S&P Global Ratings

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Summary:

Seacoast Utility Authority, Florida; Water/Sewer

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Summary:

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Credit Profile		
US$43.21 mil wtr and swr uti sys rfdg rev bnds ser 2016B due 09/30/2039		
Long Term Rating	AA+/Stable	New
US$7.7 mil wtr and swr uti sys rfdg rev bnds ser 2016A due 03/01/2039		
Long Term Rating	AA+/Stable	New
Seacoast Util Auth WTRSWR		
Long Term Rating	AA+/Stable	Upgraded

Rationale

S&P Global Ratings has raised its long-term rating on the Seacoast Utility Authority (the authority), Fla.'s utility system revenue bonds two notches to 'AA+' from 'AA-'. In addition, we assigned our 'AA+' long-term rating to the authority's series 2016A and B water and sewer utility system refunding revenue bonds. The outlook is stable. We base the rating on what we consider the combination of a very strong enterprise risk profile and an extremely strong financial risk profile.

The upgrade reflects our view of consistently strong debt service coverage (DSC) and an improved and strong liquidity position, which we expect will continue.

The rating also reflects what we view as the system's strong economic and strong financial metrics, as well as the application of our revised criteria, "Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds" (published Jan. 19, 2016, on RatingsDirect).

The ratings reflect our assessment of the system's enterprise risk profile based on its:

- Participation in the economically diverse and affluent Palm Beach County;
- Very low industry risk assessment;
- Strong market position with combined water and sewer rates being 1.5% of median household effective buying income (MHHEBI); and
- "Good" operational management assessment (OMA).

The ratings also reflect our assessment of the system's financial risk profile, including its:

- Very strong financial position, with historically strong DSC;
- Very strong liquidity position;
- Low debt burden as indicated by a debt-to-capitalization ratio of 30.6%; and
- "Good" financial management assessment (FMA).

A pledge of the water and sewer systems' net revenues and connection charges secures the bonds. Bond proceeds will be used to refund portions of the authority's series 2009A and B bonds. We consider legal provisions credit neutral.

The rate covenant with the trust agreement requires net revenues to cover at least 1.1x annual debt service on parity debt. Formal financial policies (adopted as part of the budgeting process) specifically related to the enterprise system provide additional strength to these provisions. The policies also call for an additional bonds test at a minimum of 1.1x. In our view, the adoption of these thresholds for DSC and liquidity and the system's historically strong DSC and high liquidity mitigate the lack of a debt service reserve.

An interlocal agreement with the authority's five member governments governs the authority. The agreement establishes rates, quality standards, and the authority as the exclusive supplier of water and sewer service to its member governments. The authority does not sell water directly to the member governments, but rather to the individual customers within these municipalities on a retail basis. There is no concentration in the customer base. The 10 leading customers represent 4% of revenues, which we consider very diverse.

The authority has two interest rate swaps outstanding that related to two privately placed loans that Bank of America purchased directly. The notional amount on the swaps equals the principal outstanding on the 2005 and 2006 commercial loans. As of Sept. 30, 2016, principal outstanding for the 2005 and 2006 commercial loans was $6.6 million and $6.2 million, respectively. As of Oct. 12, 2016, the mark-to-market value for the authority's swaps was $567,545, not in the authority's favor. the authority has no plans to terminate the swaps. We consider the contingent liability risk low for these loans and swaps because we view the potential for potential liquidity events to be limited or remote.

Enterprise risk

The authority is a regional water and wastewater utility encompassing about 65 square miles in Palm Beach County, consisting of five members. The authority provides retail water and sewer service to approximately 94,000 residents in the member governments, which include incorporated areas of Palm Beach County, the city of Palm Beach Gardens, the village of North Palm Beach, and the towns of Lake Park and Juno Beach. The area's economy is deep and diverse, in our opinion, and is part of the broad and diverse Miami-Fort Lauderdale-West Palm Beach metropolitan area. Wealth levels in the area vary depending on the municipality, but tend to be levels we consider strong. Within the county itself, 2015 MHHEBI measured 98% of the national average, which we view as strong. Unemployment rates also vary somewhat, depending on the municipality. The county's overall unemployment rates, however, have historically been above average. In 2015, county unemployment was at 5%.

