

**RATING ACTION COMMENTARY**

# **Fitch Affirms Central Brown County Water Auth, WI's Water System Revs at 'AA-'; Outlook Stable**

Fri 04 Dec, 2020 - 3:29 PM ET

Fitch Ratings - Austin - 04 Dec 2020: Fitch Ratings has affirmed the following bonds issued by the Central Brown County Water Authority, WI (CBCWA, or the authority) at 'AA-':

--Approximately \$92.8 million water system revenue refunding bonds, series 2014A.

In addition, Fitch has assigned a 'AA-' Issuer Default Rating (IDR) to CBCWA.

The Rating Outlook is Stable.

## **ANALYTICAL CONCLUSION**

Fitch's 'AA-' rating and IDR reflect the authority's sufficient and improving net-adjusted debt to adjusted funds available for debt service (FADS), or net leverage, of approximately 9.5x in 2019 (the authority's fiscal year ends Dec. 31) within the context of its very strong revenue defensibility and operating risk profiles. The revenue defensibility assessment considers the strength of authority's wholesale contracts to its six members (the members),

which allows it to reallocate any hypothetical shortfalls by a nonpaying member among its performing members. Member purchaser credit quality (PCQ) is strong, driven primarily by the authority's two largest members, the city of De Pere (water revenue bonds rated 'A+'/'Stable) and the village of Howard (unrated by Fitch but internally assessed to be of very strong credit quality). The operating risk profile considers the authority's very low cost burden coupled with its similarly very favorable lifecycle ratio.

## **CREDIT PROFILE**

CBCWA provides wholesale water to its members, which - in addition to De Pere and Howard - include the villages of Allouez and Bellevue and the towns of Lawrence and Ledgeview. The retail members provide service to a combined total of approximately 30,400 water customers in and around the city of Green Bay, WI. CBCWA is a wholesale water customer of Manitowoc Public Utilities (MPU), which provides the authority's treated water supply drawn from Lake Michigan. MPU's current treatment capacity allocated to CBCWA is 20 million gallons per day (mgd), well above the combined members' average demand of approximately 6.7 mgd in 2019.

### Coronavirus Considerations

The ongoing coronavirus pandemic reportedly has not materially impacted the authority's revenue. Further, water use remains relatively unchanged from historical consumption patterns. However, Fitch's ratings remain forward-looking in nature; as such, the agency will continue to monitor developments related to the severity and duration of the pandemic and revise expectations for future performance as appropriate.

## **KEY RATING DRIVERS**

### **Revenue Defensibility 'aa'**

Full Ability to Reallocate Costs, Strong Purchaser Credit Quality

Agreements with the authority's members include an unlimited step-up provision that requires performing members to absorb any nonpayment of defaulting members. Rate-

setting is not subject to external approval, providing sound rate flexibility. Lastly, the authority's largest members are of strong credit quality overall.

### **Operating Risks 'aa'**

Very Low Operating Cost Burden, Favorable Capital Planning

The cost per million gallons (mg) delivered is very low, as the authority's operating cost burden finished at just \$1,947 per mg in 2019. The authority's lifecycle ratio is equally favorable given that the distribution-system infrastructure is within the midrange of its useful life.

### **Financial Profile 'aa'**

Improving Leverage Metrics, Minimal Capital Needs

Net leverage has improved to 9.5x in 2019 from 14.1x in 2015. Capital needs are manageable and no new debt is expected, which should lead to further improvements in leverage over time. The authority's coverage of full obligations (COFO) and liquidity profile are also sound and neutral to the assessment.

### **ASYMMETRIC ADDITIVE RISK CONSIDERATIONS**

No asymmetric additive risk considerations affected this rating determination.

### **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Continued improvements in net leverage that approach the 7.0x-8.0x range, assuming no deviations from the current revenue defensibility and operating risks assessments.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Unexpected changes in the authority's planned capital spending that result in a need to issue material levels of debt, in turn leading to net leverage generally exceeding 10.0x.

--Downward revisions to the authority's largest members' credit quality.

--Material declines in liquidity that expose bondholders to timing risk of the true-up.

--Less than sum-sufficient COFO without offsetting liquidity, per Fitch's criteria.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [\[https://www.fitchratings.com/site/re/10111579\]](https://www.fitchratings.com/site/re/10111579).

## **SECURITY**

The bonds are secured by net system revenues of the authority, which consist of payments made under water sales contracts from its six members' respective water systems.

## **REVENUE DEFENSIBILITY**

The authority's revenue defensibility is very strong, supporting an assessment of 'aa'. Under the water supply contract between the authority and its members, which provides for full cost recovery, members are billed for operations and maintenance costs, fixed costs (including the payment of debt service and capital costs) and security fund deposits, with such funds held by CBCWA. The contracts are absolute and unconditional take-or-pay obligations requiring members to pay debt service regardless of whether or not any water is delivered. Member systems make payments as an operating expense of their respective retail water systems, senior to any debt service. Although the authority is subject to the jurisdiction of the state's Public Service Commission (PSC), rates are not subject to PSC approval.

