



## Fitch Rates East Central Reg'l Wastewater Treatment Facils Ops Bd, FL Sewer Revs 'AA+'

Fitch Ratings-New York-06 December 2017: Fitch Ratings has assigned an 'AA+' to the following revenue bonds issued by the East Central Regional Wastewater Treatment Facilities Operation Board, Florida (the ECR):

--\$89.7 million sewer system revenue refunding bonds, series 2017.

Proceeds will be used to advance refund certain of the ECR's outstanding series 2014 bonds and pay issuance costs. The bonds will be sold via negotiation the week of Dec. 11.

In addition, Fitch affirms the following ratings:

--\$86.6 million sewer system revenue bonds, series 2014 (prior to refunding) at 'AA+'.

The Rating Outlook is Stable.

### SECURITY

The bonds are secured by net revenues of the ECR, which are derived primarily from wastewater flow charges (WFCs) received from the member entities - Palm Beach County (the county), the cities of West Palm Beach (WPB), Lake Worth and Riviera Beach, and the town of Palm Beach. Net revenues also include septage charges, penalties, and other income.

### KEY RATING DRIVERS

**MEMBER PAYMENT OBLIGATIONS:** An interlocal agreement (IA) was established in 1992 to consolidate existing separate agreements with the ECR and provide a single unified set of policies and procedures to operate the plant. The tenets of the original IA are currently in effect through 2052 and

include provisions that provide for a joint-and-several agreement among the members for the repayment of obligations to the ECR, including debt service on the bonds.

**STRONGEST MEMBERS DRIVE RATING:** The rating reflects the credit quality of the ECR's strongest member - Palm Beach County (utility bonds rated AAA/Stable) - but also takes into consideration some operational risk borne by the system operator, WPB. The service area is wholly contained within the county and the underlying customer base exhibits strong economic and credit fundamentals.

**SOLID FINANCIAL PROFILE:** ECR has historically maintained strong cash reserves and solid ongoing debt service coverage (DSC). DSC levels are forecast to decline to 1.5x going forward with the onset of additional expenses associated with the opening of a new biosolids facility.

**HIGH LEVERAGE:** A series of recent consecutive debt issuances has led to heightened, albeit manageable leverage metrics. While the five-year capital improvement program (CIP) is moderate at \$68.5 million, leverage metrics are likely to remain elevated.

**STRONG OPERATING PROFILE, ESSENTIAL SERVICE:** The ECR has ample treatment capacity and a solid track record of regulatory compliance. Each member is either entirely or nearly entirely dependent on the ECR for wastewater treatment, and the development of alternative sources would likely be cost prohibitive.

## RATING SENSITIVITIES

**DETERIORATION IN LARGEST MEMBER CREDIT CHARACTERISTICS:** The East Central Regional Wastewater Treatment Facilities Operation Board's rating is driven by the credit quality of Palm Beach County (the county) and strength of the city of West Palm Beach as operator. A weakening in the county's credit fundamentals or an increase in the operating risks of West Palm Beach (could result in downward rating movement.

**FINANCIAL PROFILE DETERIORATION:** Continued surplus net revenues

and maintenance of robust reserves will be a key consideration in maintenance of the current rating.

## CREDIT PROFILE

Created in 1992 as a separate governmental entity pursuant to the IA, the ECR provides collection, treatment, and disposal of wastewater flows on a wholesale basis to a large and diverse service area that includes roughly 406,000 people. The ECR is located within the east and central portions of the county in southeastern Florida and its five member entities include the county, the cities of WPB (utility revenue bonds rated AA/Stable), Riviera Beach (utility revenue bonds rated A+/Stable), Lake Worth and the town of Palm Beach. The IA expires in 2052.

The ECR is governed by a five-member board comprising a representative from each participating entity. Votes are weighted based on each entity's share of the system's treatment capacity. The city of WPB is the system operator and is responsible for tracking expenses and proposing annual budgets and revenue requirements to be approved by the board. The board meets monthly and is able to convene immediately should circumstances require.

## SOUND PAYMENT PROVISIONS, IMPLIED UNLIMITED STEP-UP

Each member entity pays a proportionate share of the ECR's operations and maintenance (O&M) expenses, debt service, R&R and catastrophic reserve balances as well as any other amounts required under the bond resolution. WPB presents the board with the subsequent year's budget no later than 150 days prior to the close of the current fiscal year. The budget is based on two years' worth of historical operating expenses and wastewater flows as well as fiscal year-to-date and projected year-end expenses. The expense budget is used to determine WFCs, which are based on the total amount of the annual operating budget divided by the estimated flows for the budget year of each entity. WFC payments are O&M expenses of each entity, superior in priority to the member's own debt obligations.

