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Fitch Ratings Updates Criteria for Water and Sewer Bonds: Butler Snow

On September 3, 2015(1), Fitch Ratings updated its sector-specific rating criteria for water and sewer bonds. The new report replaces Fitch's existing rating criteria published July 31, 2013, but Fitch does not anticipate changes to existing ratings as a result of the update. The report sets forth Fitch's four key credit rating drivers for municipal water and sewer systems and explains what Fitch refers to as the "10 Cs," specific factors included in the key rating drivers.

The four key rating drivers, as well as the specific factors included therein, that Fitch has determined affect the credit quality of water and sewer revenue bond issuers are as follows:

1. Governance and Management: Fitch assesses the management, staff and management policies to measure a utility's operating and fiscal health.

Crew: Management practices should seek to maximize expenditure stability by anticipating future regulatory and growth/supply demands, implementing necessary rate increases, ensuring sufficient liquidity and operating relatively free from day-to-day political interference.

2. Financial Profile: Fitch evaluates both historical and forecast financials to judge the utility's ability to fund operating and capital needs and meet its debt obligations.

Coverage and Financial Performance (Primary indicator of a utility's ultimate credit rating): Fitch reviews coverage of all the utility's debt to provide a complete assessment of its ability to pay operating and debt obligations. Fitch employs a number of stress analyses and financial performance indicators.

Cash and Balance Sheet Considerations: Fitch assesses a utility's cash and balance sheet to measure its ability to meet near-term liabilities, unforeseen hardships or difficult operating conditions.

Charges and Rate Affordability: Fitch emphasizes the importance of rate flexibility. Utilities should consider the impact of operational and capital programs on rate affordability, thus necessitating a balance between raising rates to preserve financial strength and maintaining sustainable and affordable rates. A major credit strength of municipal utilities is local control of rate-setting, free from external oversight.

3. Debt Profile: Fitch analyzes the level and structure of a utility's debt in determining overall creditworthiness.

Capital Demands and Debt Burden: Fitch evaluates a utility's outstanding debt on customer and per capita bases, as well as projected customer and per capita debt levels five years into the future. Fitch also evaluates the amortization of all debt payable from system revenues because it may show how much future strain will be put on a utility's financial

flexibility and borrower capacity for potential capital needs.

Covenants: Fitch views standard bond covenants as those that limit parity bond issuances to instances when historical and/or projected revenues cover 120% of annual debt service, require rate-setting annually to cover 120% of operating and debt service costs and create debt service reserve funds at the maximum levels allowed under tax law.

4. Operating Profile: Fitch evaluates the utility's operations to ascertain the utility's ability to provide service to its customers and generate revenues sufficient to meet its financial obligations.

Customer Growth and Concentration: Fitch views as a central component of a utility's operating profile the level of growth of its customer base and the level of customer concentration.

Capacity: Fitch evaluates a utility's plans to maintain existing facilities and replace aging or obsolete assets. Fitch also assess whether a water utility has adequate water supplies to meet customer demands.

Compliance with Environmental Laws and Regulation: Fitch assesses whether a utility proactively stays ahead of increased regulatory requirements. If a utility currently faces regulatory enforcement, Fitch evaluates the events that led to such action and the utility's plans for corrective action.

Community Characteristics: Fitch analyzes the service area's employment statistics, wealth levels, poverty rates and major employers relative to the total employment base.

Butler Snow serves as bond counsel and disclosure counsel for municipal water and sewer utilities across the country.

Footnotes

1 For greater detail on each of the factors Fitch uses to rate the creditworthiness of a municipal water and sewer utility, you can access the complete report at www.fitchratings.com.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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