S&P Global
Ratings

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## Summary:
# Lawrence, Indiana; Water/Sewer

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| Credit Profile | | |
|---|---|---|
| US$5.82 mil tax-exempt wtrwks util rev bnds ser 2017A due 01/01/2030 | | |
| *Long Term Rating* | BBB/Positive | New |
| US$3.97 mil taxable wtrwks util rev bnds ser 2017B due 01/01/2030 | | |
| *Long Term Rating* | BBB/Positive | New |
| Lawrence wtrworks | | |
| *Long Term Rating* | BBB/Positive | Affirmed |

## Rationale

S&P Global Ratings assigned its 'BBB' rating and positive outlook to Lawrence, Ind.'s series 2017A and 2017B waterworks utility revenue and refunding bonds and affirmed its 'BBB' rating, with a positive outlook, on the city's existing waterworks utility debt.

The positive outlook reflects our opinion of the system's recent improvements in operational and financial management, which we expect will likely reverse a trend of structural imbalance in the city's water utility fund and result in positive operating margins and improved liquidity.

Officials intend to use series 2017A and 2017B bond proceeds to refund the system's existing debt.

The rating reflects our opinion of the combination of strong enterprise risk and adequate financial risk profiles.

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

- Service area participation in the broad and diverse Indianapolis metropolitan statistical area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Adequate utility rates when factoring in a 65% rate increase implemented, effective June 2017; the city's median household effective buying income at 92% of the national average; and the county's moderately high poverty rate of 21.3%; and
- Good operational management practices and policies.

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

- All-in debt service coverage (DSC), which improved to more than 1x in fiscal 2016 and which we expect to improve materially following recently implemented and planned rate increases;
- Weak liquidity; and
- Standard financial management practices and policies.

Net waterworks utility revenue secures the bonds. Other bond provisions include:

- A rate covenant that stipulates rates that can generate net revenue of at least 100% of debt service;

- An additional bonds test that only limits additional bond issuance if net revenue for the previous fiscal year represents, at least, 125% of pro forma maximum annual debt service (MADS); and
- A debt service reserve funded at the least of MADS, 125% of average annual debt service, or 10% of par.

The water system primarily serves residents of Lawrence, 10 miles northeast of downtown Indianapolis in Marion County, which had an estimated 2016 population of 49,700. City wealth indicators are, what we consider, good but below average with median household effective buying income at 92% of the national average. The system has roughly 14,900 customers, a number management does not expect will change materially over the next few years. The 10 leading customers account for, in our opinion, a very diverse 7% of total system revenue.

Lawrence's city council adopted a rate ordinance in May 1, 2017, with first-phase rate increases effective June 2017. The rate ordinance increased water utility rates in three phases: The first phase is an approximate 68% increase, effective June 2017; the second phase increases rates by approximately 6.8%, effective Jan. 1, 2019; and the third phase increases rates by approximately 11%, effective Jan. 1, 2020. The ordinance also requires the completion of another cost-of-service study by August 2018, and phase two and three rate increases are subject to changes pending the cost-of-service study's findings. Following the phase one rate increase, water utility rates increased to $50.16 for 6,000 gallons used. We consider rate affordability adequate since new water rates account for 1.4% of income.

Based on our Operational Management Assessment, we view the system's operational management as good. The water utility has a total capacity to produce 7.72 million gallons per day (mgd) between three water treatment plants with a firm rated capacity of 5.32 mgd. This sufficiently meets average daily flows of approximately 3.99 mgd and peak flows of 5.54 mgd. Due to management completing a cost-of-service study, the city approved significant rate increases we expect will reverse a trend of structural imbalance.

Consistent with the article titled "Methodology: Industry Risk," published Nov. 19, 2013, on RatingsDirect, we consider industry risk for the system very low, the most favorable assessment possible on a six-point scale, with '1' being the best and '6' the worst.

The utility's operations-and-maintenance fund has been in structural imbalance since fiscal 2010; therefore, its cash balance declined to a negative $1.475 million at fiscal year-end 2015 from $1.6 million as of Dec. 31, 2009. The utility's cash improved to $106,000, or eight days' cash on hand, in fiscal 2016 following a $1.5 million interfund loan from the wastewater utility. Excluding the interfund loan from the wastewater utility, the operating fund balance was a negative $1.375 million. Following the 68% rate increase, effective June 2017, the water utility's operating fund will improve to $809,000.

Net revenue of the utility produced insufficient all-in DSC in fiscal years 2014 and 2015. We base our all-in DSC on net revenue of the utility, including payments and transfers into other funds from the utility, taken against all debt obligations of the utility. Following years of volatile net revenue; insufficient DSC; and structural imbalance, the new management team, which began operating in January 2016, began by commissioning a cost-of-service study, presented and approved by the city council in May 2017.

Significant rate increases will, in our opinion, have a positive material effect on the city's water utility fund. All-in DSC--taking into account debt obligations, interfund loans, payments in lieu of taxes, and additional debt--is projected to improve to 1.8x in fiscal 2017 and 1.5x in fiscal 2018. The all-in DSC of 1.5x in fiscal 2018 takes into account management's plan to repay the $1.5 million interfund loan from the wastewater utility over the course of fiscal 2018; improvement in financial operations, however, could allow the utility to begin repayment in late fiscal 2017. Projections for fiscal years 2019-2020 show DSC increasing to well in excess of 2x.

The city issued $8.505 million in waterworks revenue debt through the Indiana State Revolving Fund in June 2017. Management intends to use proceeds from the 2017 state-revolving-fund loan to complete phase-one capital projects, including wellfield rehabilitation, capacity expansion, and improvements to one of its water treatment plants. The city is also planning to issue approximately $10.6 million in debt in fiscal 2019 to fund phase-two capital projects, which include improvements to the city's remaining two water treatment plants and distribution system improvements.

Phases two and three of the implemented water rate increases will allow the utility to have capacity to service the additional debt planned in 2019, as well as operate and cash fund capital projects beyond phase 2 while maintaining strong operational margins and improved liquidity.

Based on our Financial Management Assessment methodology, we view the system's financial management as good. Management highlights include its use of historical trends for budget and operational performance analysis and monthly budget-to-actual reports to the utility board and council. Management completed a cost-of-service study that includes projections through fiscal 2020. The utility identifies capital needs, and it has updated the 20-year master plan. Management targets the maintenance of a minimum two months' operating expenses on hand, which it has not historically met; due to recent changes in rates and improved financials, however, we believe this will likely be achievable. Management presents audits on a cash basis.

## Outlook

The positive outlook reflects S&P Global Ratings' opinion that within the two-year outlook period, the water utility's financial operations will likely improve significantly, following various measures taken by management that are indicative of a higher rating.