MOODY'S
INVESTORS SERVICE

CREDIT OPINION
15 August 2019

Rate this Research

Contacts

Ryan Mills +1.214.979.6852
AVP-Analyst
ryan.mills@moodys.com

Douglas Goldmacher +1.212.553.1477
AVP-Analyst
douglas.goldmacher@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Topeka (City of) KS Combined Utility Ent.

Update to credit analysis

Summary

The Topeka Combined Utility Enterprise (Aa3 stable) benefits from a large and stable service area centered around the state capitol, the City of Topeka (Aa3). The system maintains robust capacity and healthy liquidity that is expected to remain strong. While the system's debt service coverage has improved, the system is in the middle of a large capital improvement program, which will elevate the system's debt burden and keep coverage at a moderate level. Positively, the city is committed to increase rates over the near term to support the capital plan.

Credit strengths

» Stable service area

» Healthy liquidity

Credit challenges

» Moderate leverage with plans for further issuance

» Weaker legal covenant as revenue debt is subordinate to senior state loans

Rating outlook

The stable outlook reflects the expectation that the system's credit fundamentals will remain stable over the near term despite annual debt issuance plans. The rating also incorporates conservative fiscal management and a demonstrated willingness to adjust revenues as needed to support operations and capital expenditures.

Factors that could lead to an upgrade

» Increase in debt service coverage

» Growth of the customer base

Factors that could lead to a downgrade

» Sustained negative economic trends

» Trend of declining debt service coverage

» Debt issuance above what is required for current capital plan

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 ($000)	$42,971				
Service Area Wealth: MFI % of US median	85.60%				
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	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2014	2015	2016	2017	2018
Operating Revenue ($000)	$63,138	$63,416	$65,888	$68,447	$75,133
System Size - O&M ($000)	$42,159	$43,723	$43,430	$42,040	$42,971
Net Revenues ($000)	$21,520	$20,575	$23,062	$27,116	$34,002
Net Funded Debt ($000)	$165,507	$174,183	$184,280	$190,134	$220,517
Annual Debt Service ($000)	$16,901	$16,441	$16,516	$17,594	$19,735
Annual Debt Service Coverage (x)	1.3x	1.3x	1.4x	1.5x	1.7x
Cash on Hand	202 days	462 days	487 days	633 days	898 days
Debt to Operating Revenues (x)	2.6x	2.7x	2.8x	2.8x	2.9x

[1] Days cash on hand declines to 316 days in fiscal 2018 excluding liquidity earmarked for capital projects
Sources: Moody's Investors Service; annual audited financial statements

Profile

The combined utility system provides water (wholesale and retail), wastewater and stormwater services to the city of Topeka, KS and surrounding areas. The combined utilities serve a population of approximately 165,000.

Detailed credit considerations

Service area and customer base: stable customer base in the state capitol

Topeka's service area will continue to remain stable given the city's role as state capital and continued investment from the private sector. The Kansas (Aa2 stable) state government is the top employer citywide with approximately 8,300 workers.

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 the system's demand. Over the last five years, the city has averaged 20.8 million gallons per day (MGD) with peak usage at 39.1 MGD. The city's water capacity is 63 MGD. 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: improved coverage due to rate increases

The system's operating results and debt service coverage improved in fiscal 2018 and will remain stable, albeit slightly narrow, as the utility continues to issue debt needed to fund the long range capital improvement plan. To address the growth in outstanding debt, the citycouncil has adopted a rate increase for fiscal 2020 and the 2019 adopted capital improvement plan assumes continued rate increases through 2024. If the council opted to not increase rates following fiscal 2020, the capital plan would be revisited and potentially scaled back.

Following narrow debt service coverage hovering around the 1.25 times, rates increases implemented over the past few years have aided in coverage increasing annually, up to 1.6 times in 2018. Year to date in fiscal 2019, the city reports revenues and expenses are generally tracking with the budget. Moody's calculation of the system's debt service coverage considers both senior and subordinate debt, as well as subordinate payments in lieu of taxes (PILOT) to the general fund.

Debt service coverage improves when netting out the PILOTs from the system to the general fund, which is legally subordinate to the payment of debt. In fiscal 2018, $7.2 million of the system's $43 million in operating expenses (net of depreciation) was attributable to PILOTs. Discounting PILOTs from the coverage calculation, debt service coverage on the aggregate senior state revolving fund (SRF) loans and subordinate revenue bonds increases to 2 times.

LIQUIDITY

Despite plans to cash finance certain capital projects, the system's liquidity will remain healthy in the near to medium term. Cash reserves increased to 898 days in fiscal 2018 from 633 days the prior year. Management has indicated that of the $105.8 million in unrestricted liquidity, $67.8 million is for earmarked for capital projects. The amount earmarked is consistent with previous year's unrestricted cash.

Debt and legal covenants: manageable debt burden with weaker legal covenants

The debt burden will remain manageable but will increase in the near term due to capital projects that are planned over the next several years. As of fiscal 2018, the enterprise's debt to revenues ratio was healthy at 2.6 times, and included $34.2 million in senior SRF loans, and $199.7 million in subordinate revenue bonds.

The combined utility's five year capital improvement plan calls for $119.1 million in investment from 2020 through 2024, the bulk of which will be financed with debt. Annual rate increases are expected to support debt service, though absent commensurate revenue growth, the debt to revenues ratio is expected to materially increase. The city has indicated that future borrowings would be on parity with or subordinate to the junior lien, and does not intend to issue additional SRF debt.

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 (SRF) loans. While the SRF loans are considered an expense under the bond resolution, they are ultimately loans and may be accelerated in an event of default, with consent of the bond insurer.

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. Positively, the bonds are additionally secured by a cash debt service reserve fund that is equal to the standard three-prong test.

DEBT STRUCTURE

All of the system's debt is fixed rate. The senior lien SRF loans mature in 2029 while the junior lien revenue bonds mature in 2049. Debt service is front loaded over the first ten years and then declines annually after 2030.

DEBT-RELATED DERIVATIVES

The system is not party to any derivative agreements.

PENSIONS AND OPEB

Of the city's fiscal 2018 reported $93.6 million net pension liability, the combined utility system is responsible for approximately $4.5 million, or 4.8% of the total report unfunded liability. The system's ANPL is approximately $13.2 million, a modest 0.2% of revenues.

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 utilities 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.

REPORT NUMBER 1189496

Contacts

Ryan Mills +1.214.979.6852
AVP-Analyst
ryan.mills@moodys.com

Douglas Goldmacher +1.212.553.1477
AVP-Analyst
douglas.goldmacher@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE