FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades City of Port St. Lucie, FL's Utility System Revenue Bonds to 'AA-'; Outlook Positive

Tue 01 Jun, 2021 - 3:33 PM ET

Fitch Ratings - New York - 01 Jun 2021: Fitch Ratings has assigned a 'AA-' rating to the City of Port St. Lucie, FL (the city) obligations:

--Approximately $30.8 million utility system revenue bonds, series 2021.

The bonds are expected to sell via negotiation the week of June 7. Proceeds of the series 2021A bonds will be used to (i) finance various costs relating to the acquisition, construction and equipping of certain capital improvements to the water and sewer system (the system), and (ii) pay costs of issuance.

In addition, Fitch has upgraded the following system revenue bonds to 'AA-' from 'A+':

--$237.8 million utility system revenue bonds, series 2014, 2016 and 2018.

Fitch has also assessed the system's Standalone Credit Profile (SCP) at 'aa-'. The SCP represents the credit profile of the system on a stand-alone basis irrespective of its relationship with, and the credit quality of, the city of Port St. Lucie.

Feedback

The Rating Outlook remains Positive.

ANALYTICAL CONCLUSION

The upgrade of the bond rating to 'AA-' from 'A+' and assessment of the SCP at 'aa-' reflect ample leverage capacity within the framework of very strong revenue defensibility and low operating risk, assessed at 'aa' and 'a', respectively. Leverage, measured by net adjusted debt/adjusted funds available for debt service (net debt/FADS), fell to 4.1x in fiscal 2020, down from 7.4x in fiscal 2016. Fitch expects that leverage will modestly increase with the issuance of the series 2021 bonds as the system debt-finances approximately 25% of its $158 million fiscal 2021-2025 capital improvement plan (CIP) in addition to relying on internally generated funds. The maintenance of the Positive Outlook reflects Fitch expectations for leverage to remain below 6.0x and potentially be supportive of a higher rating level.

The city maintains rate-setting autonomy and very strong rate flexibility attributable to low cost of service relative to household income levels amid a growing customer base. The operating cost burden is low, registering $6,953 per million gallons (mg) of flows in fiscal 2020 within the context of elevated investment needs and adequate capital investment. Capital investment has grown since fiscal 2016 but remains focused on expansion and redundancy projects as well as renewal and replacement (R&R) needs.

CREDIT PROFILE

Port St. Lucie is a primarily residential community of about 202,000 located along Florida's Atlantic coast approximately 100 miles north of Miami in St. Lucie County (the county). The water and sewer service area comprise 134 square miles, including the entire city limits and some unincorporated areas of the county. The system serves about 79,000 and 61,000 water and sewer customers, respectively. Water supplied originates from the Floridan and Surficial aquifers drawn from 48 wells with a total potable water production authorization of about 42 million gallons per day (mgd) compared to 20 mgd of demand in fiscal 2020. Total wastewater permitted capacity is currently 18 mgd combined at the system's two wastewater treatment plants, the Westport and the Glades, which is well in excess of fiscal 2020 flows of 10 mgd.

Fitch considers the system to be a related entity to the city for rating purposes given the city's oversight of the system, including the authority to establish rates and direct operations. The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, the issue ratings could become constrained by a material decline in the general credit quality of the city.

Coronavirus Considerations

The ongoing coronavirus pandemic has not resulted in significant impairment to the system's revenue or cost profiles. Annual rate increases paused in fiscal 2021 but are expected to resume in fiscal 2022.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Rate Flexibility; Very Favorable Service Area

Revenues are derived entirely from the city's exclusive right to provide retail water and sewer service within its service area. City council sets rates and charges independent of outside approval or oversight and system charges are deemed affordable for the vast majority of customers. The service area's characteristics are very favorable, supported by strong customer growth along with income and unemployment metrics consistent with national averages.

Operating Risks 'a'

Low Operating Costs; Adequate Capital Investment

Operating risks are low in consideration of the system's low operating cost burden amid adequate capital investment.

