

## CREDIT OPINION

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 Rate this Research

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# Portland Water District, ME

## Update to credit analysis

### Summary

Portland Water District (Aa3 water bonds, Aa1 wastewater bonds) is a well-managed district with sound debt service coverage, manageable debt profile and very strong liquidity. The district benefits as the exclusive franchise providing an essential service to the greater Portland (Aa1 stable) area, with its diverse customer base and average wealth levels. In addition, the district is deregulated from the Maine Public Utilities Commission meaning rate increases, long-term debt issuance, and other operating matters are subject to approval only by the district's Board of Trustees.

The district's bonds have weak legal provisions, including a sum sufficient rate covenant, no additional bonds test, and a sinking fund equal to at least 1% total debt outstanding. Bondholders benefit from additional post-default security provided by the district's ability to assess 10 member municipalities (as provided by Title 35-A, Section 6103 of the Maine Revised Statutes, as amended) to satisfy any debt service deficiency upon event of default.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is not a key driver for this rating action. We do not see any material immediate credit risks for Portland Water District, ME. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Portland Water District, ME changes, we will update the rating and/or outlook at that time.

### Credit strengths

- » Sizable and stable service area
- » Sound debt service coverage supported by generally annual rate increases
- » Strong management

### Credit challenges

- » Weak legal security provisions

### Rating outlook

Moody's does not usually assign outlooks to local government credits with this amount of debt outstanding.

## Factors that could lead to an upgrade

- » Significant increase in debt service coverage and liquidity position
- » Stronger legal provisions

## Factors that could lead to a downgrade

- » Decline in debt service coverage or liquidity
- » Significant increase in debt ratio
- » Downgrade to the city of Portland's general obligation rating

## Key indicators

Exhibit 1

Portland Water District, ME					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	41 years				
System Size - O&M (\$000)	\$15,361				
Service Area Wealth: MFI % of US median	112.40%				
Legal Provisions					
Rate Covenant (x)	1.00x				
Debt Service Reserve Requirement	No explicit DSRF; or funded with speculative grade surety (Baa and Below)				
Management					
Rate Management	Aaa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue (\$000)	\$21,981	\$23,508	\$23,381	\$24,285	\$24,789
System Size - O&M (\$000)	\$14,291	\$15,242	\$15,428	\$15,999	\$15,361
Net Revenues (\$000)	\$7,902	\$8,594	\$8,330	\$8,919	\$10,255
Net Funded Debt (\$000)	\$43,551	\$46,141	\$48,412	\$53,448	\$55,627
Annual Debt Service (\$000)	\$3,830	\$4,280	\$4,639	\$5,155	\$5,771
Annual Debt Service Coverage (x)	2.1x	2.0x	1.8x	1.7x	1.8x
Cash on Hand	468 days	508 days	548 days	531 days	549 days
Debt to Operating Revenues (x)	2.0x	2.0x	2.1x	2.2x	2.2x

Source: Moody's Investors Service and issuer's audited financial statements

## Profile

Portland Water District provides water and wastewater services to a population of approximately 215,000, representing 16% of the State of Maine's (Aa2 stable) population. The district's customers are located in Cumberland County (Aa2).

## Detailed credit considerations

### Service area and system characteristics: Essential service provided to stable service area; adequate water supply and treatment capacity

The district serves over 53,000 metered and over 2,300 unmetered connections across the Portland area. The district's primary water source, Sebago Lake, provides an estimated safe yield of 432 million gallons per day (MGD) supply, far exceeding the 2019 system

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average consumption of 20 MGD (5% of safe yield). The district's capacity to treat water is 50 MGD, or 40.4% of the current 20 MGD water production. The maximum daily demand in 2019 was 32.7 MGD.

Approximately 400-500 new connections per year will come online given new residential and commercial development in the City of Portland, as well as new residential development in some of the surrounding communities. The ten largest water customers, including wholesale users are Yarmouth Water District (Aa3) and Portland Housing Authority and several industrial consumers, remain largely stable and represented 20.9% of total consumption and 8.3% of total water charges in 2019, down slightly from the prior year.

Water revenues are derived primarily from residential sales (59% of 2019 total sales), but the commercial (19%) and industrial (7%) sectors represent healthy components as well. Individual cities and towns cannot withdraw from the system without the express consent of the state legislature. Wastewater revenues are derived from assessments paid by the participating members. Wealth levels of the district are favorable, with a median family income of 112% of the nation.

The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts.

#### **Debt service coverage and liquidity: Sound coverage and strong liquidity supported by generally annual rate increases**

The district's financial position will remain sound given a history of conservative budgeting, sound debt service coverage, and strong liquidity. According to the December 31, 2019 audited financials, total debt service coverage increased to 1.78x from 1.73x in the prior year. The district received a one time payment from Central Maine Power of \$125,000 during the year in addition to seeing higher than expected interest income. In previous years, coverage was over 2.00x, but coverage remains strong and the district has maintained coverage of over 1.7x for each of the past five years. The district maintains an operating reserve fund with a target balance of 25% of expenditures. This target was achieved in 2019. Days' cash on hand was very strong at approximately 549 days.

