MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to City of Topeka, KS' $44.6M Combined Utility Improvement Bonds, Ser. 2014-A

Global Credit Research - 02 Dec 2014

Aa3 rating applies to $132M of outstanding junior lien revenue debt

TOPEKA (CITY OF) KS
Combined Water & Sewer Enterprise
KS

Moody's Rating

ISSUE	RATING
Combined Utility Improvement and Refunding Revenue Bonds Series 2014-A	Aa3
Sale Amount $44,600,000	
Expected Sale Date 12/09/14	
Rating Description Revenue: Government Enterprise	

Moody's Outlook STA

Opinion

NEW YORK, December 02, 2014 --Moody's Investors Service has assigned a Aa3 rating and stable outlook to the City of Topeka's (KS) $44.6 million Combined Utility Improvement and Refunding Revenue Bonds, Series 2014-A. Concurrently, Moody's has maintained the Aa3 rating and stable outlook on the city's parity combined utility revenue debt. Post-sale, the city will have $132 million of parity combined utility revenue debt outstanding. The outlook is stable. The bonds are payable solely from a subordinate lien on the net revenues of the city's Combined Water, Water Pollution Control, and Stormwater Utility System. The subordinate lien bonds are paid after the system's $59 million in outstanding State Revolving Fund loan debt. Proceeds of the Series 2014-A bonds will finance various system improvements as well as refund portions of the combined utility's outstanding Revenue Bonds, Series 2005-A, Series 2006-B, Series 2007-B, for estimated combined present value savings of $3.5 million.

SUMMARY RATINGS RATIONALE

The Aa3 rating and stable outlook is based on the system's stable service area; satisfactory financial operations with improved liquidity in recent years; rate setting authority of the city council; recently approved rate increases; satisfactory debt service coverage with moderate future debt plans; and adequate legal covenants.

STRENGTHS

-Stable service base encompassing the Kansas state capital of Topeka (Aa3)

-Improved liquidity position in recent years

CHALLENGES

-Moderately leveraged debt position combined with planned capital improvement needs

SATISFACTORY LEGAL COVENANTS FOR REVENUE DEBT

The system's revenue debt benefits from satisfactory legal covenants. The bonds have a junior lien pledge on the net revenues from the combined utility. The $59 million in outstanding state revolving loan fund debt has a senior lien on the gross revenues of the system. The legal covenants require net revenues to provide 1.25 times coverage on annual junior lien parity debt service and an additional bonds test of 1.25 times maximum annual debt service coverage based on projected annual net revenues in any succeeding year. The net revenue pledge considers senior lien SRF loan debt service as an operating expense. Other bondholder protections include a debt service reserve account funded at the lesser of maximum annual debt service on the current bonds and any additional bonds issued on parity with the current bonds; 125% of the average annual debt service on such bonds; or 10% of the principal amount of such bonds.

STABLE SERVICE AREA IN STATE CAPITAL

The service area is expected to remain stable given the City of Topeka's role as state capital. Government-related employment in the city provides overall economic stability (the state employs approximately 8,100 people in Topeka). Also contributing to tax base stability is the presence of several large medical centers, including a Veterans Administration hospital. The system has five senior Water Rights granted by the Kansas Department of Agriculture's Kansas Water Office to the Kansas River, which is the system's sole source of water. The system provides treatment and distribution services to approximately 57,000 customers; the wastewater system serves approximately 47,000 customers; and the stormwater system serves approximately 46,000 customers. Among the water system's top customers are several rural water districts that receive water via long term contracts. The top customers are relatively diverse, representing a variety of industries, including manufacturing, government, service and health care. Notably, the city expects that Goodyear Tire & Rubber Company (Long-term corporate family rated Ba3/positive outlook), which is the third largest water utility customer, will also become a major wastewater customer next year, and is expected to generate approximately $750,000 of additional annual revenue for the wastewater system. Additionally, officials noted the recent opening of a $270 million Mars plant facility that is expected to add approximately 200 new jobs to the Topeka area. The city reports that operations at the utilities' other large customers all remain stable.

