STANDARD & POOR'S RATINGS SERVICES
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Summary:
Saratoga Springs, Utah; Water/Sewer

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Summary:

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Credit Profile		
US$9.365 mil wtr rev and rfdg bnds ser 2014 due 12/01/2033		
Long Term Rating	A/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A' long-term rating to Saratoga Springs, Utah's series 2014 water revenue and refunding bonds. The outlook is stable.

The rating reflects our view of the water system's:

- Customer base with good income levels tied into the larger Salt Lake City regional economy;
- Strong liquidity position; and
- Recent rate increases, which will likely increase revenues and reduce reliance on connection fees.

These strengths are partially offset by our view of the system's:

- Large one-time payment obligation in 2019 related to future water supply, although the city has entered into an agreement with a local landowner to cover this payment;
- Reliance on connection fee revenue in fiscal 2013 to generate debt service coverage above 1x; and
- Need for growth, rate increases, or both to cover increasing debt service.

The bonds are being issued to finance improvements to the city's water system. For the potable water system, this includes construction of a booster pump station, line upsizing, and additional turnouts. For the irrigation system, this includes construction of two storage reservoirs, development of new water sources, and installation of water meters. A portion of the proceeds will also be used to refund the city's existing water revenue bonds.

The bonds are secured by net revenues of the city's water system, which includes a potable water system and irrigation system. The bonds will not have a reserve fund. A rate covenant requires the system to generate net revenues providing at least 1.25x debt service coverage, with designated funds in a rate stabilization fund included in net revenues. The additional bonds test requires projected net revenues to provide at least 1.25x debt service coverage. As of June 30, 2013, the city had $4.6 million in water revenue bonds outstanding.

In addition to its revenue bond debt, the city has a settlement obligation that is senior to the bonds, which relates to the past acquisition of private water infrastructure. The obligation, which does not bear interest, was outstanding in the amount of $13.6 million as of February 2014. The city is required to use two-thirds of each potable water system impact fee collected to pay down the obligation. Therefore, the amount of repayment each year is dependent upon new development in the city. If as of Feb. 2, 2025, a balance remains, it must be repaid in full in one lump sum. Although the potential one-time payment does not have an explicit lien on net revenues, we still view this as an obligation of the water system that could lead to a large drawdown in cash in 2025. We understand the city could issue additional bonds to repay any remaining balance. The long-term nature of the liability allows the city time to plan for any large payment, in our view.

Saratoga Springs is located in Utah County, about 35 miles south of Salt Lake City (the state's capital and economic center) and 24 miles northwest of Provo. The city has experienced high growth during the past 25 years, with a current population of more than 20,000. Residents have access to job centers throughout the Salt Lake City region. The median household effective buying income is strong at 119% of the national median. As of June 2014, Utah County's unemployment rate was 4.0% compared with 3.9% for the state.

The potable water system, known as the culinary water system, serves about 5,738 accounts within the city. The system derives its supply from groundwater. According to management, the system has adequate supply for current demand. The city has entered into an agreement with the Central Utah Water Conservancy District (CUWCD) to purchase additional supplies in the future to accommodate additional growth.

The irrigation water system, known as the secondary water system, provides service to about 4,899 accounts (most residents are customers of both systems). The system derives its supply from groundwater and surface water. The irrigation system is not currently metered. According to management, the system has adequate supply, although shortages have been experienced during periods of heavy use in the past. We understand the city plans to install meters for irrigation accounts, which will likely reduce demand once volume-based pricing is implemented. However, the timing of the project and new pricing structure have not yet been finalized.

