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CREDIT OPINION
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Omaha Metro.Util.Dist. NE Gas Ent.

Update to credit analysis

Summary

The Metropolitan Utility District of Omaha's gas enterprise system (Aa2 stable) benefits from a number of credit strengths, including a stable service base and lack of competition. Furthermore, the gas system has a modest debt burden with fairly limited future borrowing plans which will keep annual debt service coverage strong. District management maintains independent rate setting authority and has the ability to pass on increases in natural gas commodity prices to its own customers on a monthly basis. Additionally, the system's liquidity is solid and offsets an expectation that an upcoming issuance of $32.2 million in revenue bonds will not benefit from a mandated debt service reserve fund.

Credit strengths

» Stable service area with average user base income characteristics

» Gas system does not face competition due to franchise service agreement

» Competitive rates and ability to pass on increases in natural gas prices

» Healthy liquidity, strong debt service coverage and modest debt to revenue ratio

» Unregulated rate setting authority

Credit challenges

» Base rate increases historically happen only once per year

» Volatility of natural gas commodity prices

» An extensive capital improvement plan to replace all remaining cast iron gas mains will gradually raise the system's leverage

Rating outlook

The stable outlook on the gas system reflects the district's sound financial metrics that provide cushion against potential contraction of the user base or significant increases in delinquencies.

Factors that could lead to an upgrade

» Robust residential customer growth that further improves the gas system's healthy metrics

» Sustained improvement to the system's cash on hand

» Successful completion of the system's capital program without pressuring financial metrics

Factors that could lead to a downgrade

» Material contraction of the gas system's customer base or significant increase in delinquencies that threaten the ability to recover costs

» Significant declines to available cash on hand

» Substantial increases in the system's leverage

Key indicators

Exhibit 1

Omaha Metropolitan Utility District, Gas Enterprise, NE					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	28 years				
System Size - O&M ($000)	$166,397				
Service Area Wealth: MFI % of US median	108.90%				
Legal Provisions					
Rate Covenant (x)	1.20x				
Debt Service Reserve Requirement	--				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2013	2014	2015	2016	2017
Operating Revenue ($000)	$235,758	$274,768	$195,980	$176,614	$203,680
System Size - O&M ($000)	$190,413	$229,136	$160,256	$139,394	$161,289
Net Revenues ($000)	$41,699	$41,091	$31,172	$34,179	$38,946
Net Funded Debt ($000)	$1,597	$1,386	$1,169	$947	$719
Annual Debt Service ($000)	$249	$249	$249	$249	$249
Annual Debt Service Coverage (x)	167.5x	165.0x	125.2x	137.3x	156.4x
Cash on Hand	92 days	106 days	220 days	267 days	216 days
Debt to Operating Revenues (x)	0.0x	0.0x	0.0x	0.0x	0.0x

On June 13, 2018 the district plans to sell $32.2 million in senior lien gas revenue bonds. The borrowing will increase the gas system's debt to operating revenues to 0.15x. Fiscal 2017 operating revenues provide for 17.2x projected maximum annual debt service (MADS) coverage.
Source: Moody's Municipal Financial Ratio Analysis

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Profile

The Metropolitan Utilities District of Omaha was created in the early 1900s as a political subdivision by the State of Nebraska (Aa1 stable) to provide water and gas service to the Omaha metropolitan area. The district is governed by an elected Board of Directors that serve six year terms and is the only municipal utility district in the state.

Detailed credit considerations

Service area and system characteristics: stable service area covering the majority of the Omaha MSA

We expect the gas system's service area and customer base will continue to expand at a measured pace given the growth of the broader Omaha (Aa2 stable) metropolitan area. Covering 242 square miles, including parts of Douglas (Aaa), Sarpy (Aaa stable), and Washington Counties, the system provides natural gas service to 229,365 customers, representing a population of approximately 633,000. Over the past five years the system's number of customers increased at just under 1% per year, a pace that district officials expect to continue. The customer base is diverse with the top ten users comprising 8.7% of fiscal 2017 revenue and 17.6% of volume.

The regional economy is diverse as well, supported by a number of institutions and four Fortune 500 companies. Unemployment rates are notably low, with the March 2018 rate for Douglas County standing at 3.2%. Resident income levels are slightly above average, with Douglas County's median family income estimated at 107.4% of the US. While gas rates compare favorably to other major metropolitan systems, we note the increasing tax, fee, and rate demands on the customer base, including large expected rate increases for the City of Omaha's Sanitary Sewerage System (Aa2 stable) to meet its ongoing CSO regulatory issues. Still, bad debt expense is minimal at 0.2% of revenue.

