

RatingsDirect®

Summary:

Davie, Florida; Water/Sewer

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Summary:

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Credit Profile

US\$28.15 mil wtr & swr rev bnds ser 2012 due 10/01/2042

Long Term Rating A/Stable New

Davie wtr & swr (AGM)

Unenhanced Rating A(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has assigned its 'A' long-term rating to the Town of Davie, Fla.'s water and sewer revenue bonds series 2012. At the same time, Standard & Poor's affirmed its 'A' underlying rating on Davie's parity debt outstanding. The outlook is stable.

The rating reflects what we view as the following positive credit factors:

- A strong service area economy that has above-average wealth and income levels;
- Strong historical liquidity position; and
- No additional new money debt needs through fiscal 2017.

Offsetting credit weaknesses, in our opinion, include:

- Relatively high rates that we expect to continue increasing automatically annually;
- Coverage levels that will likely fall to adequate levels from levels we consider strong due to higher, although level, debt service requirements; and
- A highly leverage system, with a debt-to-plant ratio that exceeds 80%.

Securing the bonds is a first-lien pledge on expected revenues, which consists of the system's net revenues and contribution charge. The majority of the 2012 bond proceeds will finance the construction of a new 6.0 million gallon per day (mgd) water treatment plant, finance a new 3.5 mgd wastewater treatment facility, and fund the construction of a utilities department and administration office. Similar to most the utility's outstanding revenue bonds, we expect a surety from Assured Guaranty Municipal Corp. (AA-/Stable/--) will satisfy the debt service reserve requirement.

Davie's CIP for its water and sewer system totals approximately \$86.5 million for fiscal years 2012-2017, excluding any additional capital expenditures from the possible acquisition of Ferncrest Utilities Inc., a private utility serving the town. The town is financing approximately 55% of the CIP with bond proceeds from a prior bond issue (series 2011); 31% from this issue; and the remainder from operating reserves, capital replacement account deposits, contribution charges, rate revenues, and South Florida Water Management District grants. The CIP consists of building new water production and treatment facilities as well as wastewater treatment and disposal facilities to allow for the decommissioning of certain facilities that have reached their useful service life (replacement capacity), provide

additional capacity, projects to adequately maintain the system, and meet certain regulatory mandates.

We believe the system's service area has been less affected from the recession than other parts of Florida. Davie (AA-/Stable general obligation [GO] rating), in Broward County (AA+/Stable GO rating) and with an estimated population of approximately 85,629, benefits from its proximity and access to downtown Miami and Fort Lauderdale, along with Broward's westward expansion. From 2000-2010, the town's population increased 12.5%. As a result of the recession, however, Davie's population remained relatively flat, increasing only 0.2%, on average, per year from 2008-2011. We consider the town's wealth levels strong, with 2011 wealth and income levels at 120% of state and 114% of national levels. The town's unemployment of 6.4% as of August 2012 is also favorable relative to the 9.0% state and 8.2% national averages. Although Davie's once primarily agricultural economy had been increasing significantly and becoming more urban before the downturn, it continues to have growth potential, in our opinion. The rate at which it increases, however, depends on economic conditions. The town projects additional growth based on redeveloping the Regional Activity Center (RAC) and the Transit Oriented Corridor (TOC). The RAC is a 2,244-acre area intended to serve as a center for regional education and employment. The TOC is about 925 acres in size and intended to attract businesses and residents toward a downtown business district close to major traffic arteries.

Davie's water and sewer system serves approximately 10,096 water and 7,715 sewer customers accounting for only a portion of the town. The town also provides water and sewer services through a bulk service agreement to the Seminole Tribe of Florida Hard Rock Hotel and Entertainment Complex, its largest water and sewer customer, which accounts for approximately 9% of combined water and sewer rate revenues for fiscal 2011 (year ended Sept. 30). Either party can terminate the agreement with 12 months' notice. We consider the system's customer base to be diverse, with the top 10 customers accounting for approximately 23% of combined water and sewer rate revenue for fiscal 2011. About 20% of the customer accounts for Davie's water and sewer systems are nonresidential or commercial, with single and multifamily residential accounts representing the bulk of the remaining 80%.

We consider the system's liquidity historically strong, with fiscal year-end unrestricted cash balances ranging from \$13.2 million to \$15.3 million from fiscal years 2009-2011, providing no less than 480 days' operations. As of Sept. 30, 2012 management reported an unaudited unrestricted cash balance of \$15.0 million, providing 628 days' operations.

