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 $24.3 million Combined Utility Improvement and Refunding Revenue Bonds, Series 2016A and $1.75 million Taxable Combined Utility Refunding Revenue Bonds, Series 2016B. Moody’s maintains the Aa3 rating on the system’s outstanding parity debt with a stable outlook. Post-sale, parity debt outstanding will total $146.8 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 remain 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
» Moderately leverage and manageable future debt plans

Rating Outlook
The stable outlook reflects the expectation that multi-year rate increases through fiscal 2017 will provide for improved operating results and debt service coverage in the near term. The outlook further reflects an expectation of the governing body's willingness to adjust revenues as needed to support operations and capital improvements going forward.

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

Recent Developments

Following one full year of an approximate 5% rate increase, the fiscal 2015 operating results reflected stable debt service coverage at the narrowed level of 1.27 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. Public sector employment is currently stable, though the State of Kansas (Aa2 negative) continues to face fiscal challenges. Two large medical centers in the city provide additional employment stability. The region is 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.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Debt Service Coverage and Net Working Capital: Narrowed But Adequate Coverage and Healthy System Liquidity

The system's operating results and debt service coverage will remain stable at their narrowed level over the near term supported by multi-year rate increases in process. 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. Based on more moderated weather conditions in fiscal 2016 year-to-date, and the rate increase in place, the city reports that both revenues and expenses are tracking slightly below budget, and balanced operations are expected at year end.

With an increased operating ratio, debt service coverage has narrowed over the past two fiscal years although it remains adequate. Debt service coverage including both the senior state revolving fund (SRF) loans and the junior lien revenue bonds was 1.27 times in fiscal 2015, now the third year of overall coverage at that level, and significantly lower than fiscal years 2010-2012 when coverage ranged from 1.78 - 1.91 times. However, $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 in 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 2015 increased to $55.3 million, representing a strong 465 days of operating expenses. While cash increased by over $30 million year-over-year, current liabilities also increased largely due to an outstanding note, a portion of which will be refunded with the current debt issuance. Net working capital slightly increased by approximately $3 million, bringing it to $44.9 million in fiscal 2015, or 103.4% 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. Projected capital expenditures through 2021 total approximately $138 million, which includes $119.4 million to be financed with bonds. At the present time, system debt includes $49.4 million of senior SRF loans outstanding and $146.8 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 2015 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 2046. All debt is fixed rate, and approximately 58% 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 2015 per the bond resolution is much greater at 2.6 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.

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

Use of Proceeds
Proceeds of the Series A bonds will fund system improvements, retire a portion of the outstanding 2015A notes, and refund the outstanding 2007B bonds for debt service savings. The Series B bonds will refund the 2007C bonds for debt service savings.

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 Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

<table>
<thead>
<tr>
<th>Issue</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combined Utility Improvement and Refunding Revenue Bonds Series 2016-A</td>
<td>Aa3</td>
</tr>
<tr>
<td>Rating Type</td>
<td>Underlying LT</td>
</tr>
<tr>
<td>Sale Amount</td>
<td>$24,320,000</td>
</tr>
<tr>
<td>Expected Sale Date</td>
<td>08/09/2016</td>
</tr>
<tr>
<td>Taxable Combined Utility Refunding Revenue Bonds Series 2016-B</td>
<td>Aa3</td>
</tr>
<tr>
<td>Rating Type</td>
<td>Underlying LT</td>
</tr>
<tr>
<td>Sale Amount</td>
<td>$1,750,000</td>
</tr>
<tr>
<td>Expected Sale Date</td>
<td>08/09/2016</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the SEC.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MOODY'S Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,500,000. MCO and 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 at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan K.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japanese Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.
City of Topeka, KS Combined Utility Enterprise: New Issue - Moody’s Assigns Aa3 to Topeka, KS’s Combined Utility Revenue Bonds