The city's agreement to purchase water from CUWCD entails very large financial obligations for the city, in our view, although the payments are to be largely covered by a local landowner under a separate credit agreement. Under the CUWCD agreement, the city will begin purchasing 10,000 acre feet of water annually on a take-or-pay basis beginning in fiscal 2020. The city must make a $62.0 million one-time payment on June 1, 2019, and make annual payments starting at $3.6 million for fiscal 2020 and thereafter. At same time it entered into the CUWCD agreement, the city also entered into an agreement with the Corporation of the Presiding Bishop (CPB) of the Church of Jesus Christ of Latter-Day Saints and Property Reserve, Inc. (PRI; a subsidiary of CPB) whereby PRI will make a $62 million payment to the city to cover the payment due to CUWCD. In exchange, PRI will be granted the right to develop land it owns within the city. PRI has also agreed to cover the ongoing payments to CUWCD for the portion of its land that has not yet been developed. Over time, if PRI develops the land within the city, the city will be responsible for a greater share of the ongoing payments. To secure its obligations to the city, PRI made an irrevocable $62 million deposit to an escrow account to cover the future payment obligation. PRI has also agreed to make future annual payments to the escrow account to cover three years of ongoing CUWCD payments on a rolling basis.

In our view, if funding from PRI were not available, the city would likely be unable to cover the $62 million payment due to CUWCD in fiscal 2020 from its own reserves. Therefore, we believe the funding of an escrow is an important security feature to mitigate water system's exposure to the large payment obligation.

The city has implemented near-annual rate increases in recent years, with the last increase occurring in March 2014. Potable water customers pay a flat monthly rate plus a tiered, volume-based rate. Irrigation accounts are charged a flat rate based on lot size. A single-family residential potable and irrigation account with a quarter-acre lot using 8,000 gallons of potable water per month would pay about $57, which we view as moderate. We view the customer base as very diverse, with the top 10 potable water customer and top 10 irrigation water customers representing 10.5% of operating revenues in fiscal 2013.

The water system has historically had strong debt service coverage, though in 2013 the fund relied on connection fees to generate coverage of above 1x. Also, in our view, future rate increases or customer growth will likely be needed to maintain strong coverage as debt service increases. Operating revenues totaled $2.6 million in fiscal 2013, up 3.5% from 2012. In each case, operating revenues exclude special assessment revenues dedicated to separate special assessment bonds and connection fees. Operating expenses were up 22.3% in fiscal 2013, totaling $2.6 million. Connection and impact fee revenues available for debt service (after the two-thirds payment to the senior obligation) helped boost the slim net operating revenue in 2013, leading to net revenue of $1.6 million. This provided debt service coverage (DSC) of 3.58x, as calculated by Standard & Poor's. Without connection fee revenue, DSC would have been an inadequate 0.18x. In fiscal 2012, DSC with connection fees was 2.63x and without connection fees was 1.04x.

With this issuance and a planned future issuances, the city anticipates debt service increasing to about $1 million from the currently level of $460,000. In our view, to cover increasing debt service, the city will likely need rate increases, continued customer base growth, or both. Rate increases adopted in February 2014 will likely provide some of the needed revenue enhancement, in our view. The city is projecting DSC of more than 1.8x through fiscal 2018. These projections assume an increase in the rate of growth of the customer base during the period and assume some rate increases, particularly for the irrigation system. If growth slows and water rates are not adjusted to maintain good DSC and a stable liquidity position, credit quality would decline, in our view.

The water fund's liquidity position is strong, in our view. As of June 30, 2013 the fund had $3.9 million in unrestricted cash and investments, representing about 552 days' of operating expenses on hand. Liquidity has been near or above this level for each of the past four years. The city anticipates that it ended fiscal 2014 with a higher cash balance based on unaudited financials.

The city is planning about $14.4 million in capital spending for the two systems for fiscal years 2014 through 2018, based on its 2014 rate study. The series 2014 bond issue will provide $5.9 million in funding. The city is currently planning another $5.8 million bond issue in fiscal 2017. We understand the remainder will likely be covered with funds on hand. During the next 20 years, the city is estimating $28.3 million in potable water system expenses and $59.1 million in irrigation system expenses, based on each system's capital facilities plan. Much of these expenses are growth related. If the city continues to experience high growth, it will likely receive increased connection fees that can partly offset these costs.

Outlook

The stable outlook reflects our view of the system's strong liquidity position and recently adopted rate increases. The stable outlook also incorporates our view of the system's large financial obligation to CUCWD and the related agreements with PRI to fund these expenses. If DSC or liquidity were to fall during the outlook's two-year horizon, we could lower the rating. If DSC, based only on recurring revenues (without connection fees), improves during the next two years, we could raise the rating.

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: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

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