S&P Global
Ratings

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Summary:
Jefferson City, Missouri; Water/Sewer

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Summary:

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Credit Profile		
US$5.77 mil sewerage sys rfdg rev bnds ser 2020 due 09/01/2035		
Long Term Rating	A+/Negative	New
Jefferson City swg		
Long Term Rating	A+/Negative	Outlook Revised
Jefferson City swg (BAM)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings revised the outlook to negative from stable and affirmed its 'A+' rating on Jefferson City, Mo.'s sewerage system revenue bonds outstanding. At the same time, S&P Global Ratings assigned its 'A+' rating, with a negative outlook, to the city's approximately $5.8 million series 2020 sewerage system refunding revenue bonds.

Officials intend to use the series 2020 bond proceeds to refund the town's existing series 2010B sewerage system revenue bonds. After the proposed series 2020 bond issuance, the city will have approximately $46 million of sewage works system revenue debt and state-revolving-fund loans.

The city's net-sewage works revenue secure the bonds. The bond provisions, in our opinion, are credit neutral. They include a 1.1x rate covenant, and an additional bonds test set at 1.1x average annual debt service (AADS. It is our understanding that there will be no debt service reserve securing the series 2020 bonds.

Credit overview

The outlook revision reflects our view that there is a one-in-three chance the sewerage system's financial risk profile could be pressured due to declining debt service coverage (DSC).

The rating reflects our view of the city's sewerage system's very strong enterprise risk profile and strong financial risk profile. The system serves customers in Jefferson City as well as portions of the Cole County. Wastewater rates are low, in our view, and we assess the market position as very strong based on the annualized bill relating to income levels and county poverty rate, offering the system rate-raising flexibility. However, due to escalating debt service the city will require rate increases through 2024 in order to support its financial risk profile. In our opinion, the system's liquidity provides flexibility and a cushion to mitigate short-term disruptions due to the COVID-19 pandemic and the related recession.

In our view, there is a high degree of uncertainty related to the effects of COVID-19 on state and local economies. According to S&P Global Economics, measures to contain the outbreak have pushed the economy into a recession. We think COVID-19 and the related recession could affect system revenue in fiscal 2020 and beyond. However, we expect management will likely continue to administer the system and maintain, what we consider, at least adequate DSC and very strong liquidity levels.

All-in DSC dropped below 1.0x in 2019 resulting in the utility failing to comply with its rate covenant (set at 1.1x). Coverage declined below sufficiency from a combination of projects related to repairing damage caused by a tornado and flooding due in May 2019, and cash expensing other long-term capital improvements. Management does not anticipate these increases in operating expenses will affect the system's financial operations in the next several years. Furthermore, the city applied for and received grant funding to offset some of the cost of repairing the system after the tornado and flooding events. The system's relatively strong liquidity position will likely provide a sufficient cushion, in our view, for short-term disruptions resulting from COVID-19 and the resulting recession. Jefferson City's unemployment increased to 7.3% in April 2019, but these levels are about half of the nation's unemployment levels for the same time. Being the state capital, city's government sector is its main employer and has proven resilient to declines in employment, according to management. City officials state that, overall, the pandemic has not significantly affected the system; noting there was only a 2% decline in revenues in May 2020.

While we continue to monitor COVID-19, we do not expect it to affect the system's ability to maintain budgetary balance and debt-service payments. However, we expect reduced regional economic activity could negatively affect demand from volumetric sales, although the system's very strong liquidity would mitigate this.

The rating also reflects our opinion of the sewerage system's very strong enterprise-risk profile, including its:

- Stable service area economy, anchored by state government;
- Established annual rate increase while maintaining affordability; and
- Good Operational Management Assessment (OMA).

The rating also reflects our opinion of the sewerage system's strong financial-risk profile, including its:

- Declining all-in debt service to levels that we consider adequate, and insufficient coverage in fiscal 2019 due to one-time capital expenditures relating to damage from a tornado and flooding and cash expensing long-term capital improvements;
- Leverage position that we consider very strong, given 70% of the system's debt amortizes within 10 years; and
- Good financial practices and policies under our Financial Management Assessment (FMA) methodology.

The negative outlook reflects our view that the sewerage system's financial profile is being pressured due to declining all-in DSC with additional debt needs. The system's financial profile is reliant on rate increases, pending the completion of a rate study, in order to sustain just adequate coverage levels meeting the city's rate covenant. Given the city's currently affordable wastewater rates, we believe these increases would be possible under normal economic conditions, however, given the current recession, future rate-raising flexibility could be hampered due to affordability and political concerns. However, if, as S&P Global Economics projects, the recovery does not begin until late in the third quarter of 2020, we believe that credit conditions for local governments, including their utilities, will face headwinds even into 2021. We believe this increases the possibility that unfavorable variances to budget could extend beyond fiscal 2020. For more information, see "An Already Historic U.S. Downturn Now Looks Even Worse" (published April 16, 2020, on RatingsDirect).