The district owns and operates one liquefied natural gas (LNG) plant and two propane-air plants, and the system has over 2,832 miles of gas mains and ten town border stations. Gas is supplied through various contracts, including natural gas prepay transactions that provide a significant discount to the natural gas index price. Approximately 40% of the system's gas is supplied through three contracts with the Central Plains Energy Project (CPEP) expiring in 2020, 2039, and 2042. Additionally, in late 2017 and early 2018, the district entered into three 30 year gas purchase agreements which together will provide approximately 11% of annual gas requirements. The agreements allow for fixed discounts to market prices ranging from $0.20 to $0.37 per Dth. The remaining 49% of the district's gas requirements are purchased via various market-based gas supply contracts, with a variety of suppliers.

Debt service coverage and liquidity: very strong coverage and solid system liquidity

The gas system's financial condition will remain healthy as added costs associated with new capital borrowing are low. Furthermore, the distribution system can easily pass on any rising gas commodity prices to costumers through monthly adjustments, and the district's Board of Directors has independent rate setting authority. The district's revenue structure includes a moderate portion of fixed charges, including an infrastructure replacement charge that collects approximately $13 million in annual revenue to finance pay-as-you-go capital projects.

The system's fiscal 2017 net revenue would provide 17.2x coverage on maximum annual debt service (MADS) on the system's upcoming revenue backed bond issuance. While management expects to issue an additional $38 million in senior lien revenue bonds in 2021, we anticipate net revenue coverage to remain robust. In addition to the gas system, the district operates the region's water enterprise system (revenue debt rated Aa2 stable) which also has a strong credit profile. While the water and gas systems have managerial overlap, and share in the retiree liability burden, each enterprise is operated through separate funds. For more information on the performance of the water system, please refer to our report dated October 16, 2017.

LIQUIDITY

The system's liquidity is solid and has improved since close of fiscal 2013 in which it had 92 days cash on hand. Following three base rate increases since 2012, including the most recent increase of 12% effective January 1, 2017, the system boosted cash, closing fiscal 2017 with 216 days cash on hand. Management reports an internal goal to maintain cash at an amount equal to 180 days of operating expenses, which includes the cost of natural gas.

Debt and legal covenants: modest debt ratio, moderate exposure to unfunded legacy liabilities

The gas system's low debt burden is a credit strength. Following the upcoming issuance of revenue bonds the system's debt to operating revenue ratio will stand at a modest 0.15x. The system cash finances most of its ongoing capital through cash on hand, though management anticipates borrowing in 2021 to complete its cast iron gas main replacement program. The current asset condition of the gas system equates to a useful life of 28 years.

DEBT STRUCTURE

The upcoming revenue bonds will be fixed rate with an even debt service schedule through 2038. In addition to the revenue bonds, the district entered into a Business Loan Agreement on December 16, 2010 for $2.2 million. The low-interest loan is an unsecured obligation obtained from the Nebraska Energy Office and its lending partner. The loan was used to fund the construction of CNG stations and matures December 15, 2020. The loan has a level debt service schedule of approximately $250,000 per year and the interest rate is fixed at 2.5%. The district does not plan to invest additional capital into CNG station construction projects going forward.

DEBT-RELATED DERIVATIVES

The district is not a party to any debt-related derivative products.

PENSIONS AND OPEB

The district sponsors a single-employer defined benefit pension plan for all full-time employees of the water and gas departments, administered by a third-party administrator. An employee of the district is eligible for coverage at the time of employment and vesting is achieved upon the completion of five years of service. Membership in the pension plan was 836 active employee participants and 648 beneficiaries as of January 1, 2017, at which time the plan had a funded ratio of 91%. In addition to pension liabilities the district has a $200.7 million unfunded actuarial accrued liability (UAAL) associated with its defined benefit other post-employment benefit (OPEB) healthcare plan. The district recently began prefunding its OPEB plan which will likely lead to moderate future cost increases to cut into the accrued liability. Contributions supported by both the gas and water funds for pension and OPEB totaled $22.1 million in fiscal 2017.

Management and governance: Board of Directors have unlimited rate setting authority and oversight of enterprises

The Board of the Metropolitan Utilities District has unlimited rate setting authority. The majority of the district's employees are represented by one local union. The current contract is settled through March 31, 2023. Under Nebraska law, unions and their members are not permitted to strike or otherwise disrupt the operations of a public utility service.

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