Rating Update: Seacoast Utility Authority, FL

MOODY'S AFFIRMS A2 RATING ON SEACOAST UTILITY AUTHORITY'S (FL) WATER AND SEWERAGE REVENUE BONDS

AFFIRMATION IN CONJUNCTION WITH ASSIGNMENT OF A2 RATING TO AUTHORITY'S SERIES 1989 BONDS

Water/Sewer
FL

Opinion

NEW YORK, May 30, 2008 -- Moody's Investors Service has affirmed the A2 rating on Seacoast Utility Authority's Water and Sewerage Revenue Bonds Series 2001 and assigned a rating of A2 to the Series 1989 bonds. This A2 rating is based on satisfactory financial operations and significant borrowing program supported by a sizable rate increase, an affluent customer base, ample capacity, and sound management. The manageable debt ratio is expected to increase with anticipated debt issuance, especially in light of significantly slowed growth in this developing system.

Adequate legal provisions include a 1.1 times rate covenant; a 1.05 times (exclusive of connection fees) additional bonds test; and a reserve requirement equal to maximum annual debt service. About 26.6% ($19.4 million) of utility debt is represented by two bank loans (Series 2005 and Series 2006) that are parity to Series 1989 and Series 2001 rated bonds.

Seacoast Utility Authority (The Authority) has a number of positive credit features that include: an above average residential base; good debt service coverage; and solid current liquidity. However, these factors are balanced against: the continuing negative impact of the general economic turndown; the requirement to fund an $8.65 million debt service reserve now being provided for by a surety from an insurer who's rating has been downgraded; and issuance of a sizable amount of debt to replace water treatment facilities which, in concert with revenue impacts, could reduce coverage levels.

ABOVE-AVERAGE SERVICE AREA; SYSTEM HAS AMPLE CAPACITY

The Authority provides water supply and wastewater treatment and disposal to an affluent service area in the unincorporated areas of Palm Beach County, the incorporated areas of City of Palm Beach Gardens, the Village of North Palm Beach and the towns of Lake Park and Juno Beach. The established water and sewer system, due to the combination of a mostly developed (84%) service area and the severe housing market correction, experienced a significant slowdown in new meter installations from a peak of 1,441 annually in fiscal 2005 to a low of 266 in fiscal 2007- the lowest amount in at least the past eight years. Growth thus far (six months) in fiscal 2008 is reportedly down another 40% from the prior-year period. The system serves approximately 47,152 water equivalent residential connections (ERC's) and 35,800 sewer ERC's, or a population of roughly about 100,000. The system is well-diversified, deriving approximately 78% of revenues from residential customers and with the top ten customers representing a minimal 5.21% of fiscal 2007 operating revenues. Facilities have reportedly been hardened against storms and have back-up generators to minimize service disruptions. Updated security measures have been implemented in accordance with a vulnerability assessment conducted at the end of 2003. Additionally, both systems are in good operating condition. Capacity limits are currently comfortable in both systems.

The Authority derives its water from wells supplied by the Surficial Aquifer, with additional wells being constructed to the upper Floridan Aquifer (more brackish water requiring membrane treatment). Officials plan to replace the two older lime-softening treatment plants with a single membrane plant having the same (30.5 MGD) capacity by the end of 2012. The plant will have a nanofiltration train (26 MGD) that will continue to treat water from the Surficial Aquifer, and a low-pressure reverse osmosis train (4.5 MGD) to treat the more brackish Floridan Aquifer water that will be blended. The current water system can treat 30.5 MGD per day, with a fiscal 2007 average and peak daily usage of 17.0 MGD (55.7% of total capacity) and 24.6 MGD (80.7% of total capacity), respectively. Officials anticipate water supply and treatment capacity to be adequate to buildout. Unaccounted for water is a reportedly modest 5.4% in 2007. Officials anticipate compliance with expected DBP-Stage 2 regulations.

The sewer system can treat 12 MGD of wastewater daily, with a fiscal 2007 average and peak daily usage of 7.9 MGD (65.8% of total capacity) and 10.1 MGD (84.2% of total capacity), respectively. The system is reportedly in compliance with all state and federal regulations and there are no issues related to TMDL's. Effluent is reused (about 7 MGD to 8 MGD currently) or can also be deepwell injected (15 MGD capacity). Officials are looking to blend wastewater effluent with about 4 MGD of treated water by-product to supply about 12 MGD of reuse product. Sludge treatment levels are adequate with Class 1 landfill disposal. There are about 3,500 septics in the system, with mandatory tie-in required for non-residential customers only. Infiltration/inflow is reported to be a modest 8%.

