S&P Global
Ratings

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## Summary:
# Washington, Indiana; Water/Sewer

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| Credit Profile | | |
|---|---|---|
| US$1.725 mil tax-exempt wtrwks BANs ser 2018 due 12/20/2023 | | |
| *Long Term Rating* | A/Stable | New |
| Washington tax-exempt wtrwks (AGM) | | |
| *Unenhanced Rating* | A(SPUR)/Stable | Affirmed |
| Washington wtrwks | | |
| *Long Term Rating* | A/Stable | Affirmed |

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings assigned its 'A' rating and stable outlook to Washington, Ind.'s series 2018 waterworks bond anticipation notes (BANs). At the same time, S&P Global Ratings affirmed its 'A' rating, with a stable outlook, on the city's existing waterworks revenue debt.

The rating reflects our opinion of the combination of an adequate enterprise risk profile and a strong financial risk profile. Our rating also reflects our opinion that the city has strong authority to issue long-term debt to take out the BANs and low market-access risk in order to do so.

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

- Service-area participation in a limited local area economy;
- Concentrated revenue bonds;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable rates when measured against the city's adequate, but below-average, median household effective buying income (EBI) and Daviess County's 13.8% poverty rate; and
- Standard operational management practices and policies under our Operational Management Assessment (OMA).

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

- Generally stable all-in debt service coverage (DSC) at levels we consider strong;
- Strong unrestricted liquidity; and
- Good financial management practices and policies under our Financial Management Assessment (FMA) methodology.

The city is issuing the series 2018 BANs for the purpose of relocating and replacing water lines affected by improvements of highway 50, installation of new mains in various locations along the highway, and to pay issuance expenses.

The city pledges revenue bond proceeds to the repayment of BAN principal and interest. BAN interest is also payable from net waterworks system revenue, which is junior and subordinate to outstanding bond payments. We understand that officials plan to issue long-term revenue bonds through Indiana's state revolving fund and that such bonds will rank on parity with the city's senior-lien waterworks revenue bonds outstanding.

Net waterworks system revenue--defined in the bond ordinance as gross revenue after deductions only for the payment of reasonable operation expenses, repairs, and maintenance--secure the BANs. We, however, adjust all-in DSC to account for all obligations utility operating revenue ultimately secures, including transfers out, regardless of lien or accounting treatment.

Bond provisions are, in our view, credit neutral. The rate covenant requires net revenue to cover annual debt service sufficiently by 1x. The additional bonds test for first-lien debt requires 1.25x pro forma maximum annual DSC. The utility will maintain a debt-service reserve, funded at the three-prong test.

The waterworks utility serves Washington. The city's economy is stable, and officials expect growth in eastern Washington over the next few years. Washington's population grew by 4.5% since 2010 to 11,941 in 2017. Perdue Farms Inc., the leading employer, employs 825, followed by Daviess County Hospital with 573, and Walmart Stores Inc. with 300. In our opinion, median household EBI was adequate, yet below average, at 80% of national levels for 2017. As of October 2018, county unemployment was 2.9%, below the state's 3.4% and the nation's 3.6%.

The system serves approximately 5,600 water accounts. The customer base is concentrated: The 10 leading customers accounted for 34% of total revenue for the 12 months ended Dec. 1, 2017. The two leading customers are Perdue Farms (13% of fiscal 2017 sales) and Daviess County Rural Water System Inc. (DCRW) (12%). In the city's view, Perdue's operations have been, at least, stable. The utility's water supply comes from two wellfields that draw water from two aquifers; according to city officials, this supply is plentiful.

In our view, water treatment capacity is adequate. The system's facility treats 10 million gallons per day (mgd) with an average daily flow of 3.2 mgd, or 32% of treatment capacity, and a peak daily flow of 5.5 mgd, or 55%. In addition, according to city officials, the utility is not encountering any regulatory issues.

Washington passed a 20% rate increase in December 2018. The rate increase will go into effect May 1, 2019, increasing the rate to $36.98 for the average user consuming 533 cubic feet, as reported by management, which includes a minimum charge and a fire protection fee. We note the city implemented a rate increase of 14.8% for out-of-city customers in 2018.

Updated water rates account for 1.16% of median household EBI. Management performs a rate study every two years. The city maintains rate-setting authority. Management does not currently plan to implement additional rate increases.

Based on our OMA, we view the system's operational management as standard. The system has capacity to treat average and peak flows. The city is working on a three-phase improvement program: It recently completed the first phase, the construction of a 600,000-gallon water tower. Management commissions rate studies for rate increase recommendations every two years.

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

In our opinion, total DSC remained relatively stable from fiscal years 2014-2016. Following a 40% rate increase in fiscal 2012, the system maintained DSC at 1.4x or above from fiscal years 2013-2015 based on financial statements provided by the city's financial consultant. In fiscal 2016, operating expenses increased due to litigation between the utility and DCRW. Therefore, all-in DSC fell to 1.2x in fiscal 2016 and remained at 1.2x in fiscal 2017. When excluding one-time litigation expenses, DSC improves to 1.3x. Our expectation is that all-in DSC will improve to over 1.4x by fiscal 2019. Should all-in DSC fail to recover, particularly as the city issues additional waterworks debt, we could lower the rating.

Liquidity remained relatively stable during fiscal years 2015-2017 when including operating and depreciation funds balances. We note that depreciation funds are earmarked for capital improvements; however, they are not legally restricted and the city may use these funds for any purpose with council approval. Unrestricted cash was $1.7 million in fiscal 2017 or 201 days' cash on hand.

The debt-to-plant ratio, in our view, is moderate at about 43%. The system reported $12.365 million of debt outstanding at fiscal year-end Dec. 31, 2017. We understand officials plan to issue additional debt over the next few years. They are currently planning a new series of bonds for capital improvements in 2021, when the system will fully repay its series 2013 bonds. Management maintains a five-year capital improvement plan (CIP), and it currently plans to spend about $1.3 million from fiscal years 2019-2023.

Based on our FMA methodology, we view the system's financial management as standard, indicating the finance department maintains adequate policies in some, but not all, key areas. The system produces and shares interim financial results with the city council monthly. Management updates its multiyear CIP annually. The city does not update long-term financial projections; however, it completes projections during formal rate studies every couple of years. The system produces financial statements using accrual accounting.

## Outlook

The stable outlook reflects S&P Global Ratings' expectation that the system will likely produce all-in DSC and liquidity at levels above recent historical trends following recent rate adjustments set to go into effect in 2019.

### Downside scenario

We could lower the rating if DSC or liquidity do not improve or if they decline to levels we do not view as commensurate with the current rating, particularly as the city works through the final two phases of the three-phase waterworks system improvements.

### Upside scenario

While it might take longer than our two-year outlook period, the key to a higher rating would be the city's economy expanding and diversifying, leading to improved economic indicators. We could also raise the rating if the system were to demonstrate a sustained improvement in all-in DSC and liquidity comparable with those of higher-rated peers.

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.