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CREDIT OPINION
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New Issue

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City of Topeka, KS Combined Utility Enterprise

New Issue - Moody's Assigns Aa3 to Topeka, KS's Combined Utility Revenue Bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to the City of Topeka, KS's $18.1 million Combined Utility Improvement Revenue Bonds, Series 2017-A. Moody's maintains the Aa3 rating on the system's outstanding parity debt with a stable outlook. Post-sale, parity debt outstanding will total $141.9 million.

The Aa3 rating reflects the system's large and stable service area, healthy system liquidity, history of intermittent rate increases to support operations and capital improvement plans, and moderate debt burden expected to slightly increase based on future debt plans. The rating also takes into account the narrowed debt service coverage ratio when considering subordinate lien pledge to bondholders.

Credit Strengths

» Stable service area encompassing the Kansas state capital of Topeka (Aa3)

» Healthy system liquidity

Credit Challenges

» Narrowed debt service coverage based on senior and subordinate lien debt

» Moderate leverage and manageable future debt plans

Rating Outlook

The stable outlook reflects the expectation that the system's credit fundamentals will remain stable over the near term despite planned future debt issuance due to the city's strengthened long range planning, conservative fiscal management and the governing body's willingness to adjust revenues as needed to support operations and capital improvements.

Factors that Could Lead to an Upgrade

» Sustained increases to debt service coverage including senior and subordinate lien debt

» Sustained significant increases to combined system cash balance

» Moderated debt burden

Factors that Could Lead to a Downgrade

» Further sustained decreases in debt service coverage

» Material liquidity declines

Key Indicators

Exhibit 1

Topeka (City of) Combined Utility Enterprise, KS					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	25 years				
System Size - O&M (in $000s)	43,430				
Service Area Wealth: MFI % of US median	85.50%				
Legal Provisions					
Rate Covenant (x)	1.25x				
Debt Service Reserve Requirement	DSRF funded at the lesser of the standard 3-prong test (Aa)				
Management					
Rate Management	A				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue ($000)	64,835	60,508	63,138	63,416	65,888
System Size - O&M (in $000s)	32,960	40,019	42,159	43,723	43,430
Net Funded Debt ($000)	187,581	178,753	167,194	175,455	190,758
Annual Debt Service Coverage (x)	1.91x	1.23x	1.27x	1.25x	1.40x
Cash on Hand	265 days	221 days	202 days	462 days	487 days
Debt to Operating Revenues (x)	2.9x	2.9x	2.6x	2.7x	2.9x

Source: Moody's Investors Service; Combined Utility System audited financial reports

Recent Developments

Following two full years of 5-6% rate increases, the fiscal 2016 operating results reflected slightly improved debt service coverage at 1.4 times, including both the senior State Revolving Fund loans and the subordinate parity bonds debt. Further details on the system's financial position and future rate increases to support capital plans are discussed herein.

Detailed Rating Considerations

Service Area and Customer Base: Stable service area in state capital

The service area will remain stable given the City of Topeka's role as state capital and positive developments in the private sector. Government related employment represents approximately 15% of jobs in the metro area. Two large medical centers in the city provide additional employment stability. The region has been seeing growth in food manufacturing due to its proximity to agricultural inputs and strong transportation infrastructure that benefits manufacturing and distribution.

The combined utility system includes the water, wastewater and stormwater utilities. The water system possesses five senior water rights to the Kansas River granted by the Kansas Department of Agriculture's Water Office. The system provides water treatment and distribution to approximately 57,000 customers, and sewer and stormwater services to approximately 47,000 customers. The enterprises have more than sufficient capacity to address these systems' demand. Among the water system's largest customers are several rural water districts that receive raw water via long-term contracts. The top retail customers are relatively diverse, representing a variety of industries, including manufacturing, government, service and healthcare.

Debt Service Coverage and Net Working Capital: Narrowed but adequate coverage and healthy system liquidity

The system's operating results and debt service coverage slightly improved in fiscal 2016 and will remain stable, albeit slightly narrow, due to an expectation that the city council will continue to support rate increases as needed to fund the long range capital plan. Following drought conditions in 2010 through 2012, wetter weather since 2013 has led to decreased system revenues, while operating expenses have significantly increased due to past water main breaks. Positively, the 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. System rates and fees were increased in all fiscal years 2008 - 2011. Following no increases in 2012-2014, council adopted another round of multi-year increases which include an increase of 6% in 2015, 5% in 2016 and 5% in 2017. The city expects to reports that revenues and expenses are tracking slightly better than budgeted in fiscal 2017 leading to stable coverage ratios.

