

## CREDIT OPINION

21 September 2017

New Issue

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# Johnson County Water District 1, KS

New Issue: Moody's Upgrades Johnson County Water District 1's (KS) Water Revenue Bonds to Aaa; Outlook Remains Stable

## Summary Rating Rationale

Moody's Investors Service has assigned a Aaa rating to Johnson County Water District 1's (KS) \$107.4 million Water Revenue Refunding Bonds, Series 2017A and \$38.6 million Water Revenue Bonds, Series 2017B. Concurrently, we have affirmed the Aaa rating on the Series 2007 bonds and upgraded the district's Series 2009, 2010, 2012, and 2014 bonds to Aaa from Aa1. All of the district's Series 2007 bonds will be refunded with this issuance and post sale all of the district's outstanding bonds will be on parity.

The Aaa rating reflects the district's large, stable, and affluent customer base, well-managed financial operations including above average liquidity and coverage levels, and manageable debt burden with satisfactory legal covenants. The outlook remains stable.

## Credit Strengths

- » Large, stable, and affluent customer base
- » Above average liquidity and debt service coverage levels
- » Autonomous rate setting authority
- » Manageable debt burden

## Credit Challenges

- » Slightly declining water consumption

## Rating Outlook

The stable outlook reflects that the system is the primary provider in a large and stable service area, as well as the expectation that the financial profile will remain healthy and the debt burden manageable despite a capital improvement plan that calls for cash and debt funding of large expenditures over the medium term.

## Factors that Could Lead to a Downgrade

- » Material erosion of the system's customer base
- » Pressured financial operations leading to declines in debt service coverage and liquidity

## Key Indicators

Exhibit 1

<b>Johnson County Water District 1, KS</b>					
<b>System Characteristics</b>					
Asset Condition (Net Fixed Assets/ Annual Depreciation)	42 years				
System Size - O&M (in \$000s)	48,082				
Service Area Wealth: MFI % of USmedian	143.7%				
<b>Legal Provisions</b>					
Rate Covenant (x)	1.25				
Debt Service Reserve Requirement	DSRF funded at lesser of standard 3-prong test (Aa)				
<b>Management</b>					
Rate Management	Aaa				
Regulatory Compliance and Capital Planning	Aaa				
<b>Financial Strength</b>					
	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Operating Revenue (\$000)	123,492	109,778	108,720	105,944	121,109
O&M (\$000)	48,870	47,214	48,770	46,817	48,082
Net Funded Debt (\$000)	214,724	194,825	261,603	246,942	233,057
Annual Debt Service Coverage (x)	3.57	2.49	1.87	1.95	2.57
Cash on Hand	583 days	617 days	836 days	811 days	811 days
Debt to Operating Revenues (x)	1.7x	1.8x	2.4x	2.3x	1.9x

Source: Moody's Investors Service; Johnson County Water District 1's audited financial statements fiscal years 2012-2016

## Detailed Rating Considerations

### Service Area and System Characteristics: Large, Stable, and Affluent Customer Base

The district's service area will remain stable in the near term given the strength of the local economy. [Johnson County](#) (Aaa stable) has experienced significant growth in recent years with taxable values reaching \$67.1 billion in 2016, a 5.9% increase from the prior year. Approximately 40% of the district's service area remains available for development and development activity has picked up in the last few years, primarily in the southern and western portions, although redevelopment of existing areas is also driving growth. Also ongoing is the development of a large intermodal facility in the southwestern portion of the county, which is adding value as well as ancillary facilities and development.

The system's customer base remains stable and diverse. The district serves several highly rated municipalities including [Leawood](#) (Aaa stable), [Lenexa](#) (Aaa stable), [Mission Hills](#) (Aaa), [Olathe](#) (Aa1), [Overland Park](#) (Aaa stable), [Prairie Village](#) (Aaa stable) and [Shawnee](#) (Aa1). Residential accounts comprise 91% of the district's customer base and 63% of total water sales while commercial customers comprise the remainder. Treated water service is provided to approximately 145,000 retail customers; total water customers have increased 5% since fiscal 2010 in modest annual increments. In fiscal 2016 the system's ten largest customers accounted for just 3% of total revenues and included several cities, school districts, and major commercial entities. Unemployment of 3.5% in Johnson County in July 2017 compared favorably with state (4.3%) and national (4.6%) levels during the same period. Resident wealth levels remain strong with median family income equal to 143.7% of the national average. Management does not expect any significant change to top customers in the near-term.

The district's water supply is provided by the Kansas (48% of supply in 2016) and Missouri (52%) rivers. The district is permitted to average utilization of 134.1 million gallons per day (mgd); the average demand in 2016 was 59.4 mgd, representing 44% of capacity.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

Average residential winter consumption has declined in recent years, to 147 gpd in 2017 from 198 gpd in 1996, a 26% decline. Management reports the water system is in compliance with all state and federal environmental regulations.

### **Debt Service Coverage and Liquidity: Above Average Liquidity and Coverage to Continue**

The district's financial performance remains stable as annual rate increases have bolstered revenues; management continues to closely monitor expenditures. Management has exclusive statutory authority to set rates and charges for water service and is free from any local, state, or federal authority to regulate rates or charges. The district's board annually reviews and approves rates that provide resources necessary to meet budgeted expenditures and designated coverage levels. The district utilizes a 20-year financial model for budgeting and rate setting that includes a 1% reduction in annual residential consumption, anticipated capital improvement costs, debt service requirements, rate increases, and debt service coverage. The annual budget and rates are designed to provide a minimum 2.0 times debt service coverage, exclusive of system development charges.

