MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Chester Water Auth., PA's $69M Ser. 2014 Water Revenue Bonds

Global Credit Research - 20 Oct 2014

Affirms Aa2 on $47M parity bonds

CHESTER WATER AUTHORITY, PA
Water Enterprise
PA

Moody's Rating

ISSUE		RATING
Water Revenue Bonds, Series of 2014		Aa2
Sale Amount	$68,700,000	
Expected Sale Date	11/01/14	
Rating Description	Revenue: Government Enterprise	

Moody's Outlook NOO

Opinion

NEW YORK, October 20, 2014 --Moody's Investors Service has assigned a Aa2 rating to the Chester Water Authority, PA's $68.7 million Series 2014 Water Revenue Bonds. Concurrently, we have also affirmed the Aa2 rating on approximately $47 million of previously issued parity bonds. The bonds are secured by a first lien on the authority's net water revenues.

About $35 million of the proceeds of the 2014 issue will be used to fund capital projects related to the authority's water treatment plant and water distribution mains. The remaining proceeds will be used to redeem all the authority's existing bonds in a variety of advance and current refundings. The refundings will generate estimated net present value savings of 4% of par. Upon completion of this transaction, the 2014 bonds will be the authority's only debt outstanding under a new indenture.

SUMMARY RATING RATIONALE

The Aa2 rating reflects the authority's large, diverse, and affluent service base; a dependable source of supply; above-average debt service coverage levels that are likely to decrease but remain solid; and modest debt.

STRENGTHS

Large, diverse, and affluent service base

Dependable water supply and ample treatment capacity

Modest debt

CHALLENGES

Expectations for declining debt service coverage

Recent loss of several major industrial customers

DETAILED CREDIT DISCUSSION

ADEQUATE LEGAL PROVISIONS UNDER NEW INDENTURE

The legal provisions of the 2014 bonds are adequate. The authority has drafted a new indenture, and will discharge the existing bond resolution once the previously issued bonds are redeemed. The provisions under the new indenture will be different from the ones governing the previously issued parity debt.

Under the new indenture, the 2014 bonds will be secured by a first lien on the authority's net water revenues. The authority has adopted a rate covenant requiring it to cover annual debt service by 1.2 times. The rate covenant under the previous indenture was sum sufficient. The new indenture includes an additional bonds test of 1.2 times, in contrast to the old indenture which had a complicated, multi-pronged ABT that made long-term capital planning difficult.

The authority is still evaluating whether to issue the 2014 bonds with a debt service reserve fund.

DEPENDABLE SUPPLY SOURCES; AMPLE CAPACITY

The authority benefits from abundant access to freshwater and ample treatment capacity relative to actual demand.

The authority treats and distributes water to a region in Chester County (Aaa stable) and Delaware County (Aa1) with a population totaling about 200,000 people.

The authority operates one water treatment plant, which draws water from the Susquehanna River and from the Octoraro Reservoir. The plant has a treatment capacity of 60 million gallons per day, equal to the authority's water allocation under its permit with the state Department of Environmental Protection, which expires in 2038. Supply is ample relative to actual demand of about 30 million gallons per day, which has been declining.

Last year, the authority began to experience water loss rates of more than 20%. Although the authority has actively invested in its capital infrastructure, its system is old and pipes spring leaks. After identifying a large source of leakage this year, the water loss rate is back down closer to 15%, consistent with targeted levels.

AFFLUENT SERVICE BASE

The region served by the authority is affluent, diverse, and stable.

The authority serves about 42,700 accounts in 31 municipalities in Chester and Delaware Counties. The largest municipality served by the authority is the City of Chester, which has a high poverty rate of more than 31% and low income levels, with median family income at just 54% of the US median. However, the city is only about 20% of the authority's service base, and we believe the median family incomes of Chester County (162% of US median) and Delaware County (126%) are more representative of the overall base, which is largely suburban. The next-biggest authority-served municipality after Chester is the Township of Concord (Aa1), which has an MFI equal to 194% of the US median.

The authority once served a large industrial base, which had been 40% of billings and is now less than 20%. That decline will likely continue as the region becomes less industrial and more residential. Residential accounts (40% of billings) and commercial accounts (17% of billings) have offset some of the loss of industrial use, as this region has suburbanized and developed over the past few decades. But overall flow has still been decreasing as development has flattened and water conservation techniques lead to water use declines nationwide.

The authority also serves 10 wholesale customers, including water companies and municipal utilities (17% of flow).

STRONG COVERAGE LIKELY TO DECLINE

The authority's strong debt service coverage levels are likely to decline over the next few years, but remain solid.

Because of the complicated ABT under the existing indenture, the authority has historically had difficulty debt-financing its capital needs and has engaged in a lot of pay-as-you-go capital funding.

The combination of relatively low debt and the need to generate capital funds from operations has led to strong debt service coverage levels. Coverage in 2013 was about 2.3x, and the average coverage over the past five years has been 2.6x.

Now that the authority has revised its ABT, it will likely fund more of its capital needs with debt, leading to both higher debt service and less need to generate operational surpluses for capital funding. Using conservative projections of no rate increases and flat demand, the authority projects coverage of approximately 1.7x in 2016, which is the year of projected maximum annual debt service on the 2014 bonds. Declines of this magnitude may begin to place downward pressure on the rating, especially if the service base does not grow.

MODEST DEBT THAT WILL BEGIN TO GROW

The authority's currently modest debt burden will likely grow now that the ABT has been revised. At the end of 2013, the authority's outstanding debt was $47 million, which net of debt service reserve funds was a modest 17% of net fixed assets and 0.9 times revenues. We estimate debt will increase to roughly 1.7x revenues and 27% of net fixed assets with the current issue.

The authority does not have glaring capital needs, as it has historically invested proactively in its capital assets each year. Capital investments have annually exceeded the rate of depreciation, leading to increases in net fixed assets over time. However, to the extent that capital investments will now be relatively more debt-funded than in the past, the debt burden is likely to grow further from current levels.

The system finished 2013 with a relatively lean 44 days cash on hand, a notable weakness considering the 2014 bonds may be issued without a debt service reserve fund. However, we expect liquidity to increase for two reasons. First, of the current issue, about $6 million will be used to reimburse the authority for pay-as-you-go capital funding, money that will be added to operating cash. Second, the authority prevailed in a lawsuit against its biggest wholesale customer, Artesian Water, which had withheld payments in a dispute over rates. The outcome of the lawsuit was to order Artesian Water to pay the authority roughly $3.1 million, money that will also be added to operating cash.

Between these two sources, we expect a larger operating cash balance going forward.

WHAT COULD CHANGE THE RATING UP:

Growth in service base and revenues

Improved debt service coverage and liquidity

WHAT COULD CHANGE THE RATING DOWN:

Decreases in debt service coverage beyond levels currently anticipated

Significant increases in debt beyond levels currently anticipated

KEY STATISTICS:

Population served (estimated): 200,000

Accounts: 42,732

Service area median family income (estimated): 120% - 130% of US median

Treatment capacity: 60 MGD

Actual demand: 30 MGD

Debt to fixed assets: 17%

2013 operating revenues: $41.5M

2013 net revenues: $14.1M

2013 debt service coverage: 2.3x

2014 projected debt service coverage: 2.5x

2013 net revenues to Series 2014 maximum annual debt service: 2.1x

2013 days cash on hand: 44 days

RATING METHODOLOGY

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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