

## CREDIT OPINION

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 Rate this Research

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# Little Blue Valley Sewer District, MO

## Update to credit analysis

### Summary

The credit profile of [Little Blue Valley Sewer District, MO](#) (Aa3) benefits from the district's essential purpose as a wholesale provider of regional sewer collection and conveyance services to municipal governments in the greater [Kansas City](#) (Aa2 stable) metropolitan area, ample liquidity, and the inherent strength and stability of the district's cost recovery method and unlimited rate setting authority. These positive attributes are weighed against a high debt burden with modest coverage and weak bondholder protections associated with a sum sufficient coverage requirement and the lack of a debt service reserve.

### Credit strengths

- » Serves as monopolistic provider of sewer services to large service area in the greater Kansas City, MO area
- » Stable financial operations with ample liquidity
- » District's use of cost recovery method to generate revenues and unlimited rate setting authority

### Credit challenges

- » High debt burden with modest coverage
- » Weak bondholder protections associated with a sum sufficient coverage requirement and lack of debt service reserve

### Rating outlook

Moody's does not generally assign outlooks to local government credits with this amount of debt outstanding.

### Factors that could lead to an upgrade

- » Significant mitigation of the district's debt burden
- » Substantial improvement in debt service coverage

### Factors that could lead to a downgrade

- » Deterioration in debt service coverage or liquidity levels
- » Further leveraging of the district's net revenues absent corresponding rate increases

## Key indicators

### Exhibit 1

Little Blue Valley Sewer District, MO					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	13 years				
System Size - O&M (in \$000s)	\$11,528				
Service Area Wealth: MFI % of US median	91.5%				
Legal Provisions					
Rate Covenant (x)	1.00				
Debt Service Reserve Requirement	No DSRF (Baa and Below)				
Management					
Rate Management	Aaa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2014	2015	2016	2017	2018
Operating Revenue (\$000)	\$20,441	\$21,630	\$22,877	\$24,272	\$25,545
System Size - O&M (\$000)	\$11,731	\$10,422	\$11,241	\$11,214	\$11,528
Net Revenues (\$000)	\$13,703	\$16,053	\$16,426	\$17,920	\$16,827
Net Funded Debt (\$000)	\$186,492	\$181,413	\$176,070	\$185,667	\$180,861
Annual Debt Service (\$000)	\$11,537	\$9,010	\$16,434	\$16,944	\$15,147
Annual Debt Service Coverage (x)	1.2x	1.8x	1.0x	1.1x	1.1x
Cash on Hand	505 days	591 days	500 days	456 days	489 days
Debt to Operating Revenues (x)	9.1x	8.4x	7.7x	7.6x	7.1x

Note: City of Kansas City used as a proxy for Service Area Wealth

Source: Little Blue Valley Sewer District's audited financial statements fiscal years 2014-18

## Profile

Formed in 1968, the monopolistic, single purpose district was created to provide sewer collection and conveyance services to 14 wholesale customers with an estimated population of 375,000 within the Kansas City metropolitan area.

## Detailed credit considerations

### Service area and system characteristics: monopolistic wholesale provider in the Kansas City metro

The district's service area will remain stable over the long term given its role as the monopolistic provider of sewer treatment services to 14 wholesale customers, coupled with state statutes in place to protect that monopoly. The district's wholesale customers include the cities of [Belton](#) (A1), Blue Springs, Grandview, Independence, Kansas City, Lake Tapawingo, [Lee's Summit](#) (Aaa), [Raymore](#) (Aa2), Raytown, and Sugar Creek, [Jackson County](#) (Aa2 stable), Fort Osage School District, and the Middle Big Creek Subdistrict. The district also provides sewer collection and treatment services for the Lake City Army Ammunition Plant (a federal facility operated by an independent, private contractor for the US Army).