From fiscal 2013-2017, annual rate increase averaged 3% with the same level of increases projected through the medium term. In fiscal 2016, operating revenues, inclusive of system development charges, totaled \$121.1 million and increased 14% from 2015 while expenditures increased slightly by 2.7%. Revenues were primarily derived from water sales (91%). The system produced net revenues of \$73 million, a healthy 4.61 times coverage of senior lien annual debt service and 2.97 times coverage of total annual debt service. Exclusive of system development charges, net revenues provided 3.99 times coverage of senior lien annual debt service and 2.57 times coverage of total annual debt service.

Officials report year-to-date performance in line with the fiscal 2017 budget. Consumption remains in line with projections and there have been no major challenges to operations or any significant expenditure variances.

### **LIQUIDITY**

The district's liquidity remains a significant strength of the system. At fiscal year-end 2016, cash and investments were approximately \$107 million, providing a robust 811 days cash on hand. Reserves include additional stability via an operating contingency reserve and a rate stabilization reserve. District liquidity also includes approximately \$60 million in reserve to fund the district's capital plan. Over the next five years, the district anticipates cash funding approximately 75% of the \$374 million in projected capital spending. Much of the paygo funding will come from incremental water rate increases, system development charges, and developer contributions.

### **Debt and Legal Covenants: Manageable Debt Burden to Continue**

The debt profile will remain manageable given a lack of near term issuance plans in addition to planned, though not codified, rate increases. Post sale, the district will have \$267 million in parity debt outstanding. At fiscal year-end 2016, the district's debt ratio was below average at 20.7%. Management reports the district does not anticipate issuing additional debt until 2024.

Legal provisions include a rate covenant of 1.25 times on all debt. We note that all debt issued after the Series 2007 bonds was issued as subordinate debt the current refunding of the 2007 bonds will place all outstanding debt on parity. Additional bonds may be issued on parity if average annual net revenues for the two preceding fiscal years provide coverage of 1.25 times MADS for existing and additional bonds. Additionally, so long as the 2017 bonds remain outstanding, the district may not issue any debt senior to the 2017 bonds. Each outstanding series of bonds benefits from an individual cash funded reserve account equal to 5% of the par amount issued.

The 2017 Bond Resolution, expected to be adopted on October 10, 2017, includes three amendments to the 2009, 2010, 2012, and 2014 Bond Resolutions. The 2017 Bond Resolution adds a cure period should net revenues fail to provide 125% of annual debt service, defines what constitutes an event of default (remedies for bondholders unchanged), and amends the rate covenant, senior lien bonds, and parity bond sections of the previous resolutions to match the 2017 Bond Resolution. The 2017 bonds are being issued on parity with the 2009, 2010, 2012, and 2014 issuances.

### **DEBT STRUCTURE**

All of the system's debt is fixed rate and matures over the long term (final maturity fiscal 2042). Principal amortization is slow with 45.8% of the total outstanding principal satisfied over ten years, however, we note amortization matches the useful life of the assets.

### **DEBT-RELATED DERIVATIVES**

The district is not party to any interest rate swaps or other derivative agreements.

## PENSIONS AND OPEB

The district participates in the Water District No. 1 of Johnson County Sixth Revised Retirement Plan and the Cash Balance Plan, a single-employer defined benefit pension plan administered by the district. In fiscal 2016 the system contributed its actuarially determined contribution of \$2.7 million in fiscal 2016, approximately 2.4% of operating revenues. The district reported a net pension liability of \$12.8 million for fiscal 2016.

## Management and Governance

Management of the water system will remain strong, demonstrated by a history of appropriate and timely rate setting measures, prudent and conservative budgeting and forecasting of revenues, as well as maintenance of multiyear planning. The district is governed by a 7-member board elected to staggered 4-year terms. Currently, 4 of the 7 members have served on the board for more than 20 years with an average length of service of 15 years.

## Legal Security

The Bonds are special, limited obligations of the district payable solely from and secured by a pledge of and lien on the pledged revenues of the system.

## Use of Proceeds

Proceeds of the 2017A issuance, together with moneys currently held in the 2007 Bond Reserve Account and the 2007 Principal and Interest Account will be applied to currently refund all of the outstanding Series 2007 Bonds for estimated savings with no extension of maturity.

Proceeds of the 2017B issuance will fund the construction of improvements at the Hansen Water Treatment Plant and other system improvements. The district intends to reimburse itself for approximately \$12 million in improvement costs incurred prior to issuance of the 2017B bonds.

## Obligor Profile

The district services 145,000 water customers in a 272 square mile service area predominantly located in Johnson County, KS.

## Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 2

### Johnson County Water District 1, KS

Issue	Rating
Water Revenue Bonds, Series 2017B	Aaa
Rating Type	Underlying LT
Sale Amount	\$38,640,000
Expected Sale Date	10/17/2017
Rating Description	Revenue: Government Enterprise
Water Revenue Refunding Bonds, Series 2017A	Aaa
Rating Type	Underlying LT
Sale Amount	\$107,415,000
Expected Sale Date	10/17/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

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