

CREDIT OPINION

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 Rate this Research

Contacts

Max Brekke +1.312.706.9969
Associate Lead Analyst
max.brekke@moody.com

Eric Harper +1.312.706.9972
VP-Senior Analyst
eric.harper@moody.com

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Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

Whitewater (City of) WI Sewer Enterprise

Update to credit analysis

Summary

The [Whitewater \(City of\) Sewer Enterprise](#) (A1) benefits from increased rates that support strong annual debt service coverage and a solid cash position. The enterprise debt burden is high relative to the system's small operating size. One of the enterprise's largest ratepayer is the University of Wisconsin-Whitewater, which has provided stable sales in recent years. Coronavirus related shutdowns could negatively affect sewer sales to the university over the coming months. Legal protections on the system's sewer revenue debt are adequate, and its revenue debt is additionally secured by the city's pledge to cure debt service deficiencies (subject to annual appropriation).

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Whitewater's Sewer Enterprise. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the sewer enterprise changes, we will update our opinion at that time.

On April 29, 2020 we upgraded the city's outstanding revenue bonds to A1 from A2.

Credit strengths

- » Solid liquidity
- » Strong debt service coverage

Credit challenges

- » Elevated debt due to wastewater treatment plant reconstruction
- » Below average service area demographics

Rating outlook

Outlooks are typically not assigned to local governments with this amount of debt.

Factors that could lead to an upgrade

- » Significant service area growth and improved demographic profile
- » Debt burden moderation

Factors that could lead to a downgrade

- » Sustained decline in debt service coverage
- » Weakening of liquidity

Key indicators

Exhibit 1

| Whitewater (City of) Sewer Enterprise, WI | | | | | |
|--|---|----------|----------|----------|----------|
| System Characteristics | | | | | |
| Asset Condition (Net Fixed Assets / Annual Depreciation) | 32 years | | | | |
| System Size - O&M (\$000) | \$1,456 | | | | |
| Service Area Wealth: MFI % of US median | 71.60% | | | | |
| Legal Provisions | | | | | |
| Rate Covenant (x) | 1.20x | | | | |
| Debt Service Reserve Requirement | DSRF funded at the lesser of the standard 3-prong test (Aa) | | | | |
| Management | | | | | |
| Rate Management | A | | | | |
| Regulatory Compliance and Capital Planning | Aa | | | | |
| Financial Strength | | | | | |
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| Operating Revenue (\$000) | \$2,271 | \$2,290 | \$3,389 | \$3,315 | \$3,269 |
| System Size - O&M (\$000) | \$1,547 | \$1,439 | \$1,413 | \$1,395 | \$1,456 |
| Net Revenues (\$000) | \$731 | \$1,557 | \$1,979 | \$1,927 | \$1,881 |
| Net Funded Debt (\$000) | \$4,590 | \$3,987 | \$11,885 | \$19,796 | \$23,835 |
| Annual Debt Service (\$000) | \$738 | \$726 | \$796 | \$651 | \$810 |
| Annual Debt Service Coverage (x) | 1.0x | 2.1x | 2.5x | 3.0x | 2.3x |
| Cash on Hand | 223 days | 221 days | 222 days | 382 days | 380 days |
| Debt to Operating Revenues (x) | 2.0x | 1.7x | 3.5x | 6.0x | 7.3x |

Source: Audited financial statements, US Census Bureau, Moody's Investors Service

Profile

The sewer enterprise is owned by the [City of Whitewater](#) (A1) and provides municipal wastewater service within city limits. The design capacity of the treatment facility is for a maximum flow of 3.65 million gallons per day (mgd) and currently operates at 1.67mgd. The system has 9 lift stations and 50 miles of sewer mains. The system provides services to city's residential population of 14,750, various commercial entities and the University of Whitewater with its 11,586 students.

Detailed credit considerations

Service area and system characteristics: small system size; below average socioeconomic profile

We do not expect material declines in sewer system revenue, however revenues from commercial customers and the University of Wisconsin at Whitewater are likely to decline in the short-term. The system's service area benefits from the institutional presence of the university and location 45 miles southeast of [Madison](#) (Aaa stable) and 55 miles southwest of [Milwaukee](#) (A1 negative). The sewer system provides service to the city's stable population of 14,750 through 3,839 water meters. Service area demographics are below average with median family income at only 72% of the nation. The system's customer base is primarily residential at an estimated 48% of revenue but also has an established commercial presence at 27% of revenue. About 18% of revenue are from sales to public

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authorities with the university as the largest driver. Sewer system revenue will likely be negatively affected from university closures though the system benefits from ample liquidity and strong days cash on hand.

