

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Avon Lake (City of) Water Enterprise, OH's Rev. Bonds, Ser. 2015

Global Credit Research - 26 Feb 2015

Aa2 rating applies to \$6.1M of post-sale revenue debt

AVON LAKE (CITY OF) OH, WATER ENTERPRISE
Water Enterprise
OH

Moody's Rating

ISSUE	RATING
Water System Refunding Revenue Bonds, Series 2015	Aa2
Sale Amount \$6,105,000	
Expected Sale Date 03/11/15	
Rating Description Revenue: Government Enterprise	

Moody's Outlook NOO

NEW YORK, February 26, 2015 --Moody's Investors Service assigns a Aa2 rating to Avon Lake (City of) Water Enterprise, OH's \$6.1 million Water System Refunding Revenue Bonds, Series 2015. Concurrently, Moody's maintains the Aa2 rating on the enterprise's outstanding revenue debt. Post sale, the enterprise will have \$6.1 million of rated revenue debt outstanding.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the enterprise's relatively wealthy service area in the Cleveland (A1 stable) metro area; stable financial operations with healthy cash balances; manageable debt burden with adequate debt service coverage; and satisfactory legal covenants.

OUTLOOK

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

- Strong expansion and diversification of customer base
- Maintenance of solid net working capital and liquidity
- Strengthening of debt service coverage ratios

WHAT COULD MAKE THE RATING GO DOWN

- Significant increases in customer concentration
- Deterioration in annual debt service coverage
- Significant leveraging of net revenues above affordable levels

STRENGTHS

- Relatively wealthy service area favorably located in Cleveland metropolitan area

- Independent rate-setting authority

- Strong liquidity

CHALLENGES

- Modest system size (measured by operating expenditures) relative to many similarly-rated entities

RECENT DEVELOPMENTS

Recent developments are incorporated into the Detailed Rating Rationale below.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE: RELATIVELY WEALTHY SERVICE AREA IN THE CLEVELAND METRO AREA

The enterprise provides treated water for a service area covering approximately 680 square miles in northern Ohio that includes the City of Avon Lake (Aa2) as well as portions of Avon, Sheffield Lake, North Ridgeville, Medina, Sheffield Village, Medina County, and Rural Lorain County Water Authority. The municipalities outside of the city receive services through wholesale contracts and comprised 82% of fiscal 2013 water sales with the remaining being predominantly used by Ford Motor Company and PolyOne. The system currently has long-term contracts with all the underlying municipalities. Water is drawn from Lake Erie and treated at the enterprise's treatment plant, which has a nominal capacity of 50 mgd. The number of customers served by the Avon Lake water enterprise is approximately 200,000. Resident income levels are strong, with median family income equivalent to 156% of the national figure according to 2008-2012 American Community Survey estimates.

FINANCIAL OPERATIONS AND POSITION: STABLE OPERATIONS SUPPORTED BY HEALTHY LIQUIDITY; ADEQUATE DEBT SERVICE COVERAGE SUPPORTED BY RECENT RATE INCREASES

Operations of Avon Lake's water enterprise will likely remain steady going forward due to the stability of the customer base, and recent annual rate increases. Over the past five years, unrestricted cash reserves have grown from \$6.7 million, or 127% of operating and maintenance (O&M) expenditures, in fiscal 2008 to \$7.1 million, or 101% of O&M, at the close of fiscal 2013. Management projects to maintain strong cash reserves going forward.

The maintenance of healthy liquidity through fiscal 2013 was supported by annual increases in water rates, which are set exclusively by the Avon Lake Regional Water and Utilities Board, per City Charter, and typically effective July 1st of each year. Rate increases have averaged 9% annually over the past four years resulting in steady growth in operating revenue. The board has already approved rate increases of 3% set for both July 2015 and 2016.

Audited fiscal 2013 net revenues provide an adequate 1.4 times of combined debt service coverage on the enterprise's revenue and Ohio Water Development Authority (OWDA) debt. Debt service coverage is estimated to remain adequate between 1.2 and 1.4 times based on estimated fiscal 2015 and 2016 net revenues. The majority of the enterprise's debt obligations are in the form of OWDA loans and coverage on senior lien debt is a very strong 4.62 times.

Liquidity

Fiscal 2013 liquidity was healthy with unrestricted cash of \$7.1 million, or 101% of operating and maintenance expenditures (O&M).

DEBT AND OTHER LIABILITIES: MANAGEABLE DEBT RATIO AND SATISFACTORY LEGAL COVENANTS

The legal provisions for the current bonds are satisfactory and provide adequate security for bondholders based on senior lien on the net revenues of the city's water utility. The rate covenant calls for net revenues to provide at least 1.1 times annual debt service coverage on the bonds. Repayment of the current bonds follows all operating expenditures. The Series 2015 bonds do not possess a debt service reserve fund requirement.

Debt Structure

The water enterprise's debt position is expected to remain manageable given an absence of further borrowing plans within the near term. The current revenue bonds represent all outstanding debt secured by net water

revenues, and reflect a debt ratio of 27.6% of debt to current assets. The enterprise has roughly \$10.0 million in OWDA loans outstanding. Principal amortization is average with 70% of all outstanding debt repaid over the next 10 years.

Debt-Related Derivatives

All debt issued for the water enterprise is fixed rate and is not hedged by any derivatives.

Pensions and OPEB

Pension costs associated with the employees of the enterprise are included in the city's operating expenditures and are thus not included as a liability of the water enterprise.

MANAGEMENT AND GOVERNANCE: FULL RATE SETTING AUTHORITY AND STRONG RATE SETTING RECORD

The Avon Lake Regional Water and Utilities Board has rate setting authority and has demonstrated a strong willingness to raise rates as needed to support operations and capital costs, as evidenced by consistent rate increases since 2011. The board has approved rate increases of 3% in both 2015 and 2016. Board members are elected by voters of the City of Avon Lake to four-year terms.

KEY STATISTICS

- Asset Condition (Remaining Useful Life): 30 years
- Enterprise Size (O&M in \$000): \$7,104
- Service Area Wealth (MFI): 156%
- Annual Debt Service Coverage: 1.36x
- Days Cash on Hand: 312 days
- Debt to Operating Revenues: 1.49x
- Rate Covenant: 1.1x
- Debt Service Reserve Requirement: none

OBLIGOR PROFILE

The enterprise provides water services for approximately 600 square miles in northern Ohio for the City of Avon Lake (Aa2) as well as portions of Sheffield Lake, North Ridgeville, Medina, Sheffield Village, Medina County, and Rural Lorain County Water Authority. The enterprise serves approximately 200,000 people.

LEGAL SECURITY

Outstanding debt payments are secured by a senior lien on the net revenues of the water enterprise.

USE OF PROCEEDS

The Series 2015 bonds will refund the enterprise's Series 2005 bonds for interest savings.

RATING METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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