

# RatingsDirect®

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## Summary:

# Palm Coast, Florida; Water/Sewer

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### Credit Profile

US\$85.505 mil imp & rfdg rev bnds ser 2013 due 10/01/2036

<i>Long Term Rating</i>	A+/Stable	New
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#### **Palm Coast Util Sys**

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
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Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services raised its rating to 'A+' from 'A' on Palm Coast, Fla.'s utility system revenue-secured bonds. The upgrade reflects recent adopted rate increases, above the automatic inflationary rate, which we believe will lead the city to maintain at least good coverage levels of total debt service and further cushion the combined utility's financial position in the event of any economic downturns in the city. At the same time, Standard & Poor's assigned its 'A+' rating to the city's 2013 utility system and improvement and refunding bonds. The outlook on all ratings is stable.

The rating reflects our assessment of:

- The service area's location within the Daytona Beach, Fla. metropolitan statistical area;
- A primarily residential customer base that grew steadily over time but that we believe weakened during the recent economic recession and is now showing signs of improvement;
- Adequate historical coverage of debt service on an all-in basis and improving liquidity levels that had declined in recent years; and
- The city's rate-setting autonomy.

Partially offsetting credit considerations, in our view, include a relatively high debt to plant ratio with additional debt needs and rising rates, in respect to the underlying income levels.

The bonds are secured by an irrevocable lien on the pledged revenues, which consist of the net revenues of Palm Coast's utility system and the sewer system and water system capital facilities fees. The utility was purchased in 2003 from Florida Water Services Inc., a private water company. Bond proceeds will refund the 2003 bonds for interest cost savings and fund some of the city's water and sewer's capital needs. The city plans to use the debt service reserve from its 2003 bonds to pay some of those capital needs as well. The city's capital improvement plan for the water and sewer system totaled \$54.4 million between 2013 and 2017.

Palm Coast is in the eastern portion of Flagler County, straddling Interstate 95 and extending almost to the intercoastal waterway. The city was incorporated in 1999 and has been one of the more rapidly growing cities in Florida. It estimates the current population at more than 76,450, which more than doubled between 2002 and 2012 and is

approximately three-quarters of total county population. Palm Coast's economy has weakened considerably in the past few years, with a sharp decline in residential building, increased foreclosures, and declining property values. The city's preliminary assessed value for fiscal 2013 declined to \$3.6 billion, which is down 48% from 2008 levels. Nevertheless, the utility's financial position has not significantly changed. The unemployment rate was 9.3% for the city in March 2013 after averaging 11.4% in 2012. The state rate was 7.2% in March 2013 and averaged 8.6% in 2012. Income levels have remained good, with the city's 2012 median household and per capita effective buying income (EBI) at 97% and 94%, respectively, of national averages. Peak daily water demand was at 9.5 millions of gallons per day (mgd) in 2012 down from 11.1 mgd in 2011. Average demand has been at 7.0 mgd-7.4 mgd in the past four fiscal years (2009-2012). On the wastewater side, peak daily wastewater treatment increased to 5.3 mgd in 2012 from 5.0 mgd in 2011 but was down from 5.8 mgd in fiscal 2010. Average wastewater demand was between 4.8 mgd-5 mgd over the same time period. Capacity is plentiful for both the water and sewer systems. Palm Coast is not facing any significant regulatory issues. Water loss in relation to water pumped has been low, at 5% in 2012. The city bills monthly for its water and sewer service with on-time collection levels in excess of 95%.

The utility services the city and some customers outside the city limits. We understand the majority of the existing customer base is residential with no specific customer concentration. The water system serves more than 42,720 customers while the sewer system serves nearly 35,100 customers. Both systems have experienced marginal increases in the past few years and the city expects this trend to continue over the next few years. The 10 leading customers account for a very diverse 1.5% of fiscal 2012 revenues. In affording the city's capital needs, including appropriately servicing its debt and maintaining good financial levels, the city adopted 8% rate increases for both systems that went into effect April 1, 2013, with adopted rate increases of 4% effective in both Oct. 1, 2013 and 2014. Without city council action, the city has rate adjustments in place measured against the consumer price index. Current combined rates average out to \$90.94 per 8,000 gallons for a monthly residential bill, or 2.7% of median household EBI. Water makes up \$47.11 and sewer comprises the remainder. By Oct. 1, 2015, combined rates will reach \$98.33, or 3% of median household EBI.

Despite the general economic trends in the service area, the system's financial performance has been adequate in our view. Operating revenues have continued to increase marginally in recent years, but still showed at least adequate coverage of annual debt service. Net revenues, when excluding capital facilities fees, showed annual debt service coverage of 1.5x senior-lien debt and 1.07x all-in debt in fiscal 2011 and 1.6x senior-lien debt and 1.34x all-in debt and interest earnings in fiscal 2012. The system's rate covenant is 1.1x on senior-lien debt and 1.05x on all debt excluding capital facilities fees. Using net revenues, excluding capital facilities fees, coverage of maximum annual debt service (MADS) in fiscal 2012, is at 1.29x. The city is projecting coverage of senior-lien debt service to range between 1.5x-1.69x between fiscals 2013-2017 and all-in debt of at least 1.3x. The city makes payments in lieu of taxes, which have hovered around \$880,000 in the past few years, but also has been making transfers to the renewal, replacement, and improvement fund. The transfers account for 5% of gross system revenues.

The system's liquidity position declined from 2009 to 2011, but improved slightly in fiscal 2012. However, it still continues to be good in our opinion; the utility had \$3.5 million of unrestricted cash at fiscal year-end 2012 providing 86 days of cash in hand, which was improved from \$3.1 million in fiscal 2011, or 73 days. The city is budgeting for liquidity levels to increase by more than \$2.0 million in fiscal 2013 and to continue to increase in subsequent years. It

targets to build reserves to cover at least three months of operating expenditures.

In our opinion, the utility's debt to plant ratio has been high, with fiscal 2012 levels at 77% and \$146.3 million of debt outstanding. After this issue, the city plans to issue nearly \$15 million in bonds in 2014 to fund some of the capital needs. The city, at this point, plans to use internal funds to address the remainder of its capital needs.

## **Outlook**

The stable outlook reflects our expectation of at least good financial operations as Palm Coast continue service its additional debt and capital needs to be addressed over the next few years. Upward rating movement is limited during the current two-year outlook period. Downward rating movement, while not expected, would occur if the city's finances were to significantly less than the city's projections.

## **Related Criteria And Research**

- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008

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