In the case of a member default, remaining members are obligated to compensate for nonpayment of defaulting members on a pro-rata basis via funds available in their respective security fund accounts, thereby creating an unlimited step-up feature. While Fitch views the step-up as providing unlimited ability to reallocate costs, Fitch notes that the reallocation occurs during the first quarter of the following year. However, Fitch believes the required debt service reserve and security fund reserves provides sufficient protection to mitigate any timing risks.

The city of De Pere and the village of Howard represented approximately 56% of water sales in 2019. The next two largest members, the villages of Allouez and Bellevue, represented another 32% of annual sales and are deemed to have sound credit characteristics by Fitch. The remaining members represented about 12% of total sales. Overall PCQ is considered strong.

For more information on De Pere, see Fitch's press release, "Fitch Affirms De Pere, WI's Water Utility Revs at 'A+'; Outlook Stable", dated Sept. 29, 2020, available at [www.fitchratings.com](http://www.fitchratings.com).

## **OPERATING RISKS**

The authority's operating risks assessment of 'aa' is supported by a very low operating cost burden and a very favorable lifecycle ratio. The operating cost burden finished 2019 at just \$1,950/mg, which is well below Fitch's 'aa' threshold of \$6,500/mg. Given the completion of the distribution system in 2007, the authority's lifecycle ratio is very favorable at 22%, compared to Fitch's 'aa' threshold of 45%. Capex-to-depreciation has averaged about 74% over the past five years, a level Fitch views as adequate given the robust lifecycle ratio.

Approximately \$2.0 million in planned capital spending is expected from 2020 through 2024. Capital investment focuses primarily on efficiency-improvement upgrades and maintenance of existing infrastructure. Management is also assessing future asset management needs to address renewal of the system as it begins to age. However, no major projects are currently anticipated, nor is any new debt issuance.

## **FINANCIAL PROFILE**

The authority's overall financial profile is very strong, assessed at 'aa'. Member charges are set to cover the cost of operations, resulting in COFO typically finishing at 1.0x-1.1x (for 2019, it finished at 1.1x). CBCWA's liquidity cushion ratio/days' cash has remained very strong over the past five years, most recently finishing at 988 days. The ample liquidity balance is based on a significant level of unrestricted cash in addition to restricted monies in its renewal and replacement account, operations and maintenance reserve and coverage account. Together, these funds totaled about \$6.7 million in 2019. The authority's sufficient COFO and strong cash balances result in a liquidity profile that is considered neutral to the overall financial profile assessment.

Debt financing used in the construction of CBCWA's distribution system in 2005 (which was refunded with the authority's 2014A bonds) resulted in elevated leverage metrics throughout much of the last five-plus years. For example, in 2015, net leverage was approximately 14.1x. However, with the completion of the distribution system, limited additional capital needs and ongoing debt amortization, net leverage improved to 9.5x in 2019 and should continue to improve over the next five years.

### **Fitch Analytical Stress Test (FAST)**

The five-year forward look produced by the FAST considers the potential trend of key ratios in base case and stress case scenarios. The authority does not produce a financial forecast; therefore, Fitch used management's budgeted numbers in 2020 followed by inflationary changes in expenses and flat revenue growth. The assumptions are supported by management's expectation that revenues and expenses will remain fairly flat over the next several years. Similarly, budgeted 2020 numbers were also used for capital spending for that year, followed by numbers provided by management in their 2021 10-year capital plan. No sensitization adjustments were made in the FAST related to the pandemic given the authority's minimal revenue interruption to date and the requirement for members to fund all budgeted costs regardless of usage.

The base case and stress case produced through the FAST scenario analysis indicate continued improvements in net leverage, with this metric estimated to fall in the base case to about 7.6x by 2024 due to amortization of existing debt and manageable capex. Fitch's rating stress case, which applies a 10% increase in unaccounted-for capital expenses over the five-year period, resulted in only a slight difference in results given the small size of the capital plan, although net leverage also ends at 7.6x in 2024.

## **ASYMMETRIC ADDITIVE RISK CONSIDERATIONS**

No asymmetric additive risk considerations affected this rating assessment.

## **SOURCES OF INFORMATION**

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **ESG CONSIDERATIONS**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## **RATING ACTIONS**

**ENTITY/DEBT**

**RATING**

**PRIOR**



ENTITY/DEBT	RATING			PRIOR
Central Brown County Water Authority (WI)	LT IDR	AA- Rating Outlook Stable	New Rating	
● Central Brown County Water Authority (WI) /Water Revenues/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub. 03 Apr 2020\) \(including rating assumption sensitivity\)](#)

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Central Brown County Water Authority (WI)

EU Endorsed

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