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Summary:

Mobile Board Of Water & Sewer Commissioners, Alabama; Water/Sewer

Primary Credit Analyst:

Scott W Sagen, Dallas (1) 214-765-5867; scott.sagen@standardandpoors.com

Secondary Contact:

Theodore A Chapman, Dallas (1) 214-871-1401; theodore.chapman@standardandpoors.com

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Summary:

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Credit Profile

Mobile Brd of Wtr & Swr Commissioners WS ser 2006

Unenhanced Rating

AA(SPUR)/Stable

Upgraded

Mobile Brd of Wtr & Swr Commissioners WS ser 2010

Long Term Rating

AA/Stable

Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on Mobile Board of Water & Sewer Commissioners, Ala.'s water and sewer revenue debt one notch to 'AA' from 'AA-'. The outlook is stable.

The upgrade reflects our opinion of the board's ability to maintain strong debt service coverage (DSC) and very strong liquidity consistently as it cash funds the majority of its capital needs over the next five years.

The rating also reflects our opinion of the board's:

- Strong finances with consistently strong DSC and very strong liquidity,
- Stable operations with an ample water supply, and
- Expanding local economy with a diverse and primarily residential customer base.

We believe what we consider below-average income in the service area economy somewhat constrains the rating.

A first-lien net system revenue pledge secures the series 2010 and 2006 bonds, which are senior to the board's state revolving fund loans. The upgrade affects about \$184 million of utility revenue debt.

We consider finances strong, evidenced by its strong DSC and cash. Net revenue in fiscal 2012 provided, what we view as, a strong 2x DSC of approximately \$17.3 million of annual debt service payments. When including debt service from subordinate state revolving fund loans, DSC decreases but remains, in our view, a strong 1.56x, down from, in our opinion, a strong 1.7x in fiscal 2011. The system typically designates revenue available after debt service toward pay-as-you-go capital financing, and it usually has roughly \$15 million available for such projects annually.

Management's policy is to maintain a minimum unrestricted cash reserve at 20% of budget. At fiscal year-end 2012, the system had \$24.8 million of cash, or, in our view, a good 162 days' cash on hand. According to officials, cash totaled \$23.9 million in June 2013; they also consider \$32.8 million of additional restricted general reserves available.

In fall 2012, the electorate approved the transfer of Prichard Water & Sewer Board's assets, liabilities, and operations to the board. The board began operating Prichard in February 2013. Prichard's board appealed the court's decision to

the Alabama Supreme Court. We understand Mobile's board will continue to operate the system and assume Prichard's \$23.02 million of debt unless the state Supreme Court reverses the lower court's ruling.

The board serves about 85,527 water customers and 82,658 sewer customers in Mobile, as well as some other portions of Mobile County. Two water sources supply water to the board's two treatment facilities, which are capable of treating and delivering 90 million gallons per day (mgd) to its customers. Current average and peak daily usages are well below this maximum, providing the system with ample additional water capacity. The system handles wastewater at two main treatment facilities and several smaller onsite treatment facilities that can treat up to 41 mgd. Average and peak wastewater flows are 38.3 mgd and 107 mgd, respectively; the system stores peak flows in excess of capacity and treats it when capacity becomes available. Management believes that wastewater treatment capacity is currently adequate but that it might need to expand capacity in about five years. Customer growth has been, in our view, relatively flat while usage, and subsequently revenue, has varied, depending on weather conditions. The customer base is primarily residential, but the system functions as a wholesale provider to two smaller water systems; Prichard accounts for about 8% of treated water sold. The 10 leading system customers, including wholesale providers, account for a moderately concentrated 27.8% of consumption.

The average monthly combined water and wastewater bill based on 7,500 gallons consumed is, in our view, an above-average \$71.13 in 2013. The board studies rates annually, and officials raised rates by 5% in both 2012 and 2013 to cover system costs and help fund additional capital needs. According to bond provisions, the system must set rates to provide revenue that will generate 1.2x DSC of the annual debt service requirement. Management is considering an additional rate increase of approximately 5% annually through 2016 to help fund system capital projects.

Debt is, in our opinion, moderate: The debt-to-plant ratio equaled 48% of the plant's net value in fiscal 2012. In addition, the board transferred \$4.5 million into a trust to help fund the \$39 million other postemployment benefits liability. The board has identified roughly \$83.7 million of potential additional capital needs during the next five years. To the extent surplus operating revenue is available, management will fund some remaining capital improvements with roughly \$15 million annually through pay-as-you-go financing. According to officials, the system will also likely require additional debt; we understand management plans to issue approximately \$20 million of state revolving fund loans in 2014 to fund water line improvements. The additional bonds test requires the system to generate revenue equal to 125% of projected maximum annual debt service on outstanding and proposed bonds in 12 of the previous 18 months.

Mobile, with a population estimate of 200,000, is about 27 miles north of the Gulf of Mexico at the head of Mobile Bay. The city serves as the surrounding area's regional trade and service center. The area economy centers on education, health care, manufacturing, and shipping. Unemployment was roughly 7.7% for May 2013, just above the nation's average. Median household effective buying income is, in our opinion, an adequate, but below-average, 72% of the national average. Mobile has successfully attracted a number of new employers to the region; we understand these employers are investing heavily across a number of fields, including petroleum, shipbuilding, and other manufacturing.

Outlook

The stable outlook reflects Standard & Poor's opinion of the system's ample water supply and adequate wastewater treatment capacity, as well as its strong financial performance, evidenced by strong DSC and very strong liquidity. In addition, we believe the system will likely cash fund the majority of its capital program without significantly affecting financial performance. We do not expect additional upward rating mobility due to, what we consider, the service area's below-average income.

Related Criteria And Research

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

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