S&P Global
Ratings

RatingsDirect®

Summary:
Evansville, Indiana; Water/Sewer

Primary Credit Analyst:
Malcolm N D'Silva, Centennial + 1 (303) 721 4526; malcolm.dsilva@spglobal.com

Secondary Contact:
Chloe S Weil, San Francisco (1) 415-371-5026; chloe.weil@spglobal.com

Table Of Contents

Summary:

Evansville, Indiana; Water/Sewer

Credit Profile		
US$30.0 mil swg wks rev bnds ser 2019A due 07/01/2040		
Long Term Rating	A+/Stable	New
Evansville swg		
Long Term Rating	A+/Stable	Affirmed
Evansville swg (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Evansville swg (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Evansville Local Pub Imp Bnd Bank, Indiana		
Evansville, Indiana		
Evansville Local Pub Imp Bnd Bank (Evansville) swg		
Long Term Rating	A+/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to Evansville, Ind.'s series 2019A sewage works revenue bonds, and affirmed its 'A+' long-term rating and underlying rating (SPUR) on the city's existing sewage works revenue debt. The outlook is stable.

The rating reflects, in our opinion, the combination of strong enterprise risk and very strong financial risk profiles. In 2016, the city finalized the integrated overflow control plan (IOCP) under a consent decree with the U.S. Environmental Protection Agency (EPA) known as "Renew Evansville." Combined sanitary and storm drains account for approximately 40% of the sewer system, resulting in overflows into streams and, ultimately, the Ohio River. Under the terms of the agreement, the IOCP requires significant upgrades to the sewer system with improvement projects totaling $729 million over 24.5 years. The city has already begun implementing the plan, and it has issued parity debt obligations in the past two years for planned projects under the decree. Including the 2019A bonds, the total outstanding sewer system revenue bonds total approximately $432 million. Planned bond issuance through 2019, excluding this series 2019A bonds, include an additional $63 million in sewer revenue bonds through the state revolving fund (SRF) program. We understand the city is currently in discussion with the EPA regarding timing and sizes of future projects, after which it will evaluate additional funding sources, including additional rate increases and debt.

The enterprise risk profile reflects our opinion of the sewage work's:

- Service area's adequate income indicators, anchored by its participation in Evansville metropolitan statistical area's (MSA) economy, which we view as broad and diverse;

- Very low industry risk as a monopolistic service provider of an essential public utility;
- Steady and diverse customer base, with monthly sewer rates, which we currently consider moderately high relative to the service area's income levels--rates, however, could become less affordable as the city increases them over the next few years; and
- An operational management assessment (OMA) of good, reflected by its adequate supply to meet currently growing demand, and adopted plan to address overflow issues.

The financial risk profile reflects our opinion of the sewage work's:

- Strong all-in debt service coverage (DSC) for the past three audited fiscal years after recent rate increases, which we expect to continue;
- Strong liquidity with adjusted unrestricted cash and cash equivalents at fiscal year-end 2018 providing 308 days' operating cash;
- Highly leveraged system with a pro forma debt-to-capitalization ratio of 66%, which we expect to weaken as the system may issue additional debt; and
- Good financial management assessment (FMA) policies and practices.

A net system revenue pledge secures the series 2019A bonds, which are on parity with bonds outstanding. Evansville is issuing its series 2019A bonds to finance various system improvements, upgrades, and expansions.

We view the bond provisions as credit neutral. The rate covenant calls for a sufficiency covenant. The city can issue additional parity debt two ways:

- If net revenue of the most recently completed fiscal year before issuance covers maximum annual debt service (MADS) at least 1.25x for all debt outstanding and proposed debt; or
- If adjusted net revenue of the previous fiscal year, with applicable rate increases, covers at least 1.25x MADS for all debt outstanding and proposed debt.

Evansville will also maintain a debt service reserve at the standard three-prong test.

Enterprise risk

Evansville, in southwestern Indiana's Vanderburgh County, along the Ohio River, is the state's largest city south of Indianapolis. Evansville serves as the retail, trade, and services center for southwestern Indiana and portions of northwestern Kentucky. The city is home to University of Evansville and University of Southern Indiana, as well as multiple hospitals, including Deaconess Health System and St. Vincent's Medical Center. Despite this service orientation, there are several leading manufacturers in the area, including Berry Plastics Corp. and Toyota Motor Manufacturing Corp. We view the service area's income levels as adequate based on the city's median household effective buying income (MHHEBI), which is about 70% of the national median. We anticipate that the city's economy will likely remain stable given that it continues to see ongoing growth from commercial and residential developments. The city's role as the Evansville MSA's economic base, providing a broad-and-diverse economy, also supports the service area.

The customer base is diverse, in our view, with no one customer exceeding 3% of revenue. The sewer utility provides service to approximately 53,600 customers, with 48% of total revenues derived from residential customers. The 10 leading customers accounted for 12% of total 2018 operating revenue. Management indicates about 75% of the service area is within city limits with the remaining customers spread across several townships in the county.