Environmental, social, and governance (ESG) factors

Overall, we think the system mitigates most ESG-related risk by adopting, adhering to, and adjusting its operating and financial policies and procedures. The system is currently meeting all federal and state regulations. The city completed its consent decree in 2018 and Environmental Protection Agency Region 7 agreed to terminate the order. Management is planning for rate increases annually through fiscal 2024; we do not imagine this will pressure affordability materially. Should the town's income levels or county poverty rate be stressed due to COVID-19 and the related recession, coupled with customer bills, as a percent of income, increasing significantly, this would negatively affect affordability and present a degree of social risk.

Negative Outlook

We could lower the rating if the system continues to produce DSC below the rate covenant, material decline in liquidity position, or if COVID-19 and the related recession negatively affect the city's economic fundamentals. We could revise the outlook to stable should the city's plans for increasing rates materialize and lead to all-in DSC that we consider commensurate with the rating level.

Credit Opinion

Enterprise risk

Jefferson City, Missouri's capital, is the Cole County seat, approximately 150 miles between Kansas City and St. Louis. The 38-square-mile city has a population estimate of just under 43,000. In our view, median household effective buying income (EBI) is good, but below average, at 89% of the national average. Government jobs, with Missouri serving as the leading employer (14,174 employees), anchor the local economy. Other leading employers include:

- Jefferson City Public Schools (1,627 employees);
- Scholastic Inc. (1,500);
- Capital Region Medical Center (1,527); and
- Quaker Windows and Doors (1,051).

Due to a number of stable area employers, city unemployment, although elevated due to COVID-19 and the resulting recession, remains below state and national averages; it was 7.3% as of April 2020.

The sewer system serves more than 20,000 customers in Jefferson City and portions of the surrounding communities. The customer base has been stable since 2013, and management projects less-than-2% growth within the next few years. The largely residential customer base is very diverse with the 10-leading customers accounting for approximately 8% of system usage.

The city treats wastewater at two treatment facilities, with a combined capacity of 11.8 million gallons per day (mgd). Management indicates treatment facilities are capable of handling wet-weather flows of 60 mgd. We consider treatment capacity adequate due to management's reports that average and peaks flows were 7 mgd and 40 mgd, respectively, in 2019. Management indicates system facilities comply with all regulatory mandates, and it believes there is sufficient treatment capacity for the next 20-25 years.

The city council has full rate-setting authority. The council reviews rates annually, and the system bills customers monthly. Current rates are approximately $39 for an average monthly flow of 800 cubic feet. We consider these rates affordable relative to the city's income levels, with annual sewer costs representing about 1% of median household EBI. The city is recommending annual rate increases through 2024 pending the completion of a rate study to the city council for approval in 2020.

Based on our OMA, we view Jefferson City as a '3' on a six-point scale, with '1' being the strongest. This indicates, in our view, operational and organizational goals are generally well-aligned, even if some challenges exist. The OMA of good includes wastewater treatment capacity that, while likely adequate for at least the bonds' life, the city constantly evaluates for opportunities to expand. The city has not increased rates since 2017, which has caused thinner coverage as debt service and operating expenses increased. The city is currently completing a rate study including a forecasting model to better align operational and capital needs.

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

Financial risk

We consider annual DSC adequate for fiscal years 2017 and 2018, and extremely vulnerable for fiscal 2019. DSC was about 1.1x in for fiscal years 2017 and 2018, ended Oct. 31, before falling to 0.9x in fiscal 2019. Coverage declined below sufficiency as a result of costs for system repairs due to a tornado and flooding event. In addition, management cash expensed long-term capital improvements, which increased operating expenses. Budgeted fiscal 2020 figures, excluding capital purchases and projects, indicate annual DSC will improve to 1.1x. City projections through fiscal 2024 show DSC fluctuating from 1.1x-1.2x.

Liquidity improved over the past three fiscal years to $6.6 million, however, this was partially due to grant receipts of about $1 million to offset costs associated with system repairs. Fiscal years 2017 and 2018 had liquidity of $5.9 million or 380 days' cash on hand, and $5.7 (380 days'), respectively. Management expects fiscal 2020 levels will be similar to fiscal 2018 results as grant proceeds were spent on repair projects. The city also adopted a formal liquidity policy to maintain unrestricted reserves at 10% of annual operating expenditures.

In our opinion, the system's leverage position is strong. Overall debt equaled 47% of the system's net value for fiscal 2019. The city does not currently maintain a capital improvement plan; management, however, is identifying capital needs in line with the current rate study being completed. The city does not have any direct-purchase or bank loans outstanding. The system does not have any remaining voter authorization to issue additional new money debt. Management indicates a possible $15 million-$20 million debt issuance within the next five years, either through the Missouri State Revolving Fund or from new money bonds. The city would need voter authorization for the new money debt and management expects a ballot initiative next year.

Based on our FMA, we view the city as a '3' on a six-point scale, with '1' being the strongest. An FMA of good indicates we deem practices currently standard, but not comprehensive. The city maintains good budgeting practices and strong budget monitoring practices, providing the city council with monthly actual-to-budget updates. We consider long-term financial projections included in the city's annual audit a positive practice. The lack of formal, long-term capital planning is, in our view, an area in which the city can improve. The FMA includes transparency and accountability practices that we consider good due to the city's annual and timely generally accepted accounting principles compliant audits.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020