The authority has seen slow and steady growth in customers, in a service area that is nearly built out. From fiscal years 2008-2015, the number of water customers increased to 35,259 in 2015 from 34,563 in 2008, while the number of sewer customers rose to 31,208 in 2015 from 30,636 in 2008. The majority of customers are residential.

Consistent with our criteria, titled "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for the system very low, the most favorable assessment possible on a '1' to '6' scale, with '1' being the best.

The good market assessment reflects that management has demonstrated a willingness to adjust rates, raising water or sewer rates annually from fiscal years 2009 to 2016. These increases ranged from 3% to 4%. Based on 6,000 gallons of usage, residents pay $23.85 (0.6% of 2015 MHHEBI) per month for water and $30.06 (0.8%) for sewer. Despite the annual increases, the system's rates are still affordable relative to service area wealth levels. We expect management to continue to adjust rates as needed.

Based on our OMA, we view the authority to be a '2' on a scale of '1' to '6', with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well-aligned, even if some challenges exist. The OMA of "good" includes the authority's well-embedded asset adequacy identification program and a comprehensive operational risk-reduction plan. The authority's sewer system has adequate capacity, in our opinion, with a total treatment capacity of 12.0 million gallons per day (mgd) compared with an average daily flow for fiscal 2015 of about 7.0 mgd. We also consider the water side's capacity adequate with a total treatment capacity of 30.5 mgd, compared with fiscal 2015 average daily demand of 16 mgd and maximum daily demand of 20 mgd. The authority's installed capacity and firm capacity of its wells are 52.7 mgd and 46.8 mgd, respectively. Management reports that the authority's water and wastewater treatment facilities are in full compliance with all the regulations and guidelines.

Rates are set by ordinance that the authority's board enacts, and are not subject to regulation. The board approved a full rate change effective Oct. 1, 2009, and allowed for indexing on that rate structure each year, which the board approves at the same time as the acceptance of the authority's annual budget. Subsequently, the authority has demonstrated a willingness to adjust rates. More specifically, on Oct. 1, 2009, the authority's overall rate structure increased more than 20%, followed by a 6% index increase Dec. 1, 2010, then a 3.9% index increase Oct. 1, 2011. Since then, the annual increases have ranged between 3% and 4%. We view this as affordable relative to service area wealth levels, which we generally view as strong. Officials believe their rates fall in the midrange for the area.

Financial risk

We consider the authority's financial performance strong. From fiscal years 2009-2015, DSC, not including connection and impact fees, has ranged from 1.6x-2.1x, and 1.88x based on audited 2015 results. We also consider the authority's liquidity position strong historically, and increasingly stronger in the past few years. Fiscal year-end (Sept. 30) unrestricted cash and investments balances increased from $13.2 million in fiscal 2009 to $61.0 million in fiscal 2015, providing 1,022 days' cash on hand. This is well above the authority's cash reserve policy that requires it to maintain a minimum of cash reserves equal to 90 days of budgeted operating expenses and debt service requirements. We expect the authority's liquidity position to remain strong, though it plans to use some of its cash to fund capital needs.

We consider the authority's debt burden low. The debt-to-capitalization ratio is 30.6%. With the rapid amortization of existing debt, we expect the debt burden to remain low. The capital plans are manageable. Management indicates that the five-year capital plan totals $80.3 million, which it plans to fund from operations and cash reserves.

Based on our FMA, we view the authority to be a '2' on a scale of '1' to '6', with '1' being the strongest. We believe that the financial management practices are strong, comprehensive, and supportive of high credit quality. Revenue and expenses assumptions are reasonable, and interim financial reporting is provided to the authority board through monthly budget reports. The reserve target is robust and articulates a rationale for maintaining a strong liquidity position. Financial planning and operational data are easily obtained, as the budget, financial statements, and projections are readily available on the authority's website.

Outlook

The stable outlook reflects our expectation that the authority will adjust rates as need to maintain strong DSC and liquidity. We don't expect to raise or lower the rating within our two-year outlook period.

Upside scenario

The development of an additional water supply that diversifies the source water away from the South Florida Water Management District restrictions could lead to a higher rating.

Downside scenario

Significant declines in coverage levels or liquidity could lead to a lower rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.