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Summary:

Spotsylvania County, Virginia; Water/Sewer

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Credit Profile		
US$63.0 mil wtr and swr sys rev rfdg bnds ser 2015 due 06/01/2037		
Long Term Rating	AA/Stable	New
Spotsylvania County wtr & swr		
Long Term Rating	AA/Stable	Affirmed
Spotsylvania Cnty wtr & swr		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Spotsylvania County, Va.'s series 2015 water and sewer system revenue refunding bonds. At the same time, we affirmed our 'AA' rating on the county's parity system revenue debt. The outlook is stable.

Standard & Poor's also withdrew its rating on the county's series 2004 bonds because the bonds were refunded.

In our opinion, the rating reflects the following credit strengths:

- A solid local area economy with accessibility to employment centers in northern Virginia and Washington, D.C.;
- Healthy financial position, as evidenced by maintaining adequate-to-good debt service coverage (DSC) and very strong liquidity levels; and
- Ample system resources and capacity to fulfill projected long-term customer requirements.

These credit strengths are offset, in part, by the system's:

- Continued reliance on availability fees, but to a lesser degree than in years past; and
- Capital improvement plan (CIP), which includes additional debt issuance.

Revenues of the county's water and sewer system secure the bonds. The county intends to use series 2015 bond proceeds to refund its series 2005 bonds and a portion of its series 2007 bonds for cost savings. The county privately placed its series 2013 bonds with SunTrust Bank. These direct-purchase bank bonds, however, are on parity with existing parity debt; therefore, they are subject to bond provisions in the bond ordinance. In addition, a separate credit agreement does not exist between the county and the bank. Therefore, we do not believe additional contingent liquidity risk exists.

Spotsylvania County's water and sewer system covers a service area of about 400 square miles and provides service to a mainly residential customer base with 30,054 water and 28,567 sewer accounts as of January 2015. Customer account growth has demonstrated annual growth of about 1% since 2013. Management projects accounts will continue to increase modestly by about 1% per year, through fiscal 2018. We consider the customer base diverse, given the 10 leading system customers, exclusive of the city of Fredericksburg, constitute about 5% of total 2014 operating revenues.

Spotsylvania County is in northeastern Virginia, bordering the city of Fredericksburg, about 55 miles from both Richmond and Washington, D.C., which are readily accessible by both rail and highway. The county is served by Interstate 95 and various local highways that provide for alternate routes in and around the county. The population has grown by what we consider a modest 1% annually since 2010; in our opinion, population growth should remain moderate over the next few years. County incomes remain above average, with median household effective buying income representing a very strong 149% of the national rate. Currently, roughly half the county's workforce commutes into areas outside its borders for employment, including federal government employment in D.C. and Richmond. The county's local economy continues to develop with substantial activity in the defense, technology, government, health care, recreational, and professional business service markets, as well as a number of significant transportation initiatives. Accessibility to a diverse economy has contributed to historically below-average unemployment, which was 4.7% in April 2015, remaining well below the nation's 5.1%.

The water system consists of two water treatment plants, the Ni River water treatment plant (WTP) and the Motts Run WTP, with a combined treatment capacity of 21 million gallons per day (mgd). Given 2014 average daily demands of 2.3 mgd and 7.6 mgd for each WTP, respectively, capacity is at 38% to 50%. Maximum daily demand in 2014 accounted for a combined 67% of WTP's capacity. Management anticipates ample water resources and capacity for the 20-year horizon.

The sewer system is comprised of three wastewater treatment plants (WWTPs), Massaponax, FMC, and Thornburg WWTPs, which provide total treatment capacity of 13.7 mgd. In aggregate, average daily flows for 2014 caused the system to run at about 62% of current capacity. The Massaponax WWTP was expanded in 2012 to 9.4 mgd from 8.0 mgd to accommodate future growth to build-out and therefore, management anticipates meeting sewer customer requirements into the foreseeable future. In addition to the expansion, management implemented nutrient control processes at the plant.

The board adopted a multiyear rate program in February 2013, which provides for annual rate increases through fiscal 2016. Effective July 1, 2015, an average monthly combined residential bill totaled $90.39 for 8,000 gallons' usage, a level we consider affordable at just 1.3% of the county's median household effective buying income. We believe the combined bill is projected to rise 4% and remain affordable, in our view, reaching about $94.27 in July 2016. Furthermore, rates remain competitive with nearby utility systems.

In our opinion, the system's financial profile remains good, characterized by adequate-to-good DSC and its very strong liquidity position. As calculated by Standard & Poor's and based on audited financial statements, operations provided DSC of a strong 1.52x in fiscal 2014 to an adequate 1.24x in fiscal 2013 and 1.23x in 2012. However, achieving such coverage levels continues to show some reliance on availability fees, which can be variable. On the exclusion of the availability fees, coverage margins decline to 1.16x in fiscal 2014, 0.97x in fiscal 2013, and 0.92x in fiscal 2012. Although there is still some reliance on these fees, it is reduced to about 11% of annual revenues in fiscal 2014 as compared with the mid-2000s when the fees constituted about 40%. A policy adopted January 2010 requires the county to work toward reducing system reliance on availability fees for operations and debt service, thereby precipitating the recent rate increases. Through fiscal 2020, management projects coverage to average about 1.3x and 1.1x with and without availability fees, respectively, assuming $62 million in additional debt issuance and rate adjustments are implemented as necessary through 2018.

System liquidity, in our view, remains stable and very strong. The system maintained $67 million, or the equivalent of four years of operating expenditures on hand, at the close of fiscal 2014. Management's policy is to maintain its utility fund balance equal to at least 100% of the average annual revenues for the past three fiscal years. Officials indicate the county intends to drawdown cash for capital purposes to a still very strong $51 million, or over two years of operating expenditures, in fiscal 2016.

We consider bond provisions adequate with a rate covenant equal to 1.15x senior-lien DSC and 1.0x total DSC, and an additional bonds test equal to 1.15x senior-lien maximum annual debt service (MADS) and 1.0x total DSC. In addition, a debt service reserve equal to MADS provides additional liquidity.

We consider the system's debt burden moderate with a debt to capitalization ratio equal to 47% in fiscal 2014. The system supports $132 million in total debt, and debt amortization is average with 47% of debt principal paid within 10 years. The board annually adopts a five-year CIP. The current five-year CIP covers fiscal years 2016 through 2020 and encompasses $75.6 million in total project costs with $56.5 million for water, $14.1 million for sewer, and $4.9 million for general projects. Officials intend to primarily fund its CIP with additional debt (83%) and cash from operations (15%). Officials have preliminary plans to issue roughly $17 million in 2017.

Outlook

The stable outlook reflects Standard & Poor's expectation that Spotsylvania County will continue to adjust rates as necessary to maintain its good financial profile and cash fund a portion of its CIP. Although the county will likely drawn down cash for capital purposes, we believe the system will still maintain its very strong liquidity position. In addition, we expect that the system will continue to reduce its reliance on availability fees to fund operations and debt service payments. Given these factors, we do not expect to lower the rating over the next two years. The system will need to establish a track record of consistently maintaining stronger DSC levels before a higher rating could be considered.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- . USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 2, 2015
- U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014
- 225. 2014 Review Of U.S. Municipal Water And Sewer Ratings: How They Correlate With Key Economic And Financial Ratios, May 12, 2014

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