We view the system's market position to be adequate based on its moderately high service rates, particularly relative to the area's adequate income levels, and elevated county poverty rate. Evansville reviews rates annually and incorporates the cost of service into rate adjustments as applicable. Based on a cost of service rate study and ordinance approved in October 2016, the city council preapproved annual rate increases through fiscal 2020. The adopted sewer rate schedule includes cost of service, EPA consent decree rates, and monthly fixed fees. The city most recently implemented a 14%, and 13% rate increase for fiscal years 2018; and 2019, respectively. Using our benchmark of average residential usage at 6,000 gallons monthly, we calculate the current residential sewer monthly bill to be about $94, which is equivalent to 3.4% of the city's MHHEBI when annualized. Management indicates an average residential use of about 5,000 gallons, with rates at $79.8 monthly, which we still consider moderately high at 2.8% of MHHEBI. In our view, this service rate may be even less affordable to a portion of the city's customer base given that the county poverty rate as reported by the U.S. Department of Agriculture is 17.7%. In general, we believe the market position is moderately constrained by the county's elevated poverty rate, meaning that we believe that potentially large future rate adjustments would likely be less affordable for the city's customers that are on low or fixed incomes.

Also supporting the enterprise risk profile is a good OMA, which, in our view, indicates a favorable alignment of operations and management's strategic goals, although some challenges may exist in the long term. The sewer utility includes two major wastewater treatment plants and various separate and combined sewers. Total combined wastewater treatment capacity is 53.1 million gallons per day (mgd) in dry weather and 67 mgd in wet weather. This sufficiently meets the average daily flows of approximately 33 mgd. Under the IOCP, the city is addressing its regulatory needs in conjunction with its routine capital needs over 24-and-a-half years. Through 2019, officials are funding total capital needs of approximately $100 million with current and future planned bond proceeds. The city uses various websites, social media, and press outlets for outreach to customers relating to utility strategies and long-term needs. Management undertakes periodic rate studies and recently updated its capital improvement plan (CIP) which in our view, sets a clear trajectory regarding future capital funding needs.

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

Financial risk

Financially, the system has experienced improved strong results when using unaudited accrual statements provided by the city's financial consultant. Following rate increases, adjusted operating revenue increased by about 51% since fiscal 2015 to about $76.5 million in fiscal 2018 on an accrual basis. Income available for debt service after adjusting for payments in lieu of taxes (PILOTs) provided all-in DSC ranging from 1.6x in fiscal 2015 to 2.2x in fiscal 2018, an improvement from 1.25x in fiscal 2012. However, recent bond issuances would increase annual debt service requirements, leading to a decreasing all-in DSC in the near future. Based on management's forecast, which we view as reasonable, we calculate all-in DSC, after including PILOTs, will be at least 1.6x through fiscal 2021, which we consider strong. Key assumptions in the forecast include increased revenues from rate increases through 2020 with no additional rate increase assumed in 2021, increasing expenses based on a historical five-year average and anticipated cost adjustments, and additional leverage through a SRF bonding at the end of 2019.

The system has sustained liquidity at levels we view as strong. Unrestricted cash and equivalents, when adjusted for accrual-based accounting, totaled approximately $30 million at fiscal year-end 2018 (equivalent to 308 days' of operations), and includes unrestricted available liquidity in its wastewater treatment plant (WWTP) improvement fund. The WWTP improvement fund has a minimum fund balance requirement of $1 million by bond ordinance, and any amount above this $1 million is available for system improvements, as well as debt-service-payment requirements, if needed. Unrestricted days' cash on hand has been improving and ranged between 120 days' and 308 days' since fiscal 2015. Officials are projecting cash will increase slightly over its forecast period through 2021, and based on the city's well defined reserve policy, we expect liquidity to remain strong as the system continues to fund ongoing capital needs primarily through bond proceeds. The system maintains an operating cash level target with reserves of no less than two months, and a targeted minimum balance of $3 million for the improvement fund.

The debt profile, though adequate, in our opinion, would experience pressure as the system issues additional debt in the future. The pro forma debt-to-capitalization ratio increases to 66%, which we consider highly leveraged, after accounting for the issuance of the series 2019A and 2019B bonds. The system's five year CIP for fiscals 2019 through 2023 is sizable, and totals $210 million, of which 77% will be financed with debt financing (bond proceeds and SRF), and 23% on a pay-as-you-go-basis from excess revenues and reserves.

Also supporting the financial risk profile is a good FMA. This indicates our view that financial practices exist in most areas, although all may not be formalized or regularly monitored. The management team in our view maintains good management and investment policies to govern its operations. Examples include regular budget monitoring and use of five-year historical trends for budget and operational performance analysis, monthly budget-to-actual and investment reports to the city council, long-term financial and capital planning, and a formal investment and debt management policy.

Outlook

The stable outlook reflects our opinion of the system's recent strong financial performance and expectation that management will likely take appropriate measures, including additional rate increases, to maintain finances as the system continues to address its capital needs, especially with the consent decree. The outlook further reflects our view of the city's recognized role as a regional economic center despite its adequate incomes, providing rating stability within the two-year outlook period.

Upside scenario

Upward rating movement in the longer term will be predicated by further expansion and diversification of the service area economy, leading to stronger income levels, and consistently maintaining all-in DSC and liquidity at currently strong levels beyond the outlook horizon as the system adequately addresses its long-term capital needs.

Downside scenario

Given the system's recent significant rate adjustments to produce strong all-in coverage and liquidity, we do not anticipate lowering the rating. However, we could lower the rating, if the total dollar amount of the CIP materially exceeds current expectations and liquidity levels are materially drawn down.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.