Debt service coverage (DSC), not including transfers to or from the rate-stabilization fund, has historically been strong, in our view, with or without growth-driven contribution charges. It has ranged from 2.2x-3.5x from fiscal years 2009-2011 including contribution charges and 1.7x-3.3x excluding them. This DSC, however, is the result of the town increasing rates significantly to address increasing debt service requirements that will cause DSC to decline despite the rate increases. More specifically, Davie raised its water and sewer rates significantly in January 2008 (fiscal 2008) 50% for water and 65% for sewer service. In October 2008 (fiscal 2009), it increased rates again 20% for each service, followed by a 9% and 16% annual rate increases for water and sewer, respectively, in October 2009, October 2010, and October 2011. The current rate ordinance authorizes automatic annual rate increases equal to the lesser of 3.5% or 100% of the percentage change in the CPI reported by the Bureau of Labor Statistics as of April of each year, commencing Oct. 1, 2012, unless the town council takes action. Rates increased 2% for each service on Oct. 1, 2012, reflecting the application of the indexing provision.

DSC for fiscal 2012 is what we view as a strong 1.8x, based on estimated results. Updated forecasts prepared in

connection this bond issue assume the town transferring approximately \$1.2 million in fiscal 2013, \$1.2 million in 2014, and \$660,000 in 2015 from the rate-stabilization fund to help meet coverage in those years, which is counted toward net revenues in calculating coverage. DSC from fiscal years 2013-2017 ranges from 1.25x-1.32x including contribution charges and transfers from the fund. Without these, DSC drops, ranging from 1.05x-1.16x, which we consider adequate. In addition to the fund transfers, these coverage figures assume customer growth and additional annual rate increases of 1.7% to 2.3% for each service in fiscal years 2014-2017. The rate increases reflect the index the forecast assumes and the application of price index rate adjustments approved by the town council and recognized in the rate ordinance. If operating revenues were to come in significantly lower than forecast and officials do not make timely budget adjustments, thereby increasing reliance on fund transfers to meet coverage, the rating could face downward pressure.

Usage has declined in the past three years due to water restrictions, weaker economic conditions, and price elasticity. Raw water for the town is obtained from the Biscayne Aquifer through two well fields. Average daily water consumption in fiscal 2011 was 4.15 mgd, or 63% of the 6.54 mgd capacity, with a peak flow of 5.58 mgd, or 85%. On the wastewater side, average daily flow was 3.24 mgd, or 61%; and peak flow was 3.56 mgd, or 67%. For fiscal 2012, management projects peak usage increasing to about 94% of capacity for water and 67% for sewage facilities before decreasing to 62% for water and 39% for sewerage facilities in fiscal 2013, when we expect the new facilities will come online.

We consider the rates to be high, at more than \$134.14 for 8,000 gallons of combined water and sewer use. The forecast assumes annual debt service requirements to increase 17% to nearly \$9.0 million before leveling off at \$9.2 million from fiscal 2014 on. Leverage is high in our view, with net debt-to-plant of 86% before this bond issue. The town, however, has no additional new money debt needs through fiscal 2017.

Despite Davie's recent series of material rate increases and resulting high rates, its water and sewer system has experienced a slight increase in customer accounts while experiencing modest declines in water and sewer flows. More specifically, from fiscal years 2007-2011, total system average annual water accounts increased 1.3% on average, while average daily flow (in millions of gallons per day) declined 1.6%, on average. Trends were similar for Davie's sewer system, which experienced a 1.3% average annual increase in customer accounts from fiscal years 2008-2011, while average daily flow declined 1.5%, on average.

We consider the bond provisions permissive. They include a 1.15x rate covenant based on net revenue and contribution charges; a historical 1.15x maximum annual debt service additional bonds test; and the ability to use money in the rate-stabilization fund, if necessary, to help meet coverage or pay operating expenses. The town has not used fund money yet. Management reports that on Sept. 30, 2012, the fund balance totaled approximately \$4.9 million. Davie council can also decide to transfer a portion of gross revenues to the fund after satisfying required transfers. If any fund amounts are not needed to meet DSC or pay expenses, these will be available in later years.

Outlook

The stable outlook reflects our expectation that management will adjust rates as necessary so that the system provides

DSC we consider adequate. We do not expect to raise the rating in the next two years, given the system's high debt load. We could lower the rating if a material erosion in liquidity occurs or if the town is unable to implement timely rate increases needed to produce at least adequate DSC.

Temporary telephone contact number: Joseph Pezzimenti (646-823-4311).

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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