While the IA does not contain explicit step-up language in the event of a customer default, it does require the board (via notification by the operator WPB) to amend the operating budget immediately (at any time of the year) to

adjust WFC rates upward to meet expected shortfalls. Fitch views this as an implied unlimited step-up. Members are billed two months in advance, providing time for a potential cash flow shortfall to be detected and remedied via the use of the system's abundant cash balances and/or a step-up of other member payments prior to debt service payments.

#### TOP-DOWN PAYMENT APPROACH SUPPORTS RATING

Because of the joint-and-several nature of the ECR's revenues, Fitch's analysis considers the non-defaulting members' ability to absorb any potential (albeit remote) delinquencies by other ECR members from both one-time sources (available cash) and then on a recurring basis (annual revenues). According to the IA, the occurrence of a defaulting customer would result in an immediate recalculation of WFCs based on the proportionate contributing flows by non-defaulting customers, leading to a full recovery of the ECR's revenue requirements. Though no customer has ever defaulted on its member payments, several have been late due to administrative oversight and upon notice, paid in full with a late charge.

Fitch evaluates the ability of a single member or group of members to cover payment defaults from other members of the pool without impairing the non-defaulting members' own credit quality using a top-down approach. In the event of revenue shortfalls from member payments, Fitch believes that Palm Beach County alone (the largest entity with the highest credit quality) has more than sufficient cash resources to pay any immediate revenue shortfall. For example, had the four other ECR members defaulted on their fiscal 2016 WFC payments, the combined cost for the county to recoup these missed revenues would have only amounted to 6.6% of the county's available cash and 5% of its operating revenues that year.

While Fitch believes the county's credit profile is sufficient to absorb any step-up costs from defaulting members, we also believe there is a practical limitation to this step-up, particularly given WPB's role as billing agent and operator for ECR. Consequently, ECR's rating is influenced by operating risk of the facility and payment obligations of the members that are not explicitly unconditional. This operating risk, albeit small, ultimately limits ECR's rating.

#### STRONG SYSTEM FINANCIAL RESULTS

The system's financial metrics are strong. Fitch-calculated debt service coverage (DSC) was over 1.8x in fiscals 2015 and 2016 with the full debt service costs of recent debt issuances. With additional operating expenses of the new biosolids facility, DSC is projected to decline in management's financial forecast but remain at or above 1.5x. In addition to WFC's, net revenues available for debt service include annual member entity contributions equal to 1% of ECR's net plant.

Financial flexibility is enhanced by the system's ample cash balances. In fiscal 2016, available cash amounted to an estimated \$32 million or about 872 days' cash on hand. Most of the cash is in the R&R fund, which is intended for capital improvements but is also available for debt service. Annual debt service comprised a moderate 33% of gross revenues in fiscal 2016 and is expected to remain level over the ensuing three fiscal years.

Cash balances through the fiscal 2017-2019 financial forecast are shown to remain robust given the system's stringent reserve fund replenishment policies and despite management's expectation to fund the majority of the CIP from internal resources.

#### MANAGEABLE DEBT AND CAPITAL PROGRAM

The system's combined debt totaled \$134 million in fiscal 2016, high relative to historical levels following a series of new issuances since fiscal 2013. Debt represents a very high 90% of net plant and elevated 8.5x debt/funds available for debt service (FADS). These metrics are considered manageable by Fitch, as they reflect the system's role as a wholesale provider with the debt repaid as an O&M expense from the five member entities. Debt-per-capita (given the large combined service area population) approximated a moderate \$330 (favorable compared to the 'AA' median of \$577). Bond amortization is slow with only 62% of total debt projected to be paid off in 20 years.

The system's five-year, fiscal 2018-2022 CIP totals \$68.5 million and is expected to be almost entirely cash-funded, allowing debt levels to moderate in the near term. The CIP primarily funds R&R projects. Construction of the system's largest project, a biosolids processing facility, is nearly complete and should come online in late calendar year 2018. Management's financial

forecast includes additional (and manageable) O&M costs for cleaning the new facility, spread across several years.

#### SOLID LOCAL ECONOMY, STRONG MEMBERS

The county's economy is supported by its traditional underpinnings of agriculture, tourism, government, healthcare, and aerospace supplemented by growing bioscience and higher education sectors. Employment growth remains strong, with the unemployment rate averaging around the most recent Bureau of Labor Statistics level of 3.6% in September 2017.

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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 Rating Criteria (pub. 30 Nov 2017)

(<https://www.fitchratings.com/site/re/10010508>)

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