

# RatingsDirect®

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## Summary:

# Livonia, Michigan; Water/Sewer

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## Summary:

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### Credit Profile

#### Livonia wtr

*Unenhanced Rating*

AA(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' underlying rating (SPUR) on Livonia, Mich.'s water supply and wastewater system revenue bonds. The outlook is stable.

The rating reflects the following rating factors:

- A stable service area with incomes above the national average;
- Rates that are adjusted annually;
- Strong cash levels; and
- Limited additional debt plans.

Offsetting these strengths is debt service coverage (DSC) that deteriorated to less than 1x for fiscal years 2012 and 2010. According to management, this was due to lower-than-budgeted consumption and higher-than-expected increases in billings from the utility's service providers (Detroit and Wayne County for water and sewer, respectively). Management has revised its rate methodology by adopting a much larger fixed fee component to better match the way Detroit Water and Sewerage Department (DWSD) charges for the wholesale cost of water. Because of continued rate increases and no indication from management that there are any significant negative financial variances for 2014, we expect DSC will remain at good-to-strong levels without dilution in unrestricted cash and investments.

A statutory first lien on the net revenues of the system secures payment of debt service on the bonds. Bond provisions include a rate covenant that stipulates rates need to be set that generate at least sufficient coverage of debt service (1x DSC), an additional bonds test that requires net revenues to represent at least 125% of average annual pro forma debt service, and a reserve funded at the least of maximum annual debt service (MADS), 10% of par, or 125% of average annual debt service.

Livonia is in northwestern Wayne County just west of Detroit and has a population of about 95,000. Water is supplied to Livonia directly from Detroit. The city connects with Detroit through Wayne County for sewage disposal. The customer base is stable and totaled 38,040 in 2013. Most of the volume is generated by residential users, typically about 80%. The 10 leading customers account for just 11.5% of total revenue (which we consider very diverse), with Kroger accounting for about 3.4% and a Ford Motor Co. plant accounting for about 2.5% of operating revenue.

Management adjusts rates annually, with combined water and sewer rates for 1,000 cubic feet of use equal to \$55.05. We consider these rates affordable, especially with median household effective buying income at 118% of the national

average.

The combined water and wastewater funds financial performance has been fluctuating over past few years. DSC increased to 3.4x in fiscal 2013 from an insufficient 0.8x in fiscal 2012. Management believes that levying a fixed-charge component in the rate structure starting in fiscal 2012 will help mitigate the effects of lower sales volumes in the future. DSC also dropped to an inadequate 0.8x during fiscal 2010 due to unexpected rate increases from the city's water and sewer providers as well as below-budget usage, but DSC then recovered to good 1.5x in fiscal 2011.

Despite the fluctuating DSC, liquidity has remained strong. At the end of fiscal 2013, the city's water and wastewater funds' cash and investments totaled \$13.9 million, which equated to 179 days of operating cash on hand.

For the fiscal 2014 budget, management indicates a cash balance of \$13 million (143 days' cash) and estimated DSC of 2.9x.

The city's combined water and wastewater capital improvement plan totals \$23.5 million from 2014-2019. Management has not indicated the need to issue additional debt, but it is currently drawing down on a \$3.6 million state revolving fund loan. The system's debt-to-plant ratio is, in our opinion, low at 8.1%.

## Outlook

The stable outlook reflects our expectation that Livonia will be able to produce DSC we consider strong without dilution in liquidity, given additional rate increases already in place. The mostly residential and diverse customer base also provides underlying support for the stable outlook.

We do not expect to raise the rating until strong financial performance becomes more consistent across multiple fiscal years. If uneven financial performance persists, or if financial metrics weaken, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

### Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 8, 2014

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