

CREDIT OPINION

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Omaha Metropolitan Util. Dist., NE Water Ent.

Update to credit analysis

Summary

The [Metropolitan Utility District of Omaha's water enterprise](#) (Aa2 stable) benefits from a number of credit strengths, including a stable service base and lack of competition. Furthermore, the water system's strong asset condition, moderate debt burden, and healthy annual debt service coverage are likely to be sustained through management's forward looking rate setting and capital planning. Additionally, management has actively worked towards improving the water system's liquidity in recent years, and cash now sits in excess of one year's operations.

Credit strengths

- » Growing service area that includes the economically strong Omaha metro area
- » Strong management team indicated by recent improvement in the district's liquidity and debt service coverage
- » Unlimited rate setting authority vested in the district's Board of Directors

Credit challenges

- » Customer base may be rate sensitive due to debt service obligations from overlapping entities

Rating outlook

The stable outlook reflects our expectation that the district's growing service area and strong rate setting record will continue to support healthy debt service coverage and liquidity.

Factors that could lead to an upgrade

- » Material growth in the water system's service area and strengthening of resident income
- » Strengthening of the water system's debt service coverage
- » Successful completion of the system's capital program that does not weaken other financial metrics

Factors that could lead to a downgrade

- » Material contraction of the water system's customer base or significant declines in consumption that puts downward pressure on revenue

- » Significantly narrowed debt service coverage or liquidity
- » Substantial growth in leverage of net revenue

Key indicators

Exhibit 1

Omaha Metropolitan Utilities District, Water Enterprise, NE					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	60 years				
System Size - O&M (\$000)	\$73,117				
Service Area Wealth: MFI % of US median	108.90%				
Legal Provisions					
Rate Covenant (x)	1.20x				
Debt Service Reserve Requirement	--				
Management					
Rate Management	A				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2013	2014	2015	2016	2017
Operating Revenue (\$000)	\$106,199	\$106,047	\$102,964	\$115,095	\$122,328
System Size - O&M (\$000)	\$67,854	\$69,812	\$66,147	\$67,506	\$73,117
Net Revenues (\$000)	\$38,345	\$36,339	\$36,927	\$47,691	\$49,334
Net Funded Debt (\$000)	\$204,743	\$197,141	\$224,251	\$216,662	\$207,186
Annual Debt Service (\$000)	\$15,167	\$14,849	\$14,741	\$15,696	\$16,127
Annual Debt Service Coverage (x)	2.5x	2.4x	2.5x	3.0x	3.1x
Cash on Hand	90 days	79 days	160 days	266 days	378 days
Debt to Operating Revenues (x)	1.9x	1.9x	2.2x	1.9x	1.7x

On August 23, 2018 the district plans to sell \$37.6 million in senior lien water revenue bonds. The borrowing will increase the water system's debt to operating revenues to 2.0x. Fiscal 2017 operating revenues provide for 2.4x projected maximum annual debt service (MADS) coverage

Source: District's audited financial statements, Moody's Investors Service, US Census Bureau

Profile

The Omaha Metropolitan Utilities District 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: expanding Omaha metro area anchors growing customer base

We expect the water 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 288 square miles, including parts of [Douglas](#) (Aaa), [Sarpy](#) (Aaa stable), and Washington Counties, the system provides water service to 214,142 customers, representing a population of nearly 600,000 residents. Over the past five years the system's number of customers increased at just under 1.1% per year, a pace that district officials expect to continue. The customer base is diverse with the top fifteen users comprising 6.2% of fiscal 2017 revenue and 11.8% of volume.

The regional economy is diverse as well, supported by a number of institutions and four Fortune 500 companies. Unemployment is low, with the May 2018 rate for Douglas County standing at 3.0%. Resident income is slightly above average, with Douglas County's median family income estimated at 108.9% of the US. Although we note the service area's likely ability to absorb future rate increases,

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the increasing tax, fee, and rate demands on the customer base are on the rise. For instance, the [Omaha's Sanitary Sewerage System](#) (Aa2 stable) plans to increase its rates to meet its ongoing CSO regulatory issues. We anticipate the district's management to take a measured approach to rate increases to avoid the possibility of future rate shocks.

Three water treatment plants provide a combined maximum capacity of approximately 318 million gallons per day (MGD). We estimate the water system's asset condition at a strong 60 years of useful life, based on audited information. The water system's current capacity is healthy with average daily demand measuring approximately 90 MGD. Water is provided through well fields located on the Platte River and surface water from the Missouri River.

Debt service coverage and liquidity: water rate increases spur improvement in debt service and liquidity

Debt service coverage and liquidity are expected to remain healthy. The system's fiscal 2017 net revenue would provide 2.0x coverage on maximum annual debt service (MADS) after issuance of upcoming revenue backed bonds. While management expects to issue an additional \$70 million in senior lien revenue bonds in 2022 to update its oldest treatment plant, we anticipate net revenue coverage to remain sound. In addition to the water system, the district operates the region's [gas enterprise system](#) (revenue debt rated Aa2 stable) which also has a strong credit profile. While the water and gas have managerial overlap, and share in the retiree liability burden, each enterprise is operated through separate funds and they do not currently share financial resources. For more information on the performance of the gas system, please refer to our report dated June 4, 2018.

LIQUIDITY

At the close of fiscal 2017, the water enterprise held \$75.7 million in unrestricted cash and investments, or 378 days of operating and maintenance (O&M) expenditures. Management has significantly improved the liquidity of the water enterprise since 2012, when liquidity stood at a very low \$300,000. Management targets at least 180 days of O&M and has no plans to significantly reduce current liquidity levels.

Debt and legal covenants: leverage to remain moderate, bonds offer satisfactory legal provisions

The water enterprise debt burden is moderate and plans for additional borrowing are modest through 2021. Inclusive of forthcoming senior lien bonds, debt to operating revenues will stand at 2.0x fiscal 2017 operating revenue. We expect a moderate capital needs and anticipated growth in revenue will keep the debt burden from changing too much.

Outstanding debt is secured by net revenue of the water enterprise and carries a rate covenant and an additional bonds test of 1.20x average annual debt service. Only the water system's outstanding Series 2012 bonds carry a debt service reserve requirement, which was funded with \$3 million of original bond proceeds. The required debt service reserve is set at the lessor of MADS, 1.25x average annual debt service, or 10% of original principal.

DEBT STRUCTURE

All debt secured by net revenue of the water enterprise is fixed rate.

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. The plan had 836 active employee participants and 648 beneficiaries as of January 1, 2017, at which time the plan had a funded ratio, on a reported basis, 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 \$22.2 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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