Financial Profile 'aa'

Strong Financial Profile

The system's financial profile reflects very strong leverage of 4.1x in fiscal 2020. Leverage is expected to modestly increase as the system issues new debt but should remain low and supportive of the current assessment level. Liquidity is neutral albeit well-positioned with around 540 days cash on hand at the close of 2020 and coverage of full obligations (COFO) of 2.9x.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained leverage below 6.0x in both Fitch's base and stress scenarios.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A sustained increase in leverage over 8.0x in both Fitch's base and stress scenarios.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The bonds are secured by first lien of net revenues from the operation of the city's water and sewer system and available connection fees.

REVENUE DEFENSIBILITY

Revenue defensibility is very strong and assessed at 'aa'. Revenues are derived entirely from the city's exclusive right to provide retail water and sewer service within its service area. City council sets rates and charges independent of outside approval or oversight and system charges are deemed affordable for over 80% of customers. The service area is very favorable supported by a five-year customer CAGR of 3.5% amid income and unemployment levels near the national average.

Rate flexibility is very strong with combined bills affordable for over 80% of the population. While the system did not raise rates in fiscal 2021, rate increases of around 1.5% annually are anticipated for fiscal years 2022-2025.

OPERATING RISKS

The system's operating risk is low and assessed at 'a' which takes into consideration an operating cost burden of $6,953 per million gallons of water and sewer flows, a life cycle ratio of 47%, and five-year average capital expenditures to depreciation ratio of 90%, reflecting adequate capital investment since fiscal 2016.

The system's five-year CIP totals $158 million for fiscals 2021 through 2025, up from $97.5 million last year given accelerated growth and additional projects, and will be financed using the series 2021 bond proceeds (about 25%) in addition to ample cash reserves. R&R, redundancy, and growth-related projects drive the CIP as the system works to increase treatment capacity across both water and sewer systems, and secure additional water supply sources.

FINANCIAL PROFILE

The financial profile is assessed at 'aa'. Fitch's leverage calculation was 4.1x at the end of fiscal 2020 and has steadily trended downward over the last five-year period due to sustained revenue gains spurred by service area growth and ongoing rate increases amid amortizing debt. Fitch expects leverage to modestly increase as the system debt finances approximately 25% of its $158 million CIP using 2021 bond proceeds and existing cash reserves, nonetheless remaining below 6.0x.

While neutral to the assessment, COFO (excluding connection fees) and days cash on hand have steadily strengthened over the previous five years registering 1.8x and 541 days, respectively, at the close of 2020. COFO including connection fees was 2.9x in fiscal 2020 reflecting strong growth and system expansion.

Fitch Analytical Stress Test (FAST)

The FAST considers the potential trend of key ratios in a base case and a rating case. The base case reflects Fitch's expectation of both historical financial results and projected performance while the stress case is designed to impose a 10% capital stress above expected base case levels to evaluate potential variability in projected key ratios.

The FAST is informed by the system's forecast and CIP for fiscals 2021 through 2025, which Fitch deemed reasonable. Key assumption includes revenue growth driven by service area growth and new connections coupled with modest annual increases, conservative operating expense assumptions, and full execution of the system's $158 million CIP through fiscal 2025. Fitch also sensitized the connection fee revenue amounts to more closely approximate historical levels over the last five years.

In the base case, leverage briefly increases in year 1 (fiscal 2021) as the system takes on new debt and spends cash reserves to finance its CIP, nonetheless remaining below 5.7x. The stress case produced similar trends with leverage peaking at 5.8x in year 1 before trending downward. In all cases, leverage remains comfortably below 6.0x.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 23 Feb 2021) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub. 18 Mar 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Port St. Lucie (FL)	EU Endorsed, UK Endorsed

Feedback

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Feedback

US Public Finance   Infrastructure and Project Finance   North America   United States

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Feedback

S&P Global
Ratings

55 Water Street, 38th Floor
New York, NY 10041-0003
tel 212-438-2000
reference no.: 1666473

June 2, 2021

City of Port St. Lucie
121 S.W. Port St. Lucie Boulevard
Port St. Lucie, FL 34984
Attention: Ms. Faye Henry, City Treasurer

Re: ***US$26,505,000 City of Port St. Lucie, Florida, Utility System Revenue Bonds, Series 2021, dated: Date of delivery, due: September 01, 2051***

Dear Ms. Henry:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA" . S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

The rating is subject to the Terms and Conditions, if any, attached to the Engagement Letter applicable to the rating. In the absence of such Engagement Letter and Terms and Conditions, the rating is subject to the attached Terms and Conditions. The applicable Terms and Conditions are incorporated herein by reference.

