

RatingsDirect®

Summary:

Centennial Water and Sanitation District, Colorado; Water/Sewer

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Credit Profile

Centennial Wtr & San Dist wtr & swr (AGM)

Unenhanced Rating

AA+(SPUR)/Positive

Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has affirmed is 'AA+' rating on Centennial Water and Sanitation District, Colo.'s water and sewer revenue bonds. The outlook is positive.

The positive outlook reflects our view that the rating could improve over the next one to two years depending on whether debt service and fixed-charge coverage do not drop below historical trends, and that unrestricted cash remains consistent with the rating level, in our view.

The rating reflects our view of the district's:

- Affluent, primarily residential, underlying customer base with incomes we consider strong;
- Competitive customer rates, given the strong wealth levels;
- Strong financial risk profile, including historical debt service coverage (DSC) and liquidity; and
- System leverage that we consider low, and would expect to remain low to moderate when incorporating additional loans to fund water acquisitions.

Net revenues of the district's water and wastewater system, including one-time connection fees, secure the bonds.

Other bond provisions include the following:

- A rate covenant to set rates such that recurring revenues, which exclude one-time connection fees, cover the next year's annual debt service (ADS) by at least 1.00x, and that revenues including connection fees as well as any funds in a rate-stabilization account exceed ADS by 1.25x;
- A restriction on issuing additional bonds only if recurring revenues for the previous fiscal year are at least 1.00x pro forma maximum ADS (MADS), and that revenues (including connection fees and funds in a rate-stabilization account) are at least 1.25x MADS;
- A debt service reserve funded at the lesser of 10% of principal, MADS, and 125% of average ADS (which may be in the form of a surety); and
- A rate-stabilization account that can be funded by restricting for 11 months' available funds if net revenue and capacity fees are less than 125% of ADS. (This money is not pledged to bonds.)

Centennial provides water and sewer services to two local governments -- Highlands Ranch Metropolitan District and Northern Douglas County Water and Sanitation District -- under service agreements. Pursuant to these agreements, retail customers of Highlands Ranch (which constitute about 95% of Centennial's customers) are billed directly by the

district while Northern Douglas is billed on a master meter basis (the costs of which, according to management, are then passed directly to its retail customers from Northern Douglas). Centennial also charges a one-time capacity fee for new hookups to the two districts and acts as a "right to serve" charge. For any new retail customers, management has indicated that Highlands Ranch and Northern Douglas pass these fees along as tap fees.

The district serves a total population of about 95,000, with a customer base of about 40,000. Residential customers account for approximately 90% consumption, resulting in what we view as a very diverse customer base. Income and wealth indicators for Highlands Ranch and Douglas County are very strong, in our view. Highlands Ranch's 2013 median household effective buying income (EBI) and per capita income levels were at 187% and 159% of the national average, respectively, while Douglas County's median household EBI and per capita income levels were at 179% and 161% of the national average, respectively. Given these income characteristics, we consider rates affordable. Management raised the rates about 10% in 2014, leading to combined monthly water and sewer bills of \$65.60 for 8,000 gallons of use. Management indicates that it will continue to raise rates in the near future to fund additional water rights acquisitions.

Centennial holds water rights for 29,500 acre-feet (AF) per year: 17,000 AF from groundwater and 12,500 AF from surface water. District facilities include a water treatment plant with a capacity of 40.0 million gallons per day (mgd) and an 8.5 mgd wastewater treatment facility. Management has indicated that the current water rights as well as water and wastewater's treatment facilities are sufficient to meet demand.

We believe the district's financial performance has been generally strong in the past three completed fiscal years. Based on the three most recent audited financial statements, DSC has remained what we view as strong, at 2x during the fiscal year ended Dec. 31, 2014. Adjusting net revenues to exclude fixed take-or-pay payments on several of the district's water supply agreements and treating those payments as debt, fixed-charge coverage has also remained strong, and was equal to 1.8x in 2014. The district has retained \$42.5 million in unrestricted cash and investments, equivalent to 689 days' operating expenditures, which we consider very strong. Management has a policy of maintaining at least six months' cash on hand for working capital purposes and also sets aside a full year of debt service in its restricted cash balance.

For fiscal 2015, budgeted net revenues continue to provide what we view as strong DSC of 2x and an unrestricted cash balance of \$33 million or 510 days' cash in hand; the projected cash balance excludes restricted capital projects and debt service fund balances. The drawdown in cash is primarily due to water acquisition expenses.

Most of the district's projected capital spending also relates to a mix of projects, including water acquisition, system expansion, and regulatory compliance. Apart from an expected \$34 million loan for an acquisition project, Centennial does not have any additional debt plans. In 2012, the district issued about \$50 million of bonds that Bank of America N.A. purchased. We understand that the district issued these direct-purchase bonds to refund its 2004 bonds and provide for \$6 million of funds for treatment plant improvements. We do not view that issue as a negative credit factor because we understand that the bond covenants related to payment priority, rate covenants, and additional bond covenants are the same as Centennial's debt outstanding. The system's debt-to-plant ratio in 2014 was, in our view, low at 30%. We do not expect this ratio to increase substantially after the additional \$30 million loan is closed.

Outlook

The positive outlook reflects our view that within the next two years, there is a one-in-three chance of an upgrade. We base this view on the recent improvement in DSC, and that this improvement could be sustainable given the stable customer base and management's ability to raise rates as needed. An upgrade would also be contingent on our view of the unrestricted liquidity and leverage not changing, and no significant additional debt plans being developed.

However, given the stability of the customer base and our view that the district should be able to generate financial performance at least consistent with, or better than, historical results, we believe the most probable action, absent an improvement in financial metrics, would be to affirm the rating and revise the outlook to stable.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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