

### **NOTICE OF MATERIAL EVENT**

This notice is hereby given that the City of Cape Coral, Florida (the “City”), as an obligated person under the Securities and Exchange Commission’s Rule 15c2-12 (the “Rule”), with respect to certain outstanding water and sewer bonds issued by the City (collectively, the “Bonds”).

The City hereby provides notice that on December 7, 2017, S&P Global Ratings raised its long-term rating of the City’s outstanding water and sewer bonds from ‘A’ to ‘A+’ (stable outlook).

Dated this 8<sup>th</sup> day of December, 2017.

# RatingsDirect®

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## Summary:

### Cape Coral, Florida; Water/Sewer

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## Summary:

# Cape Coral, Florida; Water/Sewer

### Credit Profile

US\$237.83 mil wtr and swr rfdg rev bnds ser 2017 due 10/01/2042

*Long Term Rating*

A+/Stable

New

Cape Coral WS

*Long Term Rating*

A+/Stable

Upgraded

## Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) on Cape Coral, Fla.'s existing water and sewer system revenue debt to 'A+' from 'A'. At the same time, we assigned our 'A+' long-term rating to the city's series 2017 water and sewer refunding revenue bonds. We also affirmed our 'BBB+' rating on the city's outstanding utility improvement assessment bonds. The outlook is stable.

The upgrade on the water and sewer revenue bonds reflects improvements in the coverage and liquidity levels, which we expect to remain very strong.

The 'A+' rating is based on the application of our revised criteria "Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds" (published Jan. 19, 2016, on RatingsDirect). We view the system as having a very strong enterprise risk profile and a strong financial risk profile. Additionally, the water and sewer revenue bonds have a prior lien to the city's special-assessment debt.

The 'BBB+' special-assessment bonds rating reflect the city's agreement to pay debt service from water and sewer system net revenue if special-assessment revenue is insufficient to cover debt service and replenish debt service reserve (DSR) shortfalls. Special-assessment revenue collected in the city's special-assessment districts also secures the bonds. Special-assessment revenue from different assessment areas secures each bond series.

Officials believe additional special-assessment revenues will limit the system's potential debt service support. In addition, management intends to maintain \$500,000 in a contingency reserve for special-assessment debt. We recognize water and sewer system net revenues will be used if there are insufficient assessment revenues for the special-assessment bonds outstanding.

Cape Coral's contractual obligation to make debt service payments is subordinate to the payment of the system's senior- and subordinate-lien debt, and it does not constitute a lien or pledge of net revenue. Should net revenue be insufficient to make debt service payments, we understand the city would draw down from the DSR, satisfied by a surety policy, which it funds at maximum annual debt service (MADS). Cape Coral also agreed to make payments from special assessments and net revenue to reestablish the DSR as soon as possible but no later than one year from the drawdown. The city further agreed to fix, establish, and maintain such rates and collect such fees, rates, and other charges to make up any debt service insufficiencies and pay any such policy costs.

Cape Coral has about \$99.95 million of special-assessment bonds outstanding, issued for specific service area improvements. Special assessments collected in these areas secure these bonds, but a subordinate-lien pledge on utility system revenue also backs the bonds. To date, there does not appear to have been any financial effect on the utility system; the system's annual exposure, however, could be approximately \$13.1 million, or another 42% of the current annual debt service it is responsible for already.

The city's net water and sewer system revenue pledge secures the series 2017, 2015, 2011, and 2011A water and sewer revenue bonds. The bonds are on parity with the city's series 2013 and 2015A privately placed bank bonds and senior to its subordinate state revolving fund loans. However, we believe contingent liquidity risk does not exist because the series 2013 and 2015A bonds are subject to the same bond provisions as parity debt. Officials intend to use series 2017 bond proceeds to refund the city's series 2011 and 2011A bonds for cost savings.

The water and sewer revenue bond rating reflects the very strong enterprise risk profile and strong financial risk profile. The enterprise risk profile reflects our view of the water and sewer system's:

- Customer base that participates in the broad and diverse Cape Coral-Fort Myers metropolitan statistical area (MSA) economy, highlighted by rapid population growth (projected to be 28% from 2010 to 2020) and adequate wealth and income levels (median household effective buying income [MHHEBI] at 91% of the U.S.);
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Service rates that we consider affordable in the context of the service area's income levels, as the combined monthly bill (\$116.68 for 6,000 gallons of usage) is 3.3% of MHHEBI; and
- Good operational management practices and policies.

The financial risk profile reflects our view of the water and sewer system's:

- Strong coverage of all in debt service coverage (DSC; 1.82x in fiscal 2016), although coverage falls to 1.24x when expansion fee revenues are excluded;
- Adequate liquidity position, with \$17.9 million of cash on hand in fiscal 2016, which is about 156 days (still above the city's policy of maintaining at least 60 days) and is significantly below historic levels;
- Manageable capital needs focused on water and sewer expansions, but the plan is heavily debt funded and the debt-to-capitalization ratio is high at 60.1%;
- Good financial management policies and practices; and
- Potential exposure to additional liabilities and debt service expenditures related to special-assessment bonds backed by the system, which could pressure the financial risk assessment by weakening the coverage, liquidity, and debt and liabilities indicators.