The wholesale customers have entered into service agreements that require participation in the district until all bonds of the district are retired. District charges to the participating entities are operating expenses of each user, payable prior to the participants own debt service obligations, which provides stability and security of payment. Budgeted expenditures are fully recovered by a rate methodology that allocates the budget based on four cost components (user volume, administrative, meter and pretreatment costs). Customer volume is over the previous five years of actual flow to reduce volatility of individual charges. The largest customers have remained fairly consistent on a historical basis with the cities of Lee's Summit, Independence, Raytown, and Kansas City providing roughly 65%

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user charges in fiscal 2018. Going forward, officials conservatively estimate dry weather flows will increase by an annual average of 1-2%.

The district operates one treatment facility with a rated capacity of 52 million gallons per day (mgd), an average treatment flow of 33 mgd, and a maximum of 400 mgd. Officials anticipate that the current plant and pumps are sufficient to serve the region's growth through at least 2020, but will likely be sufficient through 2030.

#### **Debt service coverage and liquidity: stable financial operations with ample liquidity**

The district's financial operations will remain stable given the district's cost recovery rate setting method and unlimited rate setting authority. The cost recovery method allows the district to tie revenues to expenditures thereby removing exposure to significant volumetric or population swings. Net revenues of \$16.8 million in fiscal 2018 provided somewhat narrow but adequate debt service coverage of 1.1 times debt service requirements. Debt service coverage is not likely to be as strong as other issuers in the district's peer group due to the structure of the cost recovery method. Positively, the Board, comprised of mayors of the participating entities, has unlimited rate setting authority and has planned for 6% annual rate increases through 2024, although management expects the required rate increase will be less than 6% on average. Additionally, the rates increases are not codified and must be adopted annually.

#### **LIQUIDITY**

At the close of fiscal 2018, the district had 489 days cash on hand comprised of \$15.4 million in cash and investments. Liquidity is ample with net working capital and unrestricted reserves totaling 766.8% and 133.9% of O&M expenses, respectively.

#### **Debt and legal covenants: weak bondholder protections associated with a sum sufficient coverage requirement and lack of debt service reserve**

The district's debt ratio is expected to remain high over the medium term given below average principal amortization. Inclusive of the refunding, the system's debt burden equals 7 times operating revenues which is high for the peer group. However, this is mitigated by a lack of near term debt issuance plans and the district's cost recovery revenue structure.

Legal provisions are weak. The system's rate covenant requires net revenues to provide sum sufficient coverage, however, we note budgeted expenditures, including debt service, are fully recovered from customers by the district's rate methodology. The district's status as a wholesale provider also provides helps mitigate the weaker rate covenant as the district is not reliant on retail operations for revenues. The district's additional bonds test requires net revenues of 1.10 times average annual debt service. There is also no debt service reserve requirement.

#### **DEBT STRUCTURE**

All of the district's debt is fixed rate and matures over the long-term (final maturity fiscal 2040). Principal amortization is below average with 47.5% of principal satisfied within ten years.

#### **DEBT-RELATED DERIVATIVES**

The district is not party to any interest rate swaps or other derivative agreements.

#### **PENSIONS AND OPEB**

The district contributes to the Jackson County, Missouri Revised Pension Plan, a cost sharing multiple employer defined benefit pension plan. For fiscal 2018, the district contributed \$572,216 equal to the district's contractually required contribution rate as set by the plan's Board of Trustees. Fixed costs, inclusive of debt service payments (\$15.1) million and pension contributions, totaled \$15.7 million in fiscal 2018, equal to a high 55.4% of total revenues. As stated above, the district's high fixed costs are somewhat offset by its single-purpose, wholesale operations, cost recovery method of rate setting, and unlimited rate setting authority.

#### **Management and governance: history of intergovernmental cooperation between board members representing different entities**

The district is governed by an 11-member Board of Trustees comprised of the Jackson County Executive, the mayors of the five largest customers as determined by the amount of sewer flow treated in the previous fiscal year, three additional mayors, and a member of the Jackson County legislature appointed by the county executive and approved by the legislature. Additionally, as the district extends into neighboring Cass County, the presiding commissioner of the county serves as the eleventh board member. The board appoints an Executive Director to run the day-to-day operations of the district.

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