14 AUG 2024

Fitch Revises Mountain Regional Water, UT's Water Revs Outlook to Stable; Affirms 'AA' Rating

Fitch Ratings - Austin - 14 Aug 2024: Fitch Ratings has affirmed the 'AA' rating on the following Mountain Regional Water Special Service District, UT (the district) obligations:

--Approximately $25.9 million water revenue and refunding bonds.

Additionally, Fitch has assessed the district's Standalone Credit Profile at 'aa'. The SCP represents the credit profile of the district on a stand-alone basis irrespective of its relationship with, and the credit quality of, Summit county (the county).

The Rating Outlook has been revised to Stable from Positive.

The 'AA' water revenue bond rating and 'aa' SCP reflect the system's 'Very Strong' financial profile within the framework of 'Very Strong' revenue defensibility and 'Very Strong' operating risk profile, both assessed at 'aa'. The system's leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), was extremely low at 4.2x in fiscal 2023 (FYE Dec. 31) and is projected to peak at 7.4x in fiscal 2026 in Fitch's Analytical Stress Test (FAST) rating case, retaining moderate headroom at the current rating.

The Outlook revision to Stable from Positive reflects updates in the district's growing capital improvement plan (CIP) driven by customer growth and planned investments to expand the existing water treatment plant. The CIP and forecast point to sustained higher levels of capex over the next four years than previously expected and plans now include an additional $23 million in debt to finance the plant expansion.

Fitch previously expected capital spending to peak by fiscal 2024 and then decrease annually, with leverage remaining below 6.0x. However, with the additional capital and debt, Fitch's FAST now peaks at over 7.0x around fiscal 2026, with capital spending beginning to moderate in fiscal 2028.

SECURITY

The bonds are secured by net revenues of the district, including impact fees and special assessments.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Favorable Service Area, Affordable Rates for the Vast Majority of the Population

The district retains the legal authority to adjust rates as needed without external oversight. Fitch considers the monthly residential water bill affordable for around 82% of the service area population based on standard monthly usage of 7,500 gallons. The very favorable service area is characterized by very strong income levels, a strong unemployment rate relative to the nation and strong customer growth.

Customer growth registered a five-year compound annual growth rate of 6% as of fiscal 2023, yet is boosted by a previous annexation in 2020. Absent the annexation growth is still considered strong. Income levels are about 68% above the national median as of 2022. The unemployment rate has decreased to 2.4% since 2020 and was 33% below the national average in 2023.

Customer concentration is not a concern despite the 10 largest customers accounting for around 26% of total annual operating revenue since two of the largest customers are wholesale customers: Weber Basin Water Conservancy (Weber Basin) and Park City together accounted for around 16% of operating revenue in 2023. Sales to Summit Water Distribution Company, included in the Weber Basin billings, have long been expected to taper off after fiscal 2025, which is still accounted for in the district's financial planning and will not have a material impact.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Moderate Investment Needs

In fiscal 2023, the system has a very low operating cost burden of $4,964 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was very low at 23% in fiscal 2023. Capex to depreciation is strong averaging 160% over the last five fiscal years from 2019 to 2023. Planned capital spending for the next five years should generally outpace historical depreciation, supporting a continued very low life cycle ratio.

The 2024-2028 CIP totals $53.3 million, up from $32.7 million in the prior plan, and includes updated costs and expansion of the current treatment plant. The plant expansion is in preliminary stages and currently estimated to cost about $23 million and expected to be debt funded through Water Infrastructure Finance and Innovation Act (WIFIA) and future revenue bonds.

The office building and maintenance facility cost increased to $18 million, up from $15 million last year, and will be funded with previously issued bond proceeds. The overall increase in the CIP is also attributed to the higher cost of materials and supplies. Growth-related projects in the CIP continue to have a portion of costs funded by impact fees and cash on hand.

Financial Profile - 'aa'

Leverage to Increase

As of fiscal 2023, the district had exceptionally low leverage of 4.2x. Over the past five years, leverage improved from 6.1x in fiscal 2019 to 2.6x by fiscal 2022 due to debt amortization and improved FADS. However, it increased in fiscal 2023 after the district issued $18 million to fund the new office building and maintenance facility. The liquidity profile is neutral to the overall assessment with current days cash on hand of 516 and coverage of full obligations (COFO) of 1.9x. Fitch-calculated total debt service coverage was 1.9x in fiscal 2023.

The FAST considers the potential trend of key ratios in a base case and stress scenario over a five-year period. The stress scenario is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case scenario, the leverage ratio is expected to increase to 6.8x in fiscal 2026, then decrease to 4.2x through fiscal 2028. In the stress scenario, which is considered the rating case, the leverage ratio is projected to increase to 7.4x in fiscal 2026, then decline to 4.8x through fiscal 2028. This leverage is in line with the current rating, but drives the Outlook revision to Stable as it is higher than previous expectations. Additionally, should cost increases arise with the plant expansion the district retains headroom at the current level to absorb additional debt should it become necessary. The liquidity profile is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

--Projected leverage of around 8.0x or higher in Fitch's rating case, assuming stability in the revenue defensibility and operating risk assessments.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/ Upgrade

--Sustained actual and projected leverage below 6.0x in Fitch's rating case, assuming stability in the revenue defensibility and operating risk assessments.

PROFILE

The district is a culinary (treated) and irrigation (raw) water supplier in western Summit County, an area generally known as the Snyderville Basin, about 30 miles east of Salt Lake City. The district maintains a centralized, regional water system currently serving 5,502 customers and in addition, provides water for three golf courses and wholesale water to other water companies. A regionalization agreement between the district, Summit Water, Park City and Weber Basin enables the district to sell surplus water on a wholesale basis to other water service providers in the area.

However, around 80% of annual revenue is derived from the district's direct retail customer base. The Summit County council is the district's governing body that approves the district's budget, with administrative functions, including rate setting, handled by the district's administrative control board.

The system consists of a water distribution system, water sources including wells, springs, and surface diversions, the Signal Hill Water Treatment Plant and a raw water irrigation system. Acquired water rights and current sources are expected to be sufficient for at least the intermediate term, but treatment plant expansion is needed to meet demand beyond the current 10-year window. Only the district's surface water requires treatment at the treatment plant.

Fitch considers the system to be a related entity to the county for rating purposes given the county's oversight of the system, including approval of the district's annual budget and any debt issuance. The credit quality of the county does not currently constrain the bond rating. However, as a result of being a related entity, the issue rating could become constrained by a material decline general credit quality of the county.

Updated U.S. Environmental Protection Agency (EPA) Regulations

The EPA's enhanced focus on lead and copper lines and per- and polyfluoroalkyl substances (PFAS) contaminants has led to the introduction of the Lead and Copper Rule Revisions and the proposed Lead and Copper Rule Improvements, along with specific testing requirements for PFAS chemicals. The district has been proactive in addressing PFAS contaminants in anticipation of the EPA's regulation.

The district tested its water sources and no detectable levels of PFAS were found. The majority of the district's service area was built after the federal lead ban in 1986; therefore, lead lines are in the service area are minimal. However, several pockets of homes built in the 1970s have been identified and will need further investigation.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT		RATING		RECOVERY	PRIOR
Mountain Regional Water Special Service District (UT)					
• Mountain Regional Water Special Service District (UT) /Water Revenues/ 1 LT	LT	AA (Stable)	Affirmed		AA (Positive)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	▣	

Applicable Criteria

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub.29 Feb 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Mountain Regional Water Special Service District	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating

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