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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 $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

Exhibit 1

Topeka (City of) KS Combined Utility Ent.					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	24 years				
System Size - O&M (in $000s)	43,446				
Service Area Wealth: MFI % of US median	83.33%				
Legal Provisions					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	DSRF funded at lesser of standard 3-prong test				
Financial Strength					
	2011	2012	2013	2014	2015
Operating Revenue ($000)	61,055	64,835	60,508	63,138	63,416
O&M ($000)	32,234	32,960	40,019	42,159	43,446
Long-Term Debt ($000)	203,910	196,474	188,075	191,094	183,975
Annual Debt Service Coverage (x)	1.78	1.91	1.23	1.27	1.27
Cash on Hand	250 days	265 days	221 days	202 days	465 days
Debt to Operating Revenues (x)	3.3x	3.0x	3.1x	3.0x	2.9x

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

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.

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

Topeka (City of) KS Combined Utility Ent.

Issue	Rating
Combined Utility Improvement and Refunding Revenue Bonds Series 2016-A	Aa3
Rating Type	Underlying LT
Sale Amount	$24,320,000
Expected Sale Date	08/09/2016
Rating Description	Revenue: Government Enterprise
Taxable Combined Utility Refunding Revenue Bonds Series 2016-B	Aa3
Rating Type	Underlying LT
Sale Amount	$1,750,000
Expected Sale Date	08/09/2016
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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