STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:
St. Paul, Minnesota; Water/Sewer

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Summary:

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Credit Profile		
US$8.0 mil swr rev bnds (Green Bnds) ser 2016B due 12/01/2035		
Long Term Rating	AAA/Stable	New
St Paul swr		
Long Term Rating	AAA/Stable	Affirmed
St. Paul WTRSWR		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating to St. Paul, Minn.'s series 2016B sewer revenue bonds. At the same time, Standard & Poor's affirmed its 'AAA' rating on the city's outstanding sewer revenue applying updated criteria effective Jan. 19, 2016. The outlook is stable.

The primary factors for the sewer revenue bonds rating are the following:

- A very strong enterprise risk profile, which is generally supported by a broad and diverse economic base with a stabilizing institution and a strong operational management assessment, in our view. Upward mobility in the enterprise risk profile is currently limited by underlying economic indicators for Ramsey County and the city of St. Paul that we view as weak for the rating level. Of note is the county's gross domestic product growth rate that is currently more than 1% lower than the national rate, Ramsey County's poverty rate that hovers around 15%, and St. Paul median household effective buying income (MHHEBI) that is only 86% of the national average. The higher county poverty rate is contributing to a weakened view of rate affordability, despite the low rates on a nominal basis.
- An extremely strong financial risk profile, which is generally supported by a large unrestricted liquidity position, a strong financial management assessment (FMA), and total debt service coverage (DSC) exceeding 1.6x both on a historical and projected basis.
- Despite the limitation in the enterprise risk profile, the city's consistently strong financial profile over multiple fiscal years that compares well, even with other highly rated utilities, and the fact that the service base overlaps with a very large economic base and serves as the state capital, are all factors that have contributed to the assignment and affirmation of our 'AAA' rating.

St. Paul's sewer system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the entity's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

The 2016B bonds will be special obligations of the city secured by a first charge and lien on the revenues of the sewer system. St. Paul will use the proceeds to finance improvements to its sewer system. Other bond provisions include the following:

- A covenant to set rates that generate revenues that cover at least operational expenses and debt service;
- A requirement that prior to issuing additional bonds that net revenues cover maximum pro forma annual debt service by at least 1.25x; and
- A debt service reserve funded at the lesser of 10% of par, maximum annual debt service (MADS), or the amount allowed by law with respect to yield restrictions.

The city's service area is coterminous with the city of St. Paul, and serves about 72,000 customers. Flows are fairly evenly split between residential (47%) and commercial/industrial/governmental (53%) customers. The sewer system consists of sanitary and industrial wastewater and storm water conveyance facilities, while sewage treatment is provided by the Metropolitan Council Environmental Services (MCES), a division of the Metropolitan Council.

Anchoring the city's diverse economic base are the state government and the health care, financial services, and educational services sectors. Manufacturing also retains a local presence. City unemployment rates are generally slightly below the national averages, indicating a measure of economic stability. However, income levels are below average, with MHHEBI for 2014 at 86% of the national level.

The city didn't raise rates in fiscal years 2011 and 2013, but did increase them by 3% in 2014 and then again by 3.5% in both 2015 and 2016. Current monthly-equivalent residential sewer rates for 800 cubic feet of usage, which is our typical benchmark for monthly usage, plus both a monthly base fee and a monthly-equivalent meter charge are $34.60. These charges represent just 1.1% of MHHEBI. In addition, an annual stormwater fee of $88.35 for one- and two-family homes is assessed. However, we note that in our affordability and market position measures as detailed below, our analysis only includes the sewer rates since the stormwater fee is not included on the regular utility bill and sent only once per year.

We would expect the city to continue raising rates as needed to generate financial metrics consistent with historical trends and to fund additional debt service related to its planned $8 million of annual debt to fund most of its capital plan.

Enterprise and financial risk profile details

We recognize that the city's economic base is supported, in our view, both by participation in the broad and diverse Minneapolis-St. Paul-Bloomington metropolitan area and by having several stabilizing institutions that include the University of Minnesota and state government. The very strong enterprise risk score reflects this assessment, as well as operational management policies that indicate to us the existence of both strong internal governance and controls and asset management policies.

However, the score is limited by various economic indicators at various geographic levels that are not consistent with a stronger enterprise risk profile. For Ramsey County its gross domestic product (GDP) growth rate, averaged for the prior two years and projected for the next two, is currently more than 1% lower than the national rate. This metric weakens the enterprise risk profile for all utilities rated in the county. Ramsey County also has a poverty rate that hovers around 15%, which contributes to a weakened view of rate affordability, despite the city's low sewer rates on a nominal basis. Finally, St. Paul MHHEBI is only 86% of the national average. Our methodology measures affordability for not only the median household, but also takes into account sensitivity to rate affordability based on the county poverty rate. Our view of the market position is somewhat more negative compared to a situation where a utility has both low nominal rates and a lower poverty rate.

The extremely strong financial risk score benefits from the city's large liquidity position and coverage of total debt service that generally exceeds 1.6x. For the last audited fiscal year ended Dec. 31, 2014, net revenues covered total debt service costs (which include subordinate state loans) by about 1.6x, and unaudited figures for 2015 indicate about 1.8x coverage. Liquidity for the sewer system has decreased in recent years as the city has used its available cash to pay for capital needs, but has stabilized at about 300 days' cash (including rate stabilization and an operations and maintenance reserve) at the end of 2015 (about $30 million). The city maintains a policy to keep at least 90 days' cash on hand, but informally targets no less than 300 days. From 2016-2023, it proposes to spend about $79 million in sewer-related capital projects, which would be supported by about $8 million of debt issued each year. St. Paul has not engaged in any direct-purchase or bank loans for the sewer system.

Also supporting the financial risk profile is the strong FMA. This indicates that, in our view, the financial practices are strong, well embedded, and likely sustainable. Examples include the existence of long-term financial and capital planning, formal debt and investment policies, and a formal minimum liquidity policy combined with informal financial targets more conservative than bond covenants.

Outlook

The stable outlook reflects our expectation that system operations, aided by appropriate annual rate increases and conservative revenue projections, will continue to provide for a solid financial profile characterized by financial metrics that meet or exceed the city's internal targets of 2x DSC on senior-lien bonds and 300 days' cash. Since our analysis also significantly weighs total DSC of both senior- and subordinate-lien debt service instead of coverage of just senior-lien, we would expect that this additional coverage metric would remain at or above the historical minimum of 1.6x. We base this expectation on our analysis of management's projections that show continued rate increases to meet additional debt service and operating cost requirements.

Downside scenario

If future financial trends as indicated above do not materialize, this would indicate to us that the longer term historical trend of maintaining a consistently strong financial profile over multiple fiscal years is not sustainable. In that case, we would likely lower the rating at least one notch downward.

Another factor that could lead to a downgrade in the future is our view of the utility's market position and affordability, which is already being pressured downward because of the county's poverty rate. If the residential sewer rates rise to represent more than 1.25% of MHHEBI, then this would weaken the market position/affordability assessment. Although this slight movement in the ratio of rates to MHHEBI may not in and of itself lead to a downgrade, the further weakening of the overall enterprise risk profile caused by this metric changing could lead us to weigh these limitations in the profile more than the overriding strengths, such as the support by a broad and diverse economic base with a stabilizing institution.

Related Criteria And Research

Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.