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Sincerely yours,

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cc: ***Mr. Jay Glover, Managing Director***
Public Financial Management

S&P Global Ratings

S&P Global Ratings
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S&P Global Ratings

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Summary:

Port St. Lucie, Florida; Water/Sewer

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Table Of Contents

Summary:

Port St. Lucie, Florida; Water/Sewer

Credit Profile		
US$26.505 mil util sys rev bnds ser 2021 due 09/01/2051		
Long Term Rating	AA/Stable	New
Port St Lucie WTRSWR		
Long Term Rating	AA/Stable	Upgraded

Rating Action

S&P Global Ratings raised its long-term rating on Port St. Lucie, Fla.'s utility system revenue bonds to 'AA' from 'AA-'. At the same time, we assigned our 'AA' rating to the city's series 2021 utility system revenue bonds. The outlook is stable.

The upgrade reflects management's ability to maintain very strong financial metrics while dealing with growth-related demand pressures and keeping rates currently affordable.

The purpose of the bonds is to fund various capital improvements within the system. Net revenues of the Port St. Lucie utility system, which includes a water and wastewater system, secure the debt. Net revenues also include standard system charges, and capital facilities charges (connection fees). Remaining bond provisions are credit neutral, in our opinion, with a rate covenant that is at 1x sufficiency when including standard net revenues, or 1.1x when including the current subaccounts (which are carry-forward balances of connection fee revenues). An additional bonds test allows for net revenues, retroactive rate increases, and current subaccounts to provide 1.1x pro forma maximum annual debt service (MADS) for issuing additional parity debt. Bonds benefit from a standard debt service reserve.

Credit overview

As mentioned above, the rating reflects management's ability to keep rates currently affordable while still addressing growth-related demand pressures, and additionally being able to maintain strong financial metrics. Management does in-depth capital and financial forecasting, which it tends to follow closely. Recently, mainly due to COVID-19, management did not raise rates for fiscal 2021 by 1.5% as it had tended to do in the past. Rate increases will begin again for the next fiscal year. Even with no increase, revenues are still expected to rise for fiscal 2021. The rating reflects the very strong enterprise risk profile and the extremely strong financial risk profile. However, it is tempered by the significant capital improvement plan (CIP), which will require annual rate adjustments to maintain financial metrics, potentially pressuring rate affordability should economic growth slow.

The enterprise risk profile reflects our view of the system's:

- Service area participation in the broad and diverse Port St. Lucie metropolitan statistical area (MSA);
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable rates representing 2.6% of median household effective buying income (MHHEBI); and

- Good operational management practices and policies.

The financial risk profile reflects our view of the system's:

- Strong historical all-in debt service coverage (DSC) that we believe the utility will continue to produce in the near term;
- Extremely strong liquidity position that believe is sustainable in the near term;
- Moderate leverage based on a debt-to-capitalization ratio of about 48%, with no additional debt plans in the near future; and
- Good financial management practices and policies.

We expect the outlook to remain stable over the two-year outlook period. We also expect the system to maintain all-in coverage at levels we consider generally strong and cash levels we consider very strong. In addition, the service area's participation in a broad and diverse MSA economy adds stability to the rating.

Environmental, social, and governance factors

Overall, we believe that management has mostly mitigated environmental, social, and governance (ESG)-related risk by adhering to state and federally mandated operating and financial policies and procedures. With regard to heightened social factors, health and safety precautions that officials enacted in response to the COVID-19 pandemic potentially could result in declines in operating revenue, but this has not been management's experience to date. Social risk surrounding rate affordability could become an issue should management need rate increases that outpace area incomes. Port St. Lucie benefits from strong and proactive management, which is deliberately targeting affordability concerns as it works though its substantial capital needs. Management is also undertaking ambitious investments to adapt to long-term climate change challenges to mitigate its environmental risks. We consider the environmental risk higher than for rated peers due to the utility's location on the Florida coast, which exposes it to serious storms.

Stable Outlook

Upside scenario

While not likely over the next two years, should area wealth and income levels grow faster than proposed rate increase, thereby improving the issuer's market assessment and the overall enterprise risk profile itself, then a higher rating could be warranted. This would require the system to maintain its extremely strong financial position.

