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Summary:

St. Joseph, Missouri; Water/Sewer

Primary Credit Analyst:

Gregory Dziubinski, Chicago (312) 233-7085; gregory.dziubinski@spglobal.com

Secondary Contact:

Scott D Garrigan, New York (1) 312-233-7014; scott.garrigan@spglobal.com

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Credit Profile

US\$16.0 mil sewerage sys rev bnds ser 2018 due 06/01/2038

<i>Long Term Rating</i>	A+/Negative	New
St. Joseph WTRSWR		
<i>Long Term Rating</i>	A+/Negative	Outlook Revised

Rationale

S&P Global Ratings revised its outlook to negative from stable and affirmed its 'A+' rating on St. Joseph, Mo.'s sewerage system revenue bonds. At the same time, S&P Global Ratings assigned its 'A+' long-term rating to the city's series 2018 sewerage system revenue bonds. The rating reflects, in our opinion, the combination of a strong enterprise risk profile and a strong financial risk profile.

The negative outlook reflects, in our opinion, volatile all-in debt service coverage (DSC) and liquidity, coupled with the financial pressure on these figures from rising debt service and capital needs as the system balances rate increases in a way to keep rates affordable.

The enterprise risk profile reflects our view of the system's:

- Service area participation in the weak St. Joseph, Mo., metropolitan statistical area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Currently affordable rates when compared to the city's median household effective buying income and Buchanan County's poverty rate; and
- Good operational management practices and policies.

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

- Adequate all-in DSC,
- Volatile liquidity position,
- Vulnerable leverage position, and
- Good financial management practices and policies.

The 2018 sewerage works revenue bonds will provide funds to extend and improve the system and to pay costs related to the issuance of the bonds. The 2018 bonds represent the third installment of \$190 million of sewerage system revenue bonds authorized by voters in 2015.

The 2018 bonds are secured by net revenues of the city's sewerage works system. Bond provisions, in our opinion, are

adequate and include:

A rate covenant requiring annual DSC of 1.1x, and

An additional bonds test requiring pro forma coverage of new and existing debt by 1.1x.

The city has established a debt service reserve fund for previously issued bonds; however, the city has chosen not to establish a debt service reserve fund for the 2018 bonds, which we view as a credit weakness given the volatile and fluctuating cash position of the utility.

Enterprise risk

St. Joseph encompasses 45 square miles of Buchanan County and has an estimated population of 77,000. The local economy is relatively weak, with median household effective buying income at about 84% of the national level. The current unemployment rate is about 3.0%, which is below state and national averages. Although some residents commute 50 miles to the Kansas City metropolitan area for employment, most residents are employed within the city. Residents benefit, in our opinion, from participation in the diverse St. Joseph metropolitan statistical area, which spans portions of Missouri and Kansas. The leading employers are Mosaic Life Care (4,072 employees), followed by Triumph Foods (2,900) and the St. Joseph School District (1,853).

The sewer system, which is separate from the privately operated water system, provides service to approximately 26,000 accounts. There is no concentration in the customer base, with more than 90% of the accounts classified as single-family residential. Projections show little or no growth in the base. The system consists of one treatment facility, six pumping stations, and more than 400 miles of sewers. The treatment facility currently treats, on average, about 15 million gallons per day (mgd), and can treat up to 54 mgd.

In our opinion, the current wastewater rates are affordable, with an average bill of about \$60.00 for 400 cubic feet of usage. (Water service is billed separately.) The city most recently raised rates by 11% on July 1, 2017. In order to support rising debt service costs and additional capital needs, management projects increasing the rate by approximately 3% in fiscal years 2018 and 2019. We note that additional rate increases may pressure affordability in the future, but may be needed to preserve the financial position of the utility.

Based on our OMA, we view the operational management of the system as good. The utility's capacity is adequate to meet average flow needs; however, peak wet weather flows have resulted in combined system overflows (CSOs), leading to regulatory actions against the utility. St. Joseph entered into a consent decree with the U.S. Environmental Protection Agency. Under the CSO long-term control plan, the city is addressing its regulatory needs in conjunction with its routine capital needs. Through 2022, the city's total capital needs of more than \$68 million are being funded with current and future bond proceeds. The city utilizes various websites, social media, and press outlets to reach out to customers regarding utility strategies and long-term needs. A rate consultant completes a formal rate study annually, and management has proven its willingness to raise rates in order to support operating, capital, and debt needs.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Financial risk

The system's financial profile has weakened in recent years. In fiscal 2017, operating revenues totaled \$28.2 million, and were offset by operating expenditures of \$15.1 million, including transfers out of the wastewater fund. We note that our calculation of operating expenses excludes approximately \$3.6 million in noncash pension-related expenses. In addition to revenue bond debt service, the system also pays debt service related to appropriation bonds and state revolving fund loans. Combined, these obligations totaled \$12.1 million in 2017. Net revenues of \$13.7 million provided coverage of 1.1x. Rising operating expenses and debt service payments have resulted in lower all-in DSC. All-in DSC was 1.7x and 2.1x in fiscal years 2013 and 2014, respectively, when the utility was servicing debt payments of about \$5 million. Since fiscal 2014, net revenues available for debt service rose to \$13.7 million from \$8.6 million; however, debt service obligations also increased to \$12.1 million from \$5.0 million.

The system's liquidity has been volatile in recent years. Unrestricted cash fluctuated to \$9.7 million (235 days' cash) in 2017 from \$2.8 million (72 days' cash) in 2016 and \$8.6 million (219 days' cash) in 2015. Management expects to spend down unrestricted cash in fiscal 2018, and we believe unrestricted cash will stabilize at a minimum of 60 days' cash.

The system is currently responsible for about \$157.6 million of bonds outstanding, including system revenue bonds, state loans, special revenue bonds, and appropriation-backed bonds. We consider the leverage of the system to be vulnerable, with a debt-to-capitalization ratio of 69%. We expect the utility's leverage to remain vulnerable as the utility issues additional debt to support its capital needs.

Based on our financial management assessment (FMA), we view the financial management of the system as good. Management highlights include the use of historical trends for budget and operational performance analysis; quarterly budget-to-actual and investment reports to the council; an investment policy stipulating a minimum of 60 days' operating reserves; and a five-year capital improvement and financial projection plan, which is updated annually and includes funding sources of planned projects. The city does have a debt management policy.

Outlook

The negative outlook represents, in our opinion, a one-in-three chance that we could lower the rating over the outlook period. The lack of stability in relation to the utility's financial profile may warrant a lower rating should all-in DSC and liquidity continue to be volatile. Additionally, we expect additional capital needs and rising debt service to continue to pressure the financial profile, and we may lower the rating should all-in DSC and liquidity stabilize below levels we consider commensurate with the current rating.

Upside scenario

We could revise the outlook to stable should the system's all-in DSC and liquidity stabilize at levels we consider comparable to those of similarly rated peers.

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