S&P Global
Ratings

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Summary:
Lebanon, Indiana; Water/Sewer

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Credit Profile		
US$9.3 mil swg wks rev bnds ser 2018 due 07/01/2037		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' rating and stable outlook to Lebanon, Ind.'s series 2018 sewage works revenue bonds.

The rating reflects our opinion of the combination of, what we consider, very strong enterprise- and financial-risk profiles.

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

- Service-area participation in the broad and diverse Indianapolis metropolitan statistical area (MSA) economy,
- Very low industry risk as a monopolistic service provider of an essential public utility,
- Generally affordable rates due to average residential rates at 1.4% of the city's median household effective buying income at 85% of national levels and Boone County's 7.2% poverty level, and
- Good operational management practices and policies under our Operational Management Assessment (OMA) methodology.

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

- Extremely strong all-in debt service coverage (DSC), which we expect will decrease to very strong levels as debt service on the series 2018 bonds ramps up;
- Very strong liquidity with $2.7 million, or 309 days' cash on hand, at fiscal year-end Dec. 31, 2017;
- Moderate debt with a 39% debt-to-capitalization ratio when including the series 2018 bonds, or roughly $14.6 million in debt outstanding; and
- Good financial management practices and policies under our Financial Management Assessment (FMA) methodology.

Officials intend to use series 2018 bond proceeds to fund additions, extensions, and improvements to the city's wastewater treatment plant and retire series 2017 sewage works bond anticipation notes outstanding.

Bond provisions are, in our opinion, credit neutral, including:

- A rate covenant that requires 1.1x annual DSC,
- An additional bonds test that requires 1.25x maximum annual DSC on new and existing debt, and

- A debt-service reserve funded at no more than five years at the lesser of the three-prong test.

Lebanon is Boone County's seat, about 30 miles northwest of Indianapolis. Lebanon is on Interstate 65, a major trucking throughway. Lebanon's location has helped it attract several distribution and manufacturing companies.

The system's customer base of about 6,500 has expanded steadily during the past several years by about 1% annually. Industrial and commercial customers account for approximately 40% of system operating revenue. Customer concentration is not a significant credit factor currently with no single customer accounting for more than 4% of total operating revenue. However, we note with recent growth and the addition of industrial-food manufacturers, the revenue base could become more concentrated as these customers grow. Growth in residential housing, with two housing developments currently underway for approximately 100-300 new homes, somewhat limits concentration risk.

In our opinion, city median household effective buying income is below average at 85% of the national median. With an average residential bill of $46.71 for 4,000 gallons consumed equating to 1.4% of median household effective buying income, we consider rates affordable. The system most recently increased rates by 32% on Jan. 1, 2016, in anticipation of the series 2018 bond issuance. While the city does not currently plan to increase rates, it has proposed a cost-of-living adjustor annually through 2020.

Based on our OMA, we view the system's operational management as good. The utility includes a wastewater treatment plant with an average daily treatment capacity of 3.3 million gallons per day (mgd) in dry weather and 8.6 mgd during peak flow. This sufficiently meets average daily flows of approximately 2.8 mgd. Following the expansion project's completion, average daily flow will increase to 5 mgd in dry weather, which should help alleviate current loading challenges from industrial customers.

In addition, a proactive succession plan supports the OMA. The utility operations manager maintains a succession plan for all water and wastewater employees that identifies position, classification, years of service, and potential retirement; this allows the system to develop personnel for the continuance of operations. Rate-setting practices are good, in our opinion, with the city proactively implementing a 32% rate increase in anticipation of the series 2018 bonds.

Consistent with the article titled "Methodology: Industry Risk," published Nov. 19, 2013, on RatingsDirect, we consider system industry risk very low, the most favorable assessment possible on a six-point scale, with '1' being the best and '6' the worst.

The utility's financial profile has improved consistently during fiscal years 2015-2017. We consider the improvement in all-in DSC and liquidity a result of management's anticipatory 32% rate increase in fiscal 2016 that allowed it to post strong operating margins and build liquidity. In addition, the city increased surcharge rates effective January 2018 that will continue to bolster operating revenue. All-in DSC, which includes the sewage-works-utility-interfund loan from the water utility and payments in lieu of taxes, improved to more than 3x in fiscal 2017, a level we consider extremely strong, from 1.8x in fiscal 2015. Projections show management maintaining DSC above 1.6x through 2020; however, as debt service on the series 2018 bonds ramps up, without additional rate or operating adjustments, the system forecasts DSC at 1.4x, which is still very strong, in our opinion.

System cash, similar to DSC, has increased due to increased operating margins following the last rate adjustment. Cash improved to more than $2.7 million, or 309 days' cash on hand, in fiscal 2017 from $1.08 million, or 149 days', in fiscal 2015. Days' cash on hand is at levels we consider extremely strong; however, nominal levels are adequate, in our view. System projections indicate liquidity will remain at similar, if not slightly improved, levels during the next few fiscal years.

Including the series 2018 bonds, the utility will have approximately $14.6 million of debt outstanding, including directly placed series 2013 and 2014 sewage works revenue refunding bonds. We note the directly placed bonds operate under the master indenture and are not subject to extraordinary provisions. Management does not currently plan to issue additional debt, and it plans to fund roughly $7.2 million in capital improvements with series 2018 bond proceeds and cash on hand.

Based on our FMA, we view the system's financial management as good, indicating that financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Highlights include management's:

- Use of 10-year historical normalized trends for budget and operational performance analysis,
- Monthly budget-to-actual and investment reports to the utility board,
- Five-year capital improvement plan it updates annually, and
- Production of accrual- and generally accepted-accounting-principles-based audits.

While management does not have a formal liquidity policy, it adheres to a three-month operating target.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of the system's strong recent financial performance and S&P Global Ratings' expectation that management will likely take appropriate measures, including additional rate increases, to maintain finances. The outlook further reflects our view of the city's participation in the Indianapolis MSA, lending further rating stability within the two-year outlook period.

Upside scenario

We could raise the rating if actual financial performance were to outperform projections, particularly as series 2018 debt service ramps up and management plans to cash fund capital improvements.

Downside scenario

Although we expect DSC to decline as debt-service payments increase, system projections indicate financial performance will likely remain in-line with the current rating. If future DSC or liquidity were to decline meaningfully below levels we consider commensurate with the rating, we could lower the rating.

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.

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