Downside scenario

Conversely, should financial metrics erode materially from current levels, mainly reflecting increased debt issuances or failure to sufficiently adjust rates, we may consider a lower rating.

Credit Opinion

Enterprise risk

The utility system provides water and wastewater service to an approximately 134-square-mile area, which includes most of the city limits and some unincorporated areas of the county. Port St. Lucie is in St. Lucie County on Florida's east coast, about 100 miles north of Miami. The city's population reached an estimated 202,914 in 2020, representing an increase of about 23% during the past ten years. We view its income levels as good, with MHHEBI at 88% of the national average, although the large retiree population likely skews these figures downward. The unemployment rate is low at about 4.9% as of March 2021.

Combined rates for 6,000 gallons of water and sewer service are $102.98, with $38.64 allocated to water and $64.34 to wastewater. At 2.6% of the MHHEBI, we believe rates are moderately high, but comparable to those of neighboring utilities. Officials indicate they are contemplating multiyear rate increases of 1.5% at least through 2025. The bill based on the management-provided average customer usage of 4,200 gallons per month is $81.99 per month, or 2.12% of MHHEBI.

We view the system's operational management as good. The city has a track record of converting strategic decisions into constructive action and managing its long-term needs in a methodical manner. Both the water and sewer systems have ample operational capacity to meet demand in the medium term. Over the years, management proactively secured adequate system resources, including additional surface water, and capacity to accommodate growth.

Port St. Lucie water customers total about 81,624 and wastewater about 63,709, as of May 2021. Growth in water and sewer customer accounts averaged about 2.5%-3.75% for each respective system from 2017 to 2020. We view the system's customer base to be very diverse, as the 10 leading customer accounts make up 6.2% of total 2020 operating revenues.

The city's raw-water supply is the Floridan aquifer, withdrawn via 18 deep wells, with a total capacity of about 47 million gallons per day (mgd). It also withdraws raw water via 31 shallow wells from the Surficial aquifer, providing an additional capacity of 12 mgd. Treatment is in the form of two plants that have a combined capacity of 41.7 mgd, sufficient for medium-term growth projections. The water system also manages seven water storage tanks with a combined storage capacity of about 53 million gallons. As for the sewer system, its treatment capacity, consisting of two wastewater treatment facilities, of 18.0 mgd, which compares well with an average daily use of about 8.0 mgd and a peak of about 9.0 mgd.

Financial risk

Our assessment of the system's financial risk profile as extremely strong reflects the city's positive trend in DSC, extremely strong liquidity, and a good financial management framework.

In our view, system liquidity has remained extremely strong during the past three years. All-in coverage in fiscal 2020 totaled 2.31x. The 2019 rate study suggests that there should be 1.5% rate increases annually through 2025. To date, these suggested increases have annually been adopted, except for fiscal 2021. Management is forecasting coverage levels to remain around 2x for the next five years.

The unrestricted cash balance has increased to about $44.1 million, or 387 days' cash in hand at the end of fiscal 2020. Cash levels had been somewhat erratic, although strong as a result of cash-funding a portion of the system's CIP, primarily during fiscal years 2018-2020. According to management projections, the city aims to build up the reserve contingency and the renewal and replacement accounts to a combined $50 million by 2021.

The system is highly leveraged as indicated by the debt-to-capitalization ratio being 48%, but with no new debt expected in the near future, this ratio is expected to continue getting stronger. The total CIP for the next five years (2018-2022) totals $147 million and is expected to be funded from these bonds, grants, and system reserves and available special assessments.

We view management's financial policies and procedures as good. Detailed long-term planning is done on an annual basis that incorporates multiyear projections. The CIP is manageable and composed of a variety of system improvements. While customer growth steadily continues, the city finds itself in a position of having more than adequate underground infrastructure in place and ample treatment capacities such that it does not currently anticipate the need to embark on major capital improvements during the next five years. However, the demand for services from new customers and the need to continually upgrade and improve the system requires annual maintenance and replacement of water and sewer lines. Port St. Lucie currently expects to pay for these improvements from operating revenues as well as capital facilities charges.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of June 2, 2021)		
Port St Lucie WS (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Port St Lucie WS (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		