The city indicated that there was minimal damage to the system as a result of Hurricane Irma.

### **Enterprise profile**

Cape Coral is in Lee County, about 125 miles south of Tampa. The city's population is expected to grow 28% from 2010 to 2020. Its MHHEBI is adequate yet below average, in our view, at just 91% of the U.S. levels. County unemployment continues to decline and was 4.6% in 2016.

Consistent with our criteria, titled "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for the system very low, the most favorable assessment possible on a '1' to '6' scale, with '1' being the best.

The city maintains full rate-setting autonomy while reviewing rates annually. Current combined rates, with an average monthly residential bill of about \$116.68 per 6,000 gallons usage, are high, in our opinion, given area income levels, representing nearly 3.3% of city MHHEBI. Although management has indicated there are no plans to adjust rates in the near term, future rate flexibility is limited given the current high rates.

Based on our operational management assessment (OMA), we view Cape Coral to be a '2' on a scale of '1' to '6', with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well aligned, even if some challenges exist. The OMA of "good" includes the authority's adequate asset adequacy identification program and a comprehensive operational risk-reduction plan in most critical areas. It also includes sufficient water supply for the foreseeable future.

The city's utility system currently provides service to 61,552 water and 59,904 wastewater accounts both inside and outside the city limits.

Raw water (primarily brackish) is procured from the Upper Floridan Aquifer through 55 wells with total combined capacity of about 39 million gallons per day (mgd). The city owns two water treatment plants (WTPs) with a total combined capacity of 30.1 mgd: South Reverse Osmosis WTP (18.1 mgd) and the North Reverse Osmosis WTP (12 mgd). There are two water reclamation facilities. The Southwest Water Reclamation Facility has capacity for 15 mgd and the Everest Parkway Water Reclamation Facility has capacity for 13.4 mgd. The city also operates a water reuse system: IQ Water Distribution System. Management reports the water and sewer system has ample resources and capacity to fulfill its customers' needs for at least the next 10-year horizon.

### **Financial profile**

All-in coverage in fiscal 2016 was a strong 1.82x. Management is expecting fiscal 2017 coverage levels to be in line with fiscal 2016. Coverage levels are expected to rise and fall based on usage and customer growth as there are no rate increases expected until 2027. Also, a negative adjustment is given as impact fees provide a significant amount of the net available to service all of the debt: senior lien bonds, subordinate state revolving loans, and special assessments (if needed to repay).

After a planned drawdown of liquidity to a low of \$9.9 million in fiscal 2015, it appears that liquidity will improve over the next couple of years. In fiscal 2016, there was \$17.9 million in reserves or 156 days' cash on hand. The system is highly leveraged currently with a debt-to-plant ratio of 60.1% (for fiscal 2016). The total capital improvement plan (CIP) for the next five years from fiscal years 2018 to 2022 totals \$242.8 million, with approximately \$110 expected to be funded with debt, primarily state revolving fund loans, which are expected to be secured by new special-assessment revenues.

Based on our FMA, we view Cape Coral to be a '3' on a scale of '1' to '6', with '1' being the strongest. We believe that the financial management practices are good, comprehensive, and supportive of credit quality. Revenue and expenses assumptions are reasonable, and interim financial reporting is provided to the council through monthly budget reports. The long-term planning process is somewhat rigorous, albeit a fairly new practice, and the five-year CIP is annually updated and made publicly available. The reserve target is robust and articulates a rationale for maintaining a strong liquidity position. Financial planning and operational data are easily obtained, as the budget and financial statements are readily available on the city's website.

## Outlook

The stable outlook reflects S&P Global Ratings' opinion of Cape Coral's good finances, evidenced by the city's consistent maintenance of good senior-lien DSC. Despite planned cash drawdowns, we believe system liquidity will likely remain what we consider strong while management cash funds the majority of its CIP. If the pace of customer growth were to become slower than expected, and if total DSC (excluding impact fees) were pressured absent rate increases, we will review the rating accordingly. City officials believe new special-assessment revenues will limit the system's potential support of annual special-assessment debt service. In addition, management intends to maintain \$500,000 in a contingency reserve for special-assessment debt, providing financial flexibility. Due to what we consider the system's stable finances, we do not expect to change the rating over the outlook's two-year period.

### Upside scenario

Continued growth and diversification of the service area economy that leads to improvement in wealth and income indicators, which eventually reduce the market position assessment, could lead to a higher rating.

### Downside scenario

Reductions in DSC, caused by additional debt, lower-than-expected expansion fees, assumption of the special-assessment debt service, or just lower net revenues, coupled with additional drawdowns in liquidity levels, could lead to a lower rating.

#### Ratings Detail (As Of December 7, 2017)

Cape Coral WS (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
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<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
Cape Coral WS (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
Cape Coral WS (AGM)		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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