MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to Spotsylvania County, VA's $63M Water & Sewer Rev. Bonds, Ser. 2015

Global Credit Research - 20 Jul 2015

Aa3 applies to $132.5M outstanding revenue debt

SPOTSYLVANIA (COUNTY OF) VA WATER AND SEWER ENTERPRISE
Combined Water & Sewer Enterprise
VA

Moody's Rating

ISSUE	RATING
Water And Sewer System Revenue Refunding Bonds Series 2015	Aa3

Sale Amount	$63,000,000
Expected Sale Date	07/29/15
Rating Description	Revenue: Government Enterprise

Moody's Outlook NOO

NEW YORK, July 20, 2015 --Moody's Investors Service has assigned a Aa3 rating to Spotsylvania County's (VA) $63 million Water and Sewer System Revenue Refunding Bonds, Series 2015. Concurrently, Moody's has affirmed the Aa3 rating affecting $132.5 million of outstanding revenue debt.

SUMMARY RATING RATIONALE

The Aa3 rating reflects the strong credit characteristics of the service area, the system's satisfactory financial performance with a reduced reliance on connection fees, diverse water supply, and manageable debt profile.

OUTLOOK

Outlooks are not usually assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

-Increase in debt service coverage to levels more in line with Aa2-rated entities

-Continued reduction in reliance on connection fees

-Decline in debt ratio

WHAT COULD MAKE THE RATING GO DOWN

-Decline in debt service coverage

-Weakened liquidity position

-Significant increase in debt ratio

STRENGTHS

-Strong service area

-Ample liquidity position

CHALLENGES

-Projected decline in coverage due to increasing capital and debt service costs

-Significant capital improvements to address system capacity needs

RECENT DEVELOPMENTS

Recent developments are included in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

SERVICE AREA AND SYSTEM CHARACTERISTICS: WELL MANAGED SYSTEM EXPECTING MODEST GROWTH; SUFFICIENT CAPACITY FOR THE LONG-TERM

The county's water and sewer system serves over 30,000 retail accounts, which are mostly centered in the northeastern section of Spotsylvania County (Aa2 positive), in addition to providing water and wastewater services on a wholesale basis to the City of Fredericksburg (Aa2). Located between the District of Columbia (Aa1 stable) and Richmond (Aa2 stable) metropolitan areas, the system's customer base experienced a 35.4% population increase over the last ten years (ending 2010), with annual expansion averaging approximately 3% over this period. Customer growth slowed substantially to an annual average of 1.2% (226 accounts) between 2009 and 2014, but is expected to improve slightly to an annual increase of approximately 250 accounts over the next five years.

In response to this slowing growth, and to improve coverage net of connection fees, the system has consistently implemented rate increases between fiscal 2007 and 2016 (except for fiscal 2010). We believe that current growth projections are reasonable and expect the system will continue to implement appropriate rate increases to offset any potential declines in growth and further reduce the system's reliance on connection fees. The system is well diversified, with a customer base that is approximately 94% residential and with the ten largest retail customers representing 5.2% of the operating revenues.

Capacity in both systems is projected to remain sufficient in the long-term given recent or planned system expansions. The county draws its water supply from two local rivers and three reservoirs, which are expected to provide ample water for the foreseeable future. The water system has a total treatment capacity of 21 MGD. The average daily water demands, including those of the City of Fredericksburg, were approximately 9.9 MGD (47.1% of total capacity) in fiscal 2014, with a maximum daily demand of approximately 14.2 MGD (67.6% of total capacity). Upon completion of the Ni River Water Treatment Plant to 12 MGD (27 MGD total system treatment capacity), management anticipates capacity to remain sufficient until at least 2040.

The sewer system's three wastewater treatment plants have the ability to treat 13.7 MGD of wastewater daily. With an average usage of 8.6 MGD (62.9% of total capacity) in fiscal 2014, capacity is expected to remain sufficient through 2040. The county recently expanded the Massaponax Waste Water Treatment Plant from 8 MGD to 9.4 MGD in 2012, and could easily be expanded to 16 MGD if customer growth outpaced the county's estimates. Given the county's willingness to finance expansions to accommodate further needed capacity, we believe the system will have ample treatment capacity to support ongoing, albeit slowed, customer growth.

DEBT SERVICE COVERAGE AND LIQUIDITY: SATISFACTORY COVERAGE AND AMPLE LIQUIDITY SUPPORTED BY TIMELY RATE INCREASES; REDUCED RELIANCE ON CONNECTION FEES

The system is expected to maintain satisfactory financial operations based upon a demonstrated willingness to increase user charges to reduce reliance on economically sensitive connection fee revenues for operational expenditures. The county has implemented annual rate increases in fiscal 2007 through fiscal 2016 (excluding fiscal 2010). Over the last five years (2012-2016), base rate increases have averaged at 17.6%, while user rates (tiered structure) have ranged between 0% and 4%. Rate increases for additional years have not yet been adopted, but management expects to adopt new rates for fiscal 2017, 2018, and 2019 as part of the fiscal 2017 budget process. Overall, we believe that these planned annual rate increases are a key element in ensuring the continued stability of the system's finances.

