FitchRatings

Fitch Rates Clarksville TN's Water, Sewer & Gas Rev Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-30 November 2017: Fitch Ratings has assigned a 'AA' to the following Clarksville, TN (the system) revenue bonds:

--$53.7 million water, sewer and gas revenue refunding bonds, series 2017.

The series 2017 bonds are scheduled for negotiated sale the week of Dec. 4. Proceeds will refund a portion of the system's outstanding water, sewer and gas revenue refunding bonds, series 2011 and series 2013, and pay issuance costs.

In addition, Fitch has upgraded the following ratings:

--$188.6 million senior lien water, sewer and gas revenue and refunding bonds, series 2002, 2011, 2013 and 2016 to 'AA' from 'AA-';
--$5.9 million subordinate lien water, sewer and gas revenue refunding bonds, series 2013 to 'AA-' from 'A+'.

The Rating Outlook is Stable.

In addition, Fitch has withdrawn its ratings for the following bonds due to pre-refunding activity:

--Clarksville (TN) water, sewer & gas revenue refunding & improvement bonds (pre-refunded maturities only - 182618GZ5, 182618HE1, 182618HF8, 182618HG6, 182618HH4, 182618HJ0, 182618HK7, 182618HL5, 182618HM3, 182618HN1, 182618HP6). Previous rating: 'AA-'/Rating Outlook Stable.

SECURITY

Senior lien bonds are payable from a first lien on net revenues of the city's water, sewer and gas systems (the system). Subordinate lien bonds are payable from a subordinate lien on net system revenues after payment of senior bonds.

KEY RATING DRIVERS

STABLE FINANCIAL PROFILE DRIVES UPGRADE: The rating upgrade is based on sustained improvement in the system's financial profile, buoyed by a declining debt burden and moderating capital needs. Consistent rate increases and conservative budgeting has led to solid debt service coverage (DSC) and healthy liquidity levels, which are expected to continue over the projected five-year period.

MANAGEABLE CAPITAL PLAN, MODERATING LEVERAGE: Capital needs have trended downward since the reconstruction of the system's sole wastewater treatment plant (WWTP) following damage sustained during a 2010 flood. Additional debt plans over the intermediate term are manageable and have been reduced from prior expectations.

ECONOMIC DIVERSIFICATION: Strong service area growth in recent years is driven in part by steady local economic diversification into manufacturing, education and healthcare. Fort Campbell remains the largest employer in Tennessee and Kentucky and plays a vital role in the regional employment and economic picture.

RATING SENSITIVITIES

FINANCIAL, DEBT AND GROWTH MANAGEMENT: The city of Clarksville, TN's water, sewer and gas system's rating is based on the maintenance of strong financial results and adequate rates supportive of a steadily expanding customer base and the expectation of additional debt in the intermediate term.

CREDIT PROFILE

Located 50 miles northwest of Nashville, Clarksville (Issuer Default Rating

AA/Stable) is the county seat of Montgomery County and the fifth largest city in the state. The city continues to experience strong population growth, in part driven by the expansion at Fort Campbell, which includes more than 30,000 military personnel and 53,000 family members in the region. The base is not a direct customer of the three utility systems. Local economic expansion is also attributable to investments by companies including Hankook Tires, LG, and Google.

The system's estimated service area population approximates that of the county, or 198,000. The water, sewer, and gas systems serve 65,016, 56,677 and 26,297 customers, respectively, primarily in the city and portions of Montgomery County. Water and sewer annual customer growth has increased by a 2%-3% average over the past five years and management reports that the water and sewer utilities have ample treatment capacity to absorb continued moderate growth in the customer base. Gas availability is driven by demand.

Fort Campbell is not a customer of the water or wastewater system; however, it was previously the largest natural gas customer until 2012 when it began purchasing its own natural gas. It is still a transportation customer of the city, which covers related system infrastructure costs. The margin the city made on the natural gas commodity sales to the base was minimal, so there was no financial impact on the gas system.