FINANCIAL OPERATIONS CHARACTERIZED BY IMPROVED LIQUIDITY; SATISFACTORY DEBT SERVICE COVERAGE

A trend of satisfactory financial performance characterized by an improved cash position points to the continuation of stable financial performance. The city's Water, Water Pollution Control, and Stormwater Utility Fund closed fiscal 2013 with $52 million in net working capital, including $33.9 million held as unrestricted cash and investments. The utility's unrestricted cash position reflects a significant increase over the fiscal 2009 level of $10.2 million.

The Topeka City Council has independent rate-setting authority, and rate increases have historically been implemented for multiple years at a time based on projected capital expenditures and rate covenants for debt service. The city council approved an ordinance in April 2008 for annual water system rate increases of 24.3%, 1.8%, 1.7%, and 1.8% through fiscal 2011; annual wastewater system rate increases of 4% each year through fiscal 2011; and a one-time 17% increase in stormwater system rates. The city council recently approved annual rate increases of 6% in fiscal 2015, 5% in fiscal 2016, and 5% in fiscal 2017. The rate increases scaled to cover a 5 year Capital Improvement Plan the council approved at the same time.

In fiscal 2013 operations narrowed, reducing total debt service coverage from 1.91 times in fiscal 2012 to 1.23 times coverage in fiscal 2013. Official cited lower demand due to wetter weather. Fiscal 2013 junior lien coverage was 1.41 times which is above the city's rate covenant of 1.25 times. While audited results are not yet available, officials report fiscal 2014 figures are tracking to budget and expect to meet projected coverage of over 2.0 times total debt service. Pro forma fiscal 2015 figures, which include the first phase of the three year rate increase, provides solid maximum annual debt service coverage (MADs), which occurs in fiscal 2024, of 2.06 times on junior lien revenue, after payment of senior lien debt service, which is considered an expense in determining net revenues. Future credit reviews will take into account the system's ability to ensure revenues generated are sufficient to accommodate projected borrowing and capital expenses, while maintaining current coverage ratios.

DEBT BURDEN EXPECTED TO REMAIN MANAGEABLE; MODERATE FUTURE DEBT PLANS

Topeka's combined utility system's debt burden will likely remain moderately leveraged in the near term due to capital projects that are planned over the next several years. Projected capital expenditures for major projects for the combined system total approximately $75 million over the next five years, with projected expenditures for routine projects totaling approximately $67 million through 2019. Management indicates that future debt issuance will likely be parity subordinate lien net revenue debt as opposed to SRF loans. The system currently has $59 million of senior lien SRF loan debt outstanding and $132 million of junior lien net revenue debt outstanding. The system is moderately leveraged, with a fiscal 2013 debt ratio of 46.2% combined with slow principal amortization 45.2% of the principal on all junior lien debt is retired in ten years. All of the system's debt is fixed rate, and the system is not a party to any interest rate swap agreements.

Outlook

The stable outlook reflects the system's stable service area; financial operations that are bolstered by the city council's rate setting authority; and satisfactory debt service coverage with moderate future debt plans.

WHAT COULD CHANGE THE RATING - UP

-Significantly increased combined system cash balance

-Sustained increases to debt service coverage

WHAT COULD CHANGE THE RATING - DOWN

-Decreases in debt service coverage and/or material liquidity declines

-Substantial deterioration of system service area

KEY STATISTICS

Type of system: Combined (Water, Water Pollution Control, and Stormwater)

Fiscal 2013 debt service coverage (senior lien SRF loans): 2.81 times

Fiscal 2013 debt service coverage (subordinate lien): 1.41 times

Fiscal 2013 debt ratio: 46.2%

Fiscal 2013 operating ratio: 66.1%

Fiscal 2013 net working capital: $52 million (129.6% of O&M expenditures)

Fiscal 2013 Unrestricted reserves: $33 million (60.6% of O&M expenditures)

SRF loan debt outstanding (senior lien): $59 million

Post-sale parity revenue debt outstanding (subordinate lien): $132 million

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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