

Fitch Ratings

Fitch Rates Metro St. Louis Sewer District, MO's \$261MM Wastewater Revs 'AA+'; Outlook Stable

Fitch Ratings-Austin-21 November 2017: Fitch Ratings has assigned a 'AA+' rating to the following Metropolitan St. Louis Sewer District, Missouri (the district) revenue bonds:

--Approximately \$261 million wastewater system improvement and refunding revenue bonds series 2017A.

The bonds are scheduled to sell via negotiated sale the week of Dec. 4. Bond proceeds will be used to advance refund a portion of the district's series 2011B bonds, series 2012A bonds, and series 2013B bonds for savings, finance a portion of the district's capital improvement and replacement program (CIRP) costs, and pay costs of issuance.

In addition, Fitch has affirmed the 'AA+' rating on the following district bonds:

--\$995.2 million in outstanding wastewater system revenue bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are payable from net revenues of the district's sanitary sewer system (the system). No debt service reserve is being funded in connection with the series 2017A bonds.

KEY RATING DRIVERS

HEALTHY COVERAGE MARGINS PROJECTED: Total debt service coverage (DSC) was solid at 1.8x in fiscal 2017. Fitch expects DSC margins to come in at around 1.9x over fiscal years 2018-2020.

ESCALATING DEBT BURDEN: Leverage ratios are currently moderately high, with debt per customer at about \$3,460, and debt is likely to double over the next five years as a result of additional borrowing needs to address regulatory requirements. Furthermore, debt amortization is below average, with principal payout at 36% and 74% in 10 years and 20 years, respectively.

VOTER SUPPORT FOR DEBT: The district's charter requires voter approval of new debt issuance. Strong approval levels experienced to date should provide ongoing support for rate increases necessary to service the district's increasing debt.

STRONG LIQUIDITY: Liquidity margins are projected to remain strong. Current cash and investments at fiscal year-end 2017 equaled 726 days cash on hand (DCOH), including noncurrent unrestricted investments.

STABLE AND DIVERSE ECONOMY: The system serves a sizable, diverse and stable service area.

RATING SENSITIVITIES

REDUCED FINANCIAL MARGINS: Ongoing retail rate support will be critical to maintenance of the Metropolitan St. Louis Sewer District's rating given the rapid escalation in system debt. Coverage margins or leverage that are weaker than forecast levels, or a decline in liquidity below historical norms, would be expected to result in negative rating action.

CREDIT PROFILE

REDUCED BUT STILL SOUND FINANCIAL METRICS

Total DSC (including senior and subordinate-lien debt) coverage levels have been on a somewhat downward trend since fiscal 2010 with senior lien ADS coverage dropping to 2.8x in fiscal 2017, from a high of 6.2x in fiscal 2009; total ADS coverage was 1.8x in fiscal 2017, down from 2.7x in fiscal 2009. The decline has been driven mostly by an increase in borrowings related to the district's CIRP that have resulted in a two-fold increase in total debt service costs from fiscal 2009 to fiscal 2017 and a decline in investment earnings.

Due to the planned borrowings associated with the CIRP and its July 11 consent decree (see below), total coverage on all outstanding and anticipated debt is projected to be 1.9x and coverage on senior lien debt is projected to be in the 2.6x to 2.8x range in fiscals 2018 to 2020. Fitch's rating incorporates the slightly weaker DSC, although any deterioration in financial performance beyond projected levels would be expected to result in negative rating action.

Reserve balances remain very strong, with available current cash and investments at 2017 fiscal year-end equal to \$286 million or 598 DCOH. This amount does not include an additional \$61 million in unrestricted long-term (average duration of 1.4 years) investments, which when included yields 726 DCOH. Based on issuer projected cash flows through fiscal 2020, cash balances are expected to remain robust.

REGULATORY DRIVEN CAPITAL PLAN

The district executed a consent decree with the U.S. Environmental Protection Agency in July 2011 that substantially aligns with the district's CIRP. The consent decree provides for an estimated \$4.7 billion (in 2010 dollars) in projects implemented over 23 years that include the elimination of sanitary sewer overflows (SSO), implementation of the combined sewer overflow (CSO) long-term control plan, and asset reinvestment. The consent decree was entered into on April 27, 2012 with no substantive changes after the public comment period. The district has appropriated approximately \$1.2 billion in consent decree related capital projects through fiscal 2017.

RISING DEBT AND CAPITAL NEEDS

The fiscal years 2018-2020 capital program totals a substantial \$1.1 billion, with approximately 48% of the costs focused on SSO remediation, 18% for CSO control, and the remainder dedicated for system renewal and capacity projects and wastewater treatment plant improvements.

Approximately 74% of the plan from fiscal 2018 through fiscal 2020 is expected to be funded from existing and planned debt. Leverage ratios are expected to continue escalating, with outstanding debt per customer increasing from \$3,461 at the end of fiscal 2017 to over \$5,700 by the end of fiscal 2020 (relative to Fitch's sector 'AA' median of \$1,788 in five years). Furthermore, debt

amortization is below average with principal payout at 36% and 74% in 10 to 20 years, respectively (the new money portion of the series 2017A bonds is being issued as 30-year fixed rate debt).

Bonding capacity requires voter approval and the district's board maintains strong voter confidence, as evidenced by the 85% approval rate of the \$945 million authorization in June 2012, and 76% approval rate of the recent \$900 million authorization in April 2016. The series 2012A bonds issued in July 2012 represented the first installment of the 2012 authorization to fund a portion of the CIRP/consent decree requirements. The current offering represents the seventh and last installment of the 2012 authorization and the first installment of the 2016 authorization; new money bond proceeds will be used to provide funding for collection system improvements to reduce SSO's and CSO's, reduce building backups, design work on storage tunnels, tanks and relief sewers to improve system capacity, and continue construction of the Deer Creek Sanitary Tunnel (\$151 million).

REDUCED AFFORDABILITY

To support the additional planned debt, the board accepted the rate commission's proposed 2017 to 2020 rates in October 2015 with few changes. The fiscal 2017 average monthly wastewater bill of \$48.25 (assuming Fitch's standard usage of 8 hundred cubic feet, or 6,000 gallons of sewer flows per month) is right at Fitch's affordability threshold of 1% of the median household income (MHI). With the adopted rate hikes increasing by an annual average of 10% over the fiscal 2017 to 2020 period (or by 11% over the fiscal 2018 to 2020 period), overall affordability will be reduced.

SERVICE AREA

Serving a population of around 1.3 million and roughly 427,000 accounts, the district was established in 1954 to provide wastewater treatment and stormwater services to both the city of St. Louis and the vast majority of St. Louis County. The customer base is stable, with accounts experiencing flat growth over the past five fiscal years.

For September 2017, the county unemployment was 3.2%, compared to the state rate of 3.3% and national rate of 4.1%. The St. Louis metropolitan area is

the primary economic engine for Missouri and home to a number of Fortune 1,000 companies. Given its access to major waterways, it is a hub for trade and distribution.

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Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)
(<https://www.fitchratings.com/site/re/898969>)

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)
(<https://www.fitchratings.com/site/re/890402>)

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