



Fitch Affirms Lakeland, FL's Water & Sewer Revs at 'AA+'; Outlook Stable

Fitch Ratings-New York-05 October 2017: Fitch Ratings has affirmed the following Lakeland, FL (the city) revenue bonds at 'AA+':

--\$37 million water and wastewater revenue refunding and improvement bonds, series 2012A.

The Rating Outlook is Stable.

SECURITY

The bonds are payable from a senior lien pledge of the net revenues of the city's water and wastewater system (the system).

KEY RATING DRIVERS

CONTINUED STRONG FINANCIAL PERFORMANCE: The system continues to yield very strong financial operations and debt service coverage (DSC). In fiscal 2016, senior lien and total DSC levels, net of transfers, were 7.1x and 3.4x, respectively. Out-year projections remain strong even when incorporating additional debt.

LOW DEBT BURDEN: The system's long-term liability burden will increase with the full issuance of roughly \$28 million in subordinate lien state revolving fund (SRF) debt, although debt metrics should remain low. Lack of additional debt plans beyond the SRF loans and above average amortization of outstanding debt should support a favorable debt profile going forward.

AMPLE SYSTEM CAPACITY: Water supply sources remain robust and treatment facilities provide the system with strong excess capacity to meet future demand.

MODERATE RATE FLEXIBILITY: Current rates result in a combined bill equal to approximately 1.9% of median household income (MHI), nearing Fitch's affordability threshold of 2% of MHI. However, as compared to peer systems, the city's rates are competitive.

STABLE ECONOMIC GROWTH: The city's favorable location promotes economic diversity, with growth occurring in the health care and higher education sectors. Local unemployment levels have moderated, yet wealth and education levels remain below state and national averages.

RATING SENSITIVITIES

CONTINUED FINANCIAL STABILITY: Lakeland, FL utility system's rating is sensitive to its ability to sustain strong financial margins while continuing to make sizable transfers to the general fund and support capital needs with internal resources.

CREDIT PROFILE

The city of Lakeland is located in central Florida in Polk County (Issuer Default Rating AA/Stable). The system, which extends into unincorporated portions of the county, covers 149 square miles and serves a growing population of over 197,000.

MAINTENANCE OF STRONG FINANCIAL MARGINS

The system has historically generated solid financial margins and high DSC levels. Annual operating margins have averaged 45% over the past five fiscal years, and senior and subordinate DSC levels have remained above 5x and 2.7x, respectively. In fiscal 2016, the system yielded senior and all-in DSC of 9.3x and 3.5x. Management's pro forma projections, which Fitch considers reasonable, indicate healthy coverage levels in the out-years, even when incorporating additional debt service from \$28 million in SRF loans.

The city's liquid resources, including significant renewal and replacement (R&R) funds, have averaged nearly 400 days cash on hand (DCOH) over the

past five fiscal years (including 416 DCOH in fiscal 2016). These balances are expected to decline as the system intends to cash-fund the majority of its capital plan. Nevertheless, management expects to maintain cash levels above its informal target of 180 days.

The system makes substantial annual transfers, nearly all to the city's general fund (GF), equating to an average of 14% of operating revenues over the past five years and totaling roughly \$8.1 million in fiscal 2016. These transfers effectively function as payments in lieu of taxes and have historically been incorporated and budgeted for in management's financial planning and rate setting process. When including the GF transfers, the system's coverage of all obligations drops but remains a healthy 3.4x.

SOUND CAPITAL PROGRAM

The system's six-year fiscal 2017-2022 capital improvement program (CIP) totals \$147 million. Nearly 60% of funds will support wastewater utility projects primarily related to sewer conveyance and collection system R&R, and the remaining 40% will fund water transmission and distribution system upgrades. Notable projects include several energy efficiency projects and the extension of infrastructure into the fast-growing English Oaks service area. Nearly 25% of the CIP will be debt-funded, while the remainder will be paid from the system's healthy cash and R&R balances.

LOW DEBT BURDEN

The system's debt burden has been notably low and manageable over the past five years. As of fiscal 2016, debt equated to 34% of net plant, \$908 per customer and 2.5x funds available for debt service (FADS), all very favorable relative to the 'AA' category medians of 45%, \$1,823 and 6.0x, respectively. In fiscal 2017, the city authorized the issuance of roughly \$28 million in subordinate lien SRF loans, a portion of which was closed and added to the system's balance sheet during the year with the remainder to be drawn over the next couple of years. Despite the SRF loans, Fitch expects that debt metrics will remain consistent with the rating category due to the system's already low debt burden and a rapid amortization schedule (55% of principal retired in 10 years).

AMPLE SERVICE CAPACITY

The water system consists of two water treatment plants with a combined treatment capacity of 59 million gallons per day (mgd), nearly two times the current average demand. Water supply is drawn from the Floridan Aquifer pursuant to a long-term consumptive use permit issued by the Southwest Florida Water Management District that allows the system to withdraw up to 35 mgd. Management expects that the permitted capacity will be sufficient for the system's needs through the term of the permit (2028).

The wastewater system consists of two treatment facilities with a combined treatment capacity of nearly 22 mgd, over 50% capacity above the average 14 mgd flow in fiscal 2016. A small re-use plant provides additional treatment capacity. The system currently disposes of treated effluent into an artificial wetlands system and sends excess flows via an outfall ditch to the Alafia River. This available effluent disposal method should eliminate the city's need to invest significant funding towards additional upgrades to its wastewater facilities to meet more stringent effluent discharge requirements.

MODERATE RATES, ADEQUATE FLEXIBILITY

Utility rates are approved by city council and were raised by 4.5% in both fiscals 2016 and 2017. In fiscal 2016, the average residential customer paid \$63 for combined service based on the national average consumption of 7,500 mgd of water and 6,000 mgd of sewer. This charge equated to 1.9% of city-wide MHI, approximating Fitch's rate affordability threshold of 2% of MHI. Future rate increases, which are expected to range from 6%-8%, should produce strong financial margins but could further encroach upon the 2% benchmark. Positively, the system's rates compare favorably to peer systems on a dollar basis, and actual in-city consumption rates fall lower than the national average, suggesting greater rate-raising flexibility.

HEALTHY ECONOMIC GROWTH

The city benefits from its location along Interstate 4, midway between Orlando and Tampa. Due to its location the city is the wholesale and retail

trade center for the area, with a large distribution, production, health care and education presence. Located within the city are the headquarters and primary production facility for the supermarket chain Publix as well as Lakeland Regional Medical Center, the fifth largest hospital in the state. Management indicates that several partnerships are developing to combine and expand the city's medical and educational facilities, resulting in diverse and increased employment opportunities. While unemployment has continued to improve, lowering to 5% as of July 2017, wealth levels still remain 15%-25% below that of the state and nation.

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

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Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
(<https://www.fitchratings.com/site/re/898969>)

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)
(<https://www.fitchratings.com/site/re/890402>)

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