STRONG SUSTAINED FINANCIAL MARGINS SUPPORT UPGRADE

In fiscal 2017, the combined system (water, sewer and gas) senior lien DSC net of transfers to the general fund was 2.0x, and all-in DSC after transfers was 1.5x. These coverage levels have remained stable over the past five years (averaging 2.2x and 1.6x each since 2013) due to rate increases sufficiently outpacing rising annual debt service costs attributable to the WWTP reconstruction debt. While slightly weaker than Fitch's 'AA' category DSC medians of 2.6x (senior lien) and 2.1x (all-in) after transfers, financial flexibility is further supported by average 42% operating margin and robust liquidity levels since 2013.

The system ended fiscal 2017 with a strong liquidity position, as unrestricted cash and investments of $52.8 million equating to a robust 400 days cash on hand (DCOH). Management expects that future excess cash flows should sufficiently fund projected cash-funded capital projects while maintaining unrestricted cash balances at or above the current levels going forward.

Management projects DSC levels after transfers to remain stable, with senior lien coverage at no less than 2.0x and all-in coverage above 1.6x through fiscal 2022. Forecast assumptions conservatively assume no rate increases, no customer growth, minimal annual revenue growth, and annual debt service savings from the current refunding. Also included is the release of debt service reserve funds. The system's relatively competitive rates based on actual customer consumption patterns lends management a significant degree of rate-raising flexibility should the need arise.

SOLID POST-FLOOD RECOVERY PERFORMANCE

The system has demonstrated effective and responsive capital planning and cost recovery efforts as evidenced by a swift financing and reconstruction of the city's sole WWTP and related lift stations following total submersion during a May 2010 flood event. Total project costs ultimately reached $133 million and were funded primarily by revenue bonds. The system funded escalating annual debt service costs by implementing a four-year, fiscal 2014-2017 annual 9.5% sewer rate increase, preserving financial margins.

Management initially expected to receive reimbursement funds from the Federal Emergency Management Administration (FEMA) for up to 75% of repair costs, however FEMA's actual reimbursement to the city was reduced to about $30.5 million (or about 23% of final project costs). Management expects to receive these funds in stages over the coming fiscal years, enhancing unrestricted liquidity levels.

Capital spending for the wastewater system addressed the flood damage, but also addressed permit violations that prompted the assignment of a consent order by the Tennessee Department of Environment and Conservation in 2012. The 2012 order replaced a 2004 order that dealt with similar violations. Management expects to fully close out its regulatory-driven projects (totaling $14.3 million, or 9% of capital spending) and achieve full regulatory

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compliance by March 2020.

MANAGEABLE CAPITAL PLAN

The system's five-year, fiscal 2018 - 2022 capital improvement program (CIP) totals $151 million and reflects a decline in capital spending following the completion of the WWTP reconstruction. Capital priorities have shifted to address long-term water supply and treatment expansion (79% of projected spending) in order to meet the growing service area's anticipated future needs. The total water supply expansion program will cost around $143 million over the ten year horizon, with the majority scheduled to occur in the current five-year CIP.

The WWTP project expanded dry and wet weather treatment capacities in order to withstand extreme flood events. Sewer projects currently comprise only 16% of the CIP and address R&R needs. The system previously expected to construct a 23-mile, $30 million gas pipeline however canceled the project as it was no longer being economically feasible and/or necessary. Gas projects account for only 5% of the current CIP (or $8.2 million) which management expects will be sufficient to meet projected growth demands.

MODERATING DEBT PROFILE

The system's combined debt totaled $262 million in fiscal 2017, significantly larger than the pre-flood level of $180 million fiscal in 2010. Most debt is attributable to the sewer system, and the water and sewer systems provide the majority of revenues for bondholders. The natural gas fund is healthy but accounted for only 3% of outstanding debt in fiscal 2017.

A relatively rapid amortization schedule and recent debt refundings has lowered debt metrics to more closely align with Fitch's 'AA' medians. In fiscal 2017, debt comprised 49% of net plant and equated to $1,769 per customer, similar to the 'AA' medians of 45% and $1,823 respectively. When measured by debt to funds available for debt service (FADS), debt was 7.2x at the end of fiscal 2017, which while weaker than Fitch's 'AA' category median of 6.0x, has declined over time with reduced debt and improved revenues.

Management expects to issue an additional $73 million over the next five years, or 42% of projected capital spending. Leverage metrics are projected to remain at or slightly below historical levels going forward based on projected FADS and future cash flows, which appear strong despite future capital spending and limited additional debt.