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Summary:

Metropolitan St. Louis Sewer District, Missouri; Water/Sewer

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Summary:

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Credit Profile		
US$261.175 mil wastewtr sys imp and rfdg rev bnds ser 2017A due 05/01/2047		
Long Term Rating	AAA/Stable	New
Metro St Louis Swr Dist wastewtr sys rev bnds		
Long Term Rating	AAA/Stable	Affirmed
Metro St Louis Swr Dist wastewtr		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'AAA' rating and stable outlook to Metropolitan St. Louis Sewer District (MSD), Mo.'s series 2017A wastewater system improvement and refunding revenue bonds and affirmed its 'AAA' rating, with a stable outlook, on MSD's existing debt.

The rating reflects our opinion of the combination of extremely strong enterprise and financial risk profiles.

The enterprise risk profile reflects our opinion of MSD's:

- Service area participation in the broad and diverse St. Louis metropolitan statistical area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable rates when benchmarked against income and St. Louis County's poverty rate, which overlaps with most of MSD's service base; and
- Strong Operational Management Assessment practices and policies.

The financial risk profile reflects our opinion of MSD's:

- Financial performance that routinely exceeds bond-covenant minimums for debt service coverage (DSC),
- Large unrestricted cash and investments on hand that have represented no less than 400 days' operating expenses since at least fiscal 2010, and
- Strong financial management practices and policies under our Financial Management Assessment methodology.

MSD has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent nearly all of MSD's revenue; this, coupled with operating-expense flexibility, limits exposure to federal revenue.

MSD's net wastewater operating revenue, excluding property tax revenue related to the storm water system, secures the bonds.

Officials intend to use series 2017A bond proceeds to finance various improvements as part of MSD's long-term planning when addressing needs, mostly related to the consent decree, and refund certain bonds outstanding for economic savings; these bonds have the same parity-net-revenue pledge as MSD's other revenue debt outstanding, other than its subordinate state-revolving-fund debt.

In 2012, MSD's electorate authorized the issuance of $945 million of sewer system revenue bonds. In 2016, voters again authorized MSD to issue an additional $900 million of sewer system revenue bonds. Following the series 2017A issuance, MSD will have exhausted the 2012 authorization.

MSD provides wastewater treatment and storm water management to St. Louis and most of St. Louis County. The customer base is large with approximately 425,000 accounts; stable; and diversified. County accounts represent 80% of total customers. InBev (Anheuser-Busch InBev N.V./S.A.), the leading user, in St. Louis, accounted for just 1.6% of wastewater user charges in fiscal 2017. The next nine leading users account for 3.3%.

MSD has entered into a consent decree with the U.S. Environmental Protection Agency to address $4.7 billion, in 2010 dollars, of needs over a 23-year period, incorporating various projects as part of its combined-sewer-overflow long-term-control plan and sanitary-sewer-overflow projects. The consent decree, in MSD's view, aligns with its capital-improvement-and-replacement program (CIRP). MSD invested close to $1 billion in CIRP projects from fiscal years 2013-2016, including:

- $430 million for the elimination of sanitary sewer overflows,
- $244 million for system-renewal-and-capacity projects,
- $145 million for the reduction and control of combined sewer overflows, and
- $80 million for treatment-plant improvements.

MSD earmarked $1.4 billion in the 2017-2020 CIRP to continue to address consent-decree overflows, renewal-and-capacity projects, and treatment-plant improvements. To date, we understand that fiscal 2017 CIRP spending was underbudget and that management expects this to continue through fiscal 2020. Management expects to fund these CIRP projects from a mix of debt (72%) and cash on hand (28%).

MSD is finalizing an amendment to its consent decree that would extend the compliance date by an additional five years; management expects the extension to allow it to update certain capital project schedules, which will improve affordability during the remainder of the consent decree, particularly as it begins work on larger, more capital-intensive projects.

We consider rates affordable. Following a 10.5% rate increase in July 2017, the monthly average residential rate, as reported by management, for 700 cubic feet of use is $49.31. When benchmarked against St. Louis County's median household effective buying income of 111% and its 9.6% poverty rate, we consider rates affordable. MSD has already adopted a multiyear rate increase that extends through fiscal year-end 2020, including 10.8% and 10.6% increases in fiscal years 2019 and 2020, respectively.

Historical finances, measured by DSC and liquidity, have remained, in our opinion, strong. During fiscal years 2013-2017, net pledged revenue--essentially a standard net revenue calculation less unpledged property taxes--has covered annual total debt service by no less than 1.6x. During those same five fiscal years, unrestricted current cash and investments have represented no less than 500 days' cash on hand, as well as about 720 days', or $381 million, in fiscal 2017. Our analysis of MSD's projections indicates strong financial performance is likely to continue.

A wide array of management policies--including strategic, long-term capital, and pro forma financial planning--support the enterprise and financial risk profiles. MSD has adopted rate increases through fiscal 2020 to meet its targets of no less than 1.5x all-in DSC and, at least, 500 days' cash on hand; a formal policy, however, exists to maintain 60 days' operating reserves. Although MSD is operating under a consent decree, it has met all project deadlines. Management updates its strategic business plan and CIRP annually, including goals for customer outreach, revenue diversification, formal staff training, and capital improvements and replacements. Revenue and expense assumptions in management projections are, in our opinion, reasonable. Audits are completed in a timely manner compliant with generally accepted accounting principles.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that MSD will likely continue to adjust rates and expenses, as necessary, to maintain financial performance consistent with historical trends, particularly as it continues to fund CIRP projects with additional debt and pay-as-you-go funding.

Downside scenario

While unlikely during the current two-year outlook period, we could lower the rating if MSD cannot produce financial metrics we believe are consistent with the rating level, particularly since it continues to fund the large capital plan. We believe the additional debt needed to support its capital program and possible pressure on rate affordability as rates continue to increase to preserve a strong financial profile could pressure the rating further over the long term.