As rates have continued to increase, coverage (including connection fees) has also grown to a high of 1.61 times in fiscal 2014 to a low of 1.33 times in fiscal 2011. In addition, the system has continued to reduce their reliance on connection fees to cover operating costs. Debt service coverage (net of connection fees) has improved to 1.23 times in fiscal 2014 from 0.88 times in fiscal 2009. Maximum Annual Debt Service (MADS) coverage has also improved to 1.45 times in fiscal 2014.

The system's projections for fiscal 2015 estimate coverage at 1.50 times, despite an expected 12.6% decrease in connection fees. Net of connection fees, debt service would decline to 1.19 times. Over the next five years, annual debt service coverage is projected to remain between 1.30 and 1.40 times, and between 1.10 and 1.25 times net of connection fees. The projected decline in coverage is due to increased capital and debt service costs. Going forward, the system's reduced reliance on connection fees and maintenance of healthy debt service coverage will remain key rating factors.

Liquidity

The system's financial health is further supported by substantial unrestricted reserves, which averaged over 355% of annual operations and maintenance expenditures over the last five years. Most recently, the county ended fiscal 2014 with $67.9 million of unrestricted cash and investments, equating to a very ample 1,486 days cash on hand. While 16% of the system's capital improvement plan is cash-funded, reserves are expected to remain healthy as this only equates to a moderate 18% of the system's current cash position and will be financed over a five-year period.

DEBT AND LEGAL COVENANTS: LARGE CAPITAL PROGRAM DEPENDENT UPON FUTURE RATING INCREASES; SATISFACTORY LEGAL PROVISIONS

While the system's average debt ratio of 36.9% is projected to increase in the near-term due to capital needs, we expect it will remain manageable as rates are anticipated to increase in line with debt service costs to maintain satisfactory coverage levels. The system's debt ratio increased to 36.9% (2014) from 32.8% (2010) due to ongoing and recently completed capital improvement projects. The system's five-year (2016-2020) capital improvement plan totals approximately $75.7 million, with 83% to be bond funded. Given the expected debt issuance, the debt ratio would increase to a higher 46% on a pro-forma basis. Some of the major projects included in the plan include an expansion of the Ni River Water Treatment Plant to 12 MGD ($24.9 million) and connecting Hunting Run and Ni River for a future water source ($16.5 million). Debt amortization is average with 47.2% of principal repaid within 10 years, reflecting the useful life of the financed assets.

Debt Structure

The indenture requires rates be set to generate net revenues sufficient to cover 1.15 times senior lien annual debt service and 1.0 times all debt service (inclusive of connection fees). Additional parity debt may be issued provided 1) satisfaction of the rate covenant in 12 consecutive of the prior 24 months inclusive of maximum annual debt service on existing debt and any adopted rate increases scheduled to take effect upon issuance of the bonds or 2) satisfaction of the rate covenant using pro-forma calculations (based on system expansion) for two full fiscal years following project completion, provided that projected new connection fees do not exceed the actual average number of customers paying connection fees during the three prior fiscal years multiplied by the expected amount of each connection fee. The indenture facilitates issuance of subordinate debt provided that adopted rate increases meet rate covenants immediately upon the issuance of subordinate debt. Currently, all of the system's outstanding debt is senior lien, including the current issue. In addition, the system's current debt issue is not secured by a debt service reserve fund; however we believe the absence of a reserve fund is offset by the system's very strong cash position.

Debt-Related Derivatives

The system is not party to any derivative agreements.

MANAGEMENT AND GOVERNANCE

The system is managed by the Director of Utilities, who reports to the County Administrator, and ultimately the County Board of Supervisors. The board has full rate setting authority, and has demonstrated strong willingness to raise rates in pace with growing O&M and capital needs.

KEY STATISTICS

-Asset Condition (Remaining Useful Life), 2014: 33 years

-System Size (O&M in 000s), 2014: $57,076

-Service Area Wealth (MFI), 2012: 98.5%

-Annual Debt Service Coverage, 2014: 2.01 times

-Days Cash on Hand, 2014: 1,593 days

-Debt to Operating Revenues, 2014: 3.84 times

-Rate Covenant: 1.20 times annual debt service

-Debt Service Reserve Requirement: No reserve fund

-Total Debt Outstanding, 2014: $468 million

OBLIGOR PROFILE

The systems is a combined water and sewer utility servicing over 30,000 water and sewer connections located primarily in the northeastern section of Spotsylvania County. The system is also a primary provider of water to the City of Fredericksburg.

LEGAL SECURITY

The bonds are secured by a first lien on net revenues of the water and sewer system.

USE OF PROCEEDS

Proceeds from the bonds will refund the Series 2005 and Series 2007 bonds for an estimated net present value savings of $2.9 million, or 11.4% of refunded principal, with no extension of maturity.

RATING METHODOLOGY

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

The following information supplements Disclosure 10 ("Information Relating to Conflicts of Interest as required by Paragraph (a)(1)(ii)(J) of SEC Rule 17g-7") in the regulatory disclosures made at the ratings tab on the issuer/entity page on www.moodys.com for each credit rating:

Moody's was not paid for services other than determining a credit rating in the most recently ended fiscal year by the person that paid Moody's to determine this credit rating.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Jennifer Diercksen
Lead Analyst

Public Finance Group
Moody's Investors Service

Tiphany J. Lee
Additional Contact
Public Finance Group
Moody's Investors Service

Edward Damutz
Additional Contact
Public Finance Group
Moody's Investors Service

Robert Weber
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.