WELL-MANAGED FINANCIAL OPERATIONS SUPPORTED BY GOOD DEBT SERVICE COVERAGE AND SOLID CURRENT LIQUIDITY

Moody's believes that slower system growth and recently-adopted rate increases will continue to support good debt service coverage. Net revenues in fiscal 2007 provide 2.2 times coverage from net revenues (2.7 times with additionally-pledged guaranteed revenues and connection charges). A 33.3% rate increase effective in April 2006 (the first since 1994) is intended to support upcoming debt issuance and equity contributions to the capital program. Rates and charges are reportedly regionally competitive, with the monthly average residential bill estimated at $49.12 (based on 9,000 gals. per month usage). Rates are structured for the base facility charge to cover about two-thirds of fixed costs, lessening the impact of commodity usage on revenues.

At the end of fiscal 2007 the Authority reported about $23.3 million in unrestricted cash and investments (about 490 days of cash-on-hand). Although officials do not have a working capital reserve policy, the targeted level is a minimum of $10 million, about four months of revenue. There are also $20.1 million in restricted cash and investments which mostly represents $11.7 million of connection fee revenue and $5.4 million of R&R funds (in relation to a $2 million requirement). The capital program envisions spendown of both R&R funds and working capital cash (to the $10 million level). Officials are experiencing an increase in days-in-accounts-receivable as well as bad debts due to the current depressed economic environment, and will reportedly begin to provide an allowance against them at year-end.

Fiscal 2008 operations are being negatively impacted by water restrictions and the housing slump which has reduced connection fees and developer guaranteed revenues below anticipated amounts. To date the estimated $2.1 million revenue loss is partly offset by a $1.3 million decline in expenses. In response to revenue declines, officials have implemented a $5.40 surcharge effective May 1, 2008, which is intended to offset additional revenue losses.

While the Authority has rather restrictive investment policies, there is currently about $8.3 million up at the State Board of Administration's Local Government Investment Pool (LGIP), which represents about 20% of the investment portfolio. These funds are restricted as to withdrawal depending on the pool's ability to liquidate assets. To date officials have not experienced any cash flow problems related to these investments. An actuarial study is being conducted to determine the Authority's unfunded liability related to GASB 45 (OPEB). Since benefits offered are limited, officials expect the liability to be manageable.

MANAGEABLE DEBT LOAD; CASH-FUNDING OF REPLACEMENT RESERVE COULD POSE CHALLENGES

The debt ratio of 31.4% is moderate, and should remain manageable despite additional borrowing plans, considering the Authority's solid satisfactory position. Total bond payout (including bank bonds) is above average with repayment within 12 years. Management has planned capital improvements in the amount of approximately $122 million over the next five years (excluding debt service costs). This includes $86 million for the water plant membrane conversion project discussed above. The capital improvements are expected to be funded with a $65 million bond issue, expected in September 2008, as well as cash generated from rates. Mandatory connection fees and capacity reservation charges are anticipated to support renewal and replacement needs.

On the two publicly-issued rated bonds (Series 1989 and Series 2001) the Authority maintains a debt service reserve surety with FGIC (Baa3/on review for possible downgrade). Due to insurer downgrades, officials are required to replace the debt service surety with a cash funded reserve equal to $8.65 million over a one-year period from March 31, 2008. Officials are attempting to fund the requirement with a letter of credit to avoid a material impact on system cash.

System officials have entered into two similar interest rate swap agreements for a total notional amount of $19.2 million related to the Series 2005 and Series 2006 bank loans with Bank of America, effective for the life of the loans (March 2019). Pursuant to the agreements, the Authority pays and receives a variable rate based on the same index based on a spread of .49% (for 2005 only). Simultaneously, the Authority pays a fixed rate (3.93% for the Series 2005 and 3.32% for the Series 2006). Regular swap payments are on parity with bond payments and termination payments are subordinate. Except for an event of default, the Authority has the only right to terminate the swap. There are no rating triggers and no collateral posting requirements. Based on a recent mark-to-market, if terminated, both swaps would require an Authority payment of just over one million dollars. The Authority has not yet formulated a derivative policy as part of its investment policy.

KEY STATISTICS:

Number of customers: 47,152 water ERC's; 35,800 sewer ERC's

2007 Operating Ratio: 52.7%

2007 Debt Ratio: 31.4%

2007 Debt service coverage: 2.22 times (net revenue); 2.7 times (with gtd. rev. and connection charges)

2007 Coverage of Maximum Debt service: 2.0 times (net revenue); 2.4 times (with gtd. rev. and connection charges)

Principal Payout (12 years): 100% Debt Outstanding: $72.9 million ($53.6 million rated bonds)

Analysts

John Incorvaia
Analyst
Public Finance Group
Moody's Investors Service

Geordie Thompson
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."