With an increased operating ratio, debt service coverage, including both the senior state revolving fund (SRF) loans and the junior lien revenue bonds, narrowed starting in fiscal 2014 though slightly increased to 1.4 times in fiscal 2016. Approximately $7 million of the system's $43.4 million of operating expenses (net of depreciation) is attributable to payments in lieu of taxes (PILOTS) to the city's General Fund. Discounting the PILOTS, which are subordinate to debt service per the legal provisions, coverage increases to a stronger 1.7 times aggregate senior and junior debt service.

LIQUIDITY

The system's cash position as of fiscal 2016 increased to $57.9 million, representing a strong 487 days of operating expenses. The cash position is partially tempered by a note outstanding in the par amount of $24.3 million. Net working capital increased by $5.8 million in fiscal 2016, bringing it to $50.8 million, or 116.9% of operating expenses.

Debt and Legal Covenants: Manageable debt burden; Adequate albeit weaker legal covenants

Topeka's combined utility system's debt burden will remain manageable but increase slightly in the near term due to capital projects that are planned over the next several years. The city projects issuing approximately $115 million in revenue bonds over the next five years for capital investments in the combined utility system. Following the issuance of the 2017-A bonds, system debt will include $43.5 million of senior SRF loans outstanding and $160 million of junior lien revenue bond debt. The city has indicated that future borrowings would be on parity with the junior lien, and does not intend to issue additional SRF debt. The system is moderately leveraged, with a fiscal 2016 debt to operating revenues ratio of 2.9 times.

DEBT STRUCTURE

The system's senior SRF loans mature in 2029 while the junior lien revenue bonds mature in 2047. All debt is fixed rate, and approximately 51% of principal is retired within ten years.

DEBT-RELATED DERIVATIVES

The system does not have any derivative agreements.

Legal Covenants

The system's revenue debt maintains adequate, albeit slightly weaker legal covenants relative to typical covenants in the sector. The bonds are secured by a junior lien on system net revenues from the combined utility. Per the bond resolution, net revenues available to pay debt service on the revenue bonds are defined as gross revenues less operations and maintenance expenses net of payments in lieu of taxes (PILOTs), and debt service payments on outstanding state revolving fund loans (SRF). While the SRF loans are considered an expense under the bond resolution, they are ultimately loans and can be accelerated in an event of default. The SRF loans do carry bond insurance.

The legal covenants require net revenues (as defined in the resolution) 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. While debt service coverage considering all debt in the aggregate is narrow, coverage on the junior lien bonds as of fiscal 2016 per the bond resolution is much greater at 2.5 times. The coverage test for purposes of setting rates and issuing additional bonds is based on the bond resolution. Positively, the bonds are additionally secured by a cash debt service reserve fund that is equal to the least of the standard three-prong test and based on total parity revenue bond debt.

Management and Governance

Management of the combined utilities falls under the utilities division directors, who report to the deputy city manager and finally the city manager. The city council approves budgets and policies and the city manager carries out the policies established through city departments, including the public works department. The council and city staff have generally shown a willingness and ability to adjust rates as necessary to accommodate operations and reinvestment in the combined utilities system, including recent adoption of three years of rate increases. Recently, the city has bolstered capital planning for the combined utility, moving to a formal ten year capital improvement plan.

Legal Security

The bonds are secured by a junior lien on the net revenues of the system.

Use of Proceeds

Proceeds of the Series 2017-A bonds will fund system improvements.

Obligor Profile

The combined utilities provide water (wholesale and retail), wastewater and stormwater services to the city of Topeka, KS and surrounding areas. The city of Topeka is the state capital of Kansas, and was home to approximately 127,000 people as of 2015.

Methodology

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

Ratings

Exhibit 3

Topeka (City of) KS Combined Utility Ent.

Issue	Rating
Combined Utility Improvement Revenue Bonds Series 2017-A	Aa3
Rating Type	Underlying LT
Sale Amount	$18,100,000
Expected Sale Date	08/15/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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