referenced facility to evaluate compliance with applicable requirements for public water supply systems. No violations were documented during the investigation.

The TCEQ appreciates your assistance in this matter and your compliance efforts to ensure protection of the State's environment. If you or members of your staff have any questions regarding these matters, please feel free to contact Mr. Brandon Cooper in the D/FW Region Office at 817-588-5830.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles Marshall".

Charles Marshall  
PWS Work Leader  
D/FW Region Office

CM/bac

REPLY TO: REGION 4-DALLAS/FORT WORTH • 2309 GRAVEL DR. • FORT WORTH, TEXAS 76118-6951 • 817/588-5800 • FAX 817/588-5700

P.O. Box 13087 • Austin, Texas 78711-3087 • 512/239-1000 • Internet address: [www.tceq.state.tx.us](http://www.tceq.state.tx.us)

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Attachment C