The system size is below the US median, as measured by operating and maintenance expenses at \$1.5 million in 2018. The sewer system has ample capacity at 3.65 million gallons per day (mgd) and operations well below that at 1.67mgd. We expect the sewer enterprise's service area and customer base to remain stable given the presence of the university.

Debt service coverage and liquidity: improved debt service coverage; strong liquidity

The city's strong rate management will continue to support consistent operating revenue growth and solid debt service coverage. In 2019, the city passed a large rate increase of 17.5% that will help sustain the sewer system's financial performance and debt service cost related to financing treatment plant upgrades. Annual debt service coverage increased to 2.3x in fiscal 2018, up from 1x in fiscal 2014. Net revenue increased to \$1.9 million in fiscal 2018, up from \$731,00 in 2014. Operating revenue increased to \$3.4 million from \$2.3 million during this period due to rate increases for wastewater treatment plant updates. We expect increases in operating revenue to continue, supporting strong days cash on hand and healthy annual debt service coverage.

LIQUIDITY

System liquidity is expected to remain very strong due to the system's positive operating results. Sewer system liquidity totaled \$1.5 million in fiscal 2018, equal to a very strong 380 days cash on hand. Unrestricted liquidity is expected to decrease in fiscal 2019 to \$1.3 million, or a healthy 37% of total operating revenues.

Debt and legal covenants: very high debt burden and satisfactory legal covenants

We expect the sewer systems debt burden to moderate due to scheduled payouts of outstanding debt and moderate future borrowing plans. In 2018, the sewer system had high outstanding debt to operating revenue at 7.3x due to a large state loan via the [State of Wisconsin's](#) (Aa1 stable) Clean Water Fund Loan program taken out in 2016. Total net funded debt was about \$24 million in 2018 and is expected to decrease in 2019 due to scheduled debt service payments on the state loan. In 2020, the City of Whitewater expects to issue \$5 million in long-term GO debt to refinance outstanding short-term notes and finance capital improvement projects across the city and its three business enterprises.

Legal provisions are satisfactory and include a rate covenant and additional bonds test of 1.2 times maximum annual debt service (MADS) for all outstanding revenue bonds. Additional security includes the city's pledge to cure deficiencies for reasonable costs and services should the enterprise's revenue falls below the pledge 1.2 times annual debt service requirement, though this pledge is subject to appropriation and levy limits.

DEBT STRUCTURE

All of the system's revenue debt is fixed rate and amortizes over the long-term. Debt service on the revenue bonds is secured by a senior lien on the sewer enterprise's net revenues. Amortization of the revenue debt is rapid with 97% of principal scheduled to retire within 10 years.

DEBT-RELATED DERIVATIVES

The system has no exposure to any debt-related derivatives.

PENSIONS AND OPEB

Employees of the sewer enterprise participate in one multiple-employer cost-sharing plan, the Wisconsin Retirement System (WRS). In fiscal 2018, the sewer enterprise contributed \$37,000 to the plan, equal to a low 1.1% of enterprise operating revenue. For more information on the City of Whitewater's pension obligations, please see our most recent [credit opinion](#) on the city.

ESG considerations

Environmental

Environmental considerations are not a primary credit driver. According to data of Moody's affiliate Four Twenty Seven, the City of Whitewater and the sewer enterprise are located in an area with high risk rainfall exposure and low risk to water stress exposure. The city's sewer enterprise is subject to extensive regulation pursuant to the federal Clean Water Act, the Clean Air Act, various administrative rules and regulations and State of Wisconsin regulations. The sewer enterprise is in material compliance with all existing permits relating to the operation of the system.

Social

The sewer system provides an essential public service that is critical to community health and well-being. The system's largest rate payer includes the University of Wisconsin-Whitewater which has experienced closures due to the coronavirus. Sewer system revenue will likely be negatively affected in 2020 from these closures with the severity of these effects depending on the length of closure. However, the system benefits from strong days cash on hand and we expect revenue to recover following disruptions.

Governance

The sewer system is an enterprise of the City of Whitewater and holds independent rate-setting authority, subject to approval from the city's Common Council. Management maintains a long-term capital improvement plan and currently has no outstanding consent decrees or other environmental regulatory violations. In 2015 and 2019, the city adopted rate increases to ensure revenue are sufficient to support all debt repaid with net revenue and to increase cash reserves.

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