



## Fitch Upgrades Hernando County, FL's Water & Sewer Revs to 'AA'; Outlook Stable

Fitch Ratings-New York-21 April 2017: Fitch Ratings has upgraded the following Hernando County, FL (the county) revenue bonds to 'AA' from 'AA-':

--\$31.2 million water and sewer revenue refunding bonds, series 2013A.

The Rating Outlook is Stable.

### SECURITY

The bonds are payable by a senior lien pledge of the net revenues of the county's water and sewer system (the system), and legally available connection fees.

### KEY RATING DRIVERS

**UPGRADE REFLECTS FINANCIAL PERFORMANCE AND CASH-FUNDED CAPITAL PLAN:** The upgrade reflects the system's strong debt service coverage (DSC), elevated liquidity, modest leverage levels and the county's intent to fund future capital needs from cash flow. These factors support the system's financial flexibility and its ability to meet continued system consolidation and compliance efforts.

**MODERATE DEBT BURDEN:** Debt metrics are in line with Fitch's 'AA' category medians and should stay favorable as no additional debt is currently projected for issuance in the five-year forecast.

**RATE FLEXIBILITY:** Fitch considers the combined monthly residential bill of \$58 affordable at 1.7% of median household income (MHI), which should provide the system with rate flexibility. Modest, incremental rate increases are pre-approved to continue annually through at least 2019 and customer bills

should remain affordable.

**MANAGEABLE CAPITAL NEEDS:** The system's medium-range capital needs have declined after the completion of a large project, and the current capital improvement plan (CIP) will focus on system consolidation of a dispersed collection of facilities across the service area and regulatory compliance.

**LIMITED LOCAL ECONOMY:** The economy remains limited, concentrated mostly in agriculture, manufacturing, mining, and distribution. Wealth levels are low and low-wage employment dominates the local economy. Tampa is within commuting distance to parts of the county, which provides additional employment options.

## **RATING SENSITIVITIES**

**CONTINUED FINANCIAL FLEXIBILITY:** The Hernando County water and sewer system's maintenance of strong financial flexibility, modest debt levels and manageable capital needs should result in rating stability even with the service area's limited economy.

## **CREDIT PROFILE**

Hernando County is located in west-central Florida along the Gulf of Mexico, approximately 50 miles north of the city of Tampa. The system provides retail service to a mostly residential customer base of 59,000 water accounts and 27,000 sewer accounts. There is no customer concentration.

The system serves the unincorporated parts of the county and thus has wide operational responsibility that includes a geographically dispersed network of 28 water treatment plants, six wastewater treatment plants and many private septic systems. Efforts are underway to consolidate treatment capacity into fewer plants and convert septic owners to the county system in order to maintain regulatory compliance and decrease operational risk.

## **BOLSTERED FINANCIAL POSITION SUPPORTS UPGRADE**

Consistent multi-year rate increases and cost controls put in place since fiscal 2011 have yielded a trajectory of strong, sustainable financial outcomes. Fiscal 2016 continued this trend; senior lien and all-in DSC (including

subordinate lien state revolving fund [SRF] loans) were a robust 4.3x and 2.7x each, well above the respective 'AA' medians of 2.4x and 1.9x. Including legally available connection fees, senior lien and all-in DSC was even stronger at 5.0x and 3.1x that year. Total annual debt service made up a low 16% of gross revenues, and over \$23 million in unrestricted cash and investments equated to a very strong 468 days' cash on hand. Free cash, at 133%, marked a third consecutive year above 100% of annual depreciation costs.

A forecast compiled by a rate consultant predicts continued strong financial results supported by a multi-year rate plan already approved by the county commission. Senior lien DSC is shown to exceed 3.0x through fiscal 2020 and all-in DSC is likely to decline but remain acceptable in the 1.5x-1.9x range as additional SRF loan payments commence in fiscal 2017. The lower DSC reflects higher assumed operating expenditures in the forecast than historical actual levels. Annual debt service inclusive of increased SRF payments should cause carrying costs to peak in fiscal 2018 but remain a manageable 23% of gross revenues. DSC and carrying costs should remain solid, as no additional debt is planned in the near term.

