

Research

Summary:

Olathe, Kansas; Water/Sewer

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Summary:

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Credit Profile

US\$38.3 mil wtr & swr imp rev bnds ser 2021 dtd 05/20/2021 due 07/01/2041

Long Term Rating AA/Stable New

Olathe WS

Long Term Rating AA/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' rating to Olathe, Kan.'s approximately \$38.3 million series 2021 water and sewer system improvement and refunding revenue bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating on the city's existing water and wastewater system revenue debt. The outlook is stable.

The rating reflects our opinion of the city's very strong enterprise and financial risk profiles.

Officials will use the series 2020 bond proceeds to both refund the series 2010C bonds and finance utility system capital improvements. A first-lien pledge on the system's net revenue secures the bonds. Bond provisions, in our opinion, are credit neutral. A debt service reserve requirement will be funded to equal the least of the three-prong test. The city has established a rate covenant requiring 1.1x average annual debt service coverage (DSC) on all bonds. An additional bonds test limits the issuance of new debt unless net revenue either from the previous fiscal year or on a pro forma basis is at least 1.1x annual debt service. The water and sewer system has no direct purchase or bank loans outstanding.

Credit overview

The enterprise risk profile reflects our view of the utility system's:

- Primarily residential and diverse service base in the Kansas City metropolitan statistical area economy, which we consider to be broad and diverse, along with median household effective buying income (MHHEBI) at 132% of the national level. Both of these characteristics provide significant stability in our view of the utility's enterprise risk profile because they support both the economic and rate affordability benchmarks that support the rating at its current level.
- Revenue base being supported by consistent rate increases. For 800 cubic feet of usage, the combined residential water and sewer bill would be \$100.69 for a monthly residential bill for 2019, for Olathe residents. While this could be considered a large bill on a nominal basis, when annualized, we still think this represents an affordable 1.7% of the city's MHHEBI. However, we believe that one of the challenges for the city will be to balance the need for future rate increases to fund ongoing capital needs with affordability concerns. That being said, this decision-making trade-off is not unique to Olathe, in our view.
- Strong operational management practices and policies including ample water supply and treatment capacity, planned multiyear rate increases geared toward maintaining financial capacity for both cash- and debt-funded capital spending, the existence of an automated meter information system, and a computerized maintenance

management system.

The financial risk profile reflects our view of the utility system's:

- Financial profile supported by overall unrestricted liquidity that has consistently represented at least one year of operating expenses (440 days' cash at the fiscal year ended Dec. 31, 2019).
- Net revenues that cover all of the utility's fixed obligations and enable the city to fund a modest cash-funded capital program without ongoing reliance on unrestricted liquidity. Our calculation of total DSC has ranged between about 1.2x-1.6x, with 2019 being an anomaly of about 1x due to one-time expenses and a wetter-than-normal year.
- Existence of regularly-updated financial projections that, in our view, are supportive of the current rating level. It is our understanding that management expects to continue raising rates and control its operating expenses to support a financial profile similar to historical trends.
- Debt that only represents about 30% of capitalization, but with management's representation that over the next ten years it could issue about \$300 million of debt to fund \$335 million of capital needs, we would expect this ratio to continue climbing.
- Strong financial management practices and policies, supported by regular reporting of financial and investment performance to the city council, quarterly budget-to-actual reports to the city council with internal review occurring monthly, the adoption of a general citywide financial policy that generates Olathe's key performance indicators and informs financial decisions, and a formal investment management policy.

The stable outlook reflects our expectation that the city will continue to implement revenue and expense adjustments to offset additional debt service costs as it funds its capital program. Our belief is supported by Olathe's past financial practices; the existence of a number of financial reporting tools that the city can use to understand if financial performance is tracking based on its expectations; and our review of its utility fund forecasts, which we believe are attainable given the above-mentioned supporting policies and procedures.

Environmental, social, and governance factors

Overall, we believe that the city's management has mitigated most of the system's environmental, social, and governance (ESG)-related risk by adopting, adhering to, and adjusting its operating and financial policies and procedures. Therefore, we consider most of the credit's ESG risk factors on par with those of other rated utilities. Incorporated into our assessment are ample system capacity with no environmental quality violations, the existence of a customer assistance program that began in 2019, and a governance structure that has policies supportive of maintaining the financial metrics and environmental compliance consistent with past practices.

While the city has reported little to no financial effects on its utility operations due to the coronavirus pandemic, S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect). As the situation evolves, we will update our

assumptions and estimates accordingly.

Stable Outlook

Downside scenario

Downward stress on the rating would most likely be associated with financial deterioration involving unexpected spend-down in unrestricted liquidity, an inability to produce DSC in a fashion that is consistent with past practices, or remote events such as unfunded mandates from environmental regulators.

Upside scenario

We could take a positive rating action if all-in DSC significantly exceeds management's forecast as the city progresses through its debt-funded capital improvement plan without any reductions in the amount of unrestricted liquidity reported in its financial statements. However, viewed in the context of the utility's continued debt needs, we view any improvement in the rating to be over a longer term horizon.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of April 26, 2021)

Olathe taxable wtr & swr sys rev bnds (Bab-Direct Pay) ser 2010-B dtd 05/27/2010 due 07/01/2035

Long Term Rating

NR

Olathe WS

Long Term Rating

AA/Stable

Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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