So far in 2020, water revenues are estimated to decline from anywhere between \$300,000 to \$1,000,000 due to the ongoing coronavirus crisis. However, expenditures are down by about \$400,000 from the original budget, and management is confident results will be closer to breakeven at year end. Management has a strong history of increasing rates on a timely basis: since 2011, wastewater rates have increased by 28%, while water rates increase in most years.

While the 2021 budget has not yet been finalized, management is expecting to continue its history of consistent rate increases at both the water and wastewater funds. Uncollected accounts receivable may increase mildly as the state temporarily halts the district's ability to shut off access to citizens whose accounts are past due given the ongoing coronavirus crisis; however, we expect these amounts to be immaterial relative to the size of the total budget.

#### **LIQUIDITY**

In 2019, days cash on hand measured 549 days of operating expenditures.

#### **Debt and legal covenants: Well-managed debt profile with moderate future borrowing needs; weak legal provisions**

The debt position will remain affordable given the district's history of timely rate increases structured to adequately cover debt service obligations and a reasonable capital improvement program (CIP). The debt ratio of 23% in 2019 was unchanged from the prior year. The five-year CIP for the water system calls for \$58.5 million of additional bonds, the majority of which will finance water main replacements, while the CIP for the wastewater system is looking at a smaller \$24.6 million in projects. Only a minority of these projects are expected to be financed with bonds.

The district maintains an internal target for debt service not to exceed 35% of annual expenditures. The bonds are water revenue and wastewater revenue obligations of the district, and debt service is payable from available revenues of the water and wastewater system, respectively.

Although the district operates both as a regional water distribution system and a wastewater treatment system, water bonds are payable only from water system revenues. As required by the district's charter, which was enacted by the state legislature and can only be amended by the same body, revenues are derived solely from water rates set at sums sufficient to pay for water system operating expenses and debt service. Furthermore, the district's charter requires the district to maintain water and wastewater records, accounts,

and rate-setting processes under separate systems. The district has not established a debt service reserve nor provided legal rate covenants or an additional bonds test; there is no bond indenture. However, the district's policy is to maintain debt service coverage of at least 1.25x, and the district has been in compliance with the policy since its adoption in June 2007.

Furthermore, the bonds are supported by the district's authority to initiate a post-default mechanism, which requires municipalities in the district that have adopted Section 6103 to levy a tax set at a uniform rate applied to 100% of respective equalized state valuation on all property. Municipalities are required to collect and remit the proceeds from such a tax to the district for purposes of paying debt service, although we note that subsequent to a default, under the procedure provided in Section 6103, up to a year could elapse before taxes could be levied and remitted to the district and bondholders. The district's water system serves 11 cities and towns and one water district (being a wholesale customer subject to contract). Members of the district who have accepted Section 6103 are the Cities of Portland (Aa1 stable), South Portland (Aaa stable) and Westbrook (Aa3) and the Towns of Cape Elizabeth (Aa1), Gorham (Aa2), Cumberland (Aa2), Falmouth (Aaa), Scarborough (Aa3), Windham (Aa2) and Raymond. The Town of Standish is a non-member of PWD and is therefore not subject to Section 6103; however, the town is considering becoming a member. The district's wastewater system serves as a wholesale provider of wastewater treatment to seven municipalities in the Portland region. The city of Portland owns and operates collector sewer lines and is responsible for the maintenance of such. The city, the district, and the Department of Environmental Protection have entered into agreements to minimize combined sewer overflows (CSO). The city and district have identified \$167 million in projects to be completed over the next 15 years. The district is responsible for \$45 million in projects, with the city covering the remainder.

#### **DEBT STRUCTURE**

The entire debt portfolio is fixed rate with 75% of principal retired in ten years.

#### **DEBT-RELATED DERIVATIVES**

The district is not party to any interest rate swaps or derivative agreements.

#### **PENSIONS AND OPEB**

The district contributes to its non-bargaining unit employees' pension plan and its bargaining unit employees' pension plan, two single employer defined benefit pension plans. Neither plan requires employee contributions. Participation in the plans have been closed to new members since 2010 and 2011, respectively. As of December 31, 2019, the net pension liability for the combined plans measured just \$1.4 million.

### **ESG considerations**

#### **Environmental considerations**

There are no major environmental considerations. The district's water infrastructure assets are located on high ground and management considers climate change preparedness as part of its capital planning process.

#### **Social considerations**

Outside of the coronavirus information discussed above, there are no major social considerations.

#### **Management and governance considerations**

District management employs conservative budgeting and financial management as evidenced in well-managed financial operations with satisfactory reserves and sound debt service coverage, as well as long-term planning for capital expenditures. In November 2015, the Maine Public Utilities Commission approved the district's request to become deregulated. Therefore, rate increases, long-term debt issuance, and many other operating decisions are now subject to approval only by the district's Board of Trustees.

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