The aforementioned SRF loan was acquired in order to reimburse the system for having paid for the expansion costs of its airport wastewater treatment plant (WWTP) upfront with unrestricted available cash and ample reserves. Fitch expects cash levels and reserves to remain robust going forward due to management's prudent policies to set aside 10% of prior year gross revenues in a renewal and replacement (R&R) fund and an additional 5% into a capital fund in order to meet capital needs internally. Moreover, Fitch views the system's moderate debt levels and ample rate-raising flexibility as supportive of continued financial flexibility.

#### AFFORDABLE, FLEXIBLE RATES

Rates are structured with a base charge and inclining block consumption charges designed to promote conservation. The base rate comprises an above average 43% of the total bill, which Fitch views favorably, as it decreases system dependency on flow and usage variability. The combined average residential water and sewer bill (assuming the national average usage of 7,500 and 6,000 gallons per month of water and sewer,

respectively) was about \$58 in fiscal 2016, equal to 1.7% of MHI, below Fitch's 2% threshold for rate affordability. Actual customer consumption and charges are typically lower, lending the system even greater rate-raising flexibility.

The county commission has approved multi-year rate plans since 2010 based on recommendations by the system's third-party rate consultant. In May 2014 the county commission approved combined rate increases of between 3.85% -5% through fiscal 2019. Based on current relative rate affordability, the impact of future rate increases should not impair future affordability or financial metrics.

#### MODERATE DEBT

One of the system's primary credit strengths is its moderate debt burden. Current debt represents 39% of net plant, and debt per customer is below average at \$1,062 compared to Fitch's 'AA' medians of 45% and \$1,823 respectively. Debt to FADS (funds available for debt service) was 5.7x in fiscal 2016, which was in line with the median of 6.0x. Total debt amortizes relatively quickly, with 49% and 99% repaid in 10 and 20 years, respectively. Current pro forma projections incorporating the onset of SRF loan repayments in fiscal 2017 indicate that these debt burden metrics should remain favorable.

#### MANAGEABLE CAPITAL PLAN

The county's current five-year, fiscal 2017-2021 CIP totals \$30.2 million, marking a significant decline from the \$83 million plan reported during Fitch's review two years prior. This difference is primarily due to the completion of the system's largest single project, the aforementioned expansion of the airport WWTP at a cost of \$36 million.

The current CIP funds ongoing system regionalization and interconnectedness to reduce operating costs and improve service reliability. Funding will also support expanded reclaimed water capacity to offset potable water usage, greater wastewater treatment capacity and continued regulatory compliance measures. A large program to convert septic owners to the county system is also underway and should be funded in part by state matching grants. CIP costs are expected to be fully and ably funded by

available cash, R&R and capital reserves, connection fees and state grants and matching funds.

**SOUND ALBEIT LIMITED LOCAL ECONOMY; ACCESS TO TAMPA MSA**  
Located north of Tampa on the west-central coast of Florida, the county is mainly residential and serves as a bedroom community due to its proximity and direct access via the Suncoast Parkway to the Tampa Metropolitan Statistical Area. The county experienced rapid population growth of nearly 30% from 2000 to 2010 and has a current estimated population of 183,000. The economy remains fairly narrow with concentrations in agriculture, citrus products, cattle production, limestone mining and cement production.

The county's unemployment rate of 6% in February 2017 has declined by over half since the 2008 economic downturn yet remains consistently above the state and national rates (4.7% and 4.9% in Feb. 2017). MHI for 2016 was 86% of the state's level.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

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#### **Applicable Criteria**

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

(<https://www.fitchratings.com/site/re/750012>)

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)

(<https://www.fitchratings.com/site/re/890402>)

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