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Ratings

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Summary:

Tahoe-Truckee Sanitation Agency, California; Water/Sewer

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Credit Profile		
US$20.205 mil wastewtr rev rfdg bnds ser 2020 due 07/01/2027		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to the Tahoe-Truckee Sanitation Agency, Calif.'s series 2020 wastewater revenue refunding bonds. The rating reflects our view of the agency's very strong enterprise risk profile and very strong financial risk profile. The outlook is stable.

The agency owns and operates a regional wastewater treatment plant and 17-mile interceptor. Five member districts are responsible for sewage collection and delivery to the agency's conveyance system. The agency bears no financial exposure to the member districts as it bills its retail connections directly for its services.

The series 2020 bonds are being issued to refund the agency's existing $23.3 million clean water state revolving fund loan for debt service savings. The agency has no other outstanding debt.

The very strong enterprise risk profile reflects our view of the agency's:

- Strong service area economic fundamentals, a reflection of tourist activity and the region's role as a service center for traffic travelling between Nevada and Northern California;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Stable and very diverse customer base with low residential rates, which provides management with some revenue-raising flexibility; and
- Good operational management practices and policies with ample wastewater treatment capacity.

The very strong financial risk profile reflects our view of the agency's:

- Very strong historical all-in debt service coverage (DSC) that has fluctuated on a year-over-basis but averages about 1.6x and is anticipated to remain very strong during the forecast period;
- Extremely strong liquidity, with over 700 days' of operating cash in the past five years when including all designated but legally unrestricted reserves;
- Modest leverage, with manageable capital spending and no additional debt plans in the near term; and
- Strong financial management practices and policies.

The bonds are secured by a pledge of the agency's net revenue. Bond provisions are, in our view, adequate and credit neutral, with a rate covenant of 1.25x annual debt service, including transfers from a rate stabilization fund, and an additional bonds test of 1.25x maximum annual debt service (MADS), including transfers from a rate stabilization fund. A debt service reserve fund will not be funded for the bonds.

Enterprise risk profile

The agency provides for the collection, treatment, and disposal of sewage throughout a 62.3 square mile service area located along the north and west shores of Lake Tahoe and the Truckee River corridor, including the communities of Alpine Meadows and Squaw Valley, Tahoe City and the town of Truckee. The service area is a popular year-round resort destination. We understand the Truckee River corridor has a stable, year-round residential population; however, about 50% of homes within Truckee are second homes. Income indicators are, in our view, strong, with median household effective buying income (MHHEBI) for the town of Truckee at 131% of the national median in 2018.

Although the economy is largely centered on tourism, which tempers our view of the agency's overall economic fundamentals, we recognize that the agency serves a stable, primarily residential customer base, with minimal customer concentration, which we consider to be a credit positive. In particular, the residential customer class comprised 77.2% of connections in fiscal 2019; the top 10 customers includes hotels and ski resorts, as well as a mobile home park and hospital. The top 10 customers were responsible for only 6.2% of revenue and the top customer 1.2% in fiscal 2019, which we consider diverse. Growth within the customer base has been modest, averaging 0.79%, or about 300 new connections per annum over the past five years.

The agency's treatment plant was modernized and expanded at a cost of $75 million in 2008, and is currently in compliance with all federal and state regulatory requirements.

For comparability with the rates and charges of the agency's peers, we assess the agency's rates and affordability on a combined basis with the member system's collection charges. The agency has not raised its sewage treatment rates since 2011, when its rates were increased to $306.00 per annum, or $25.50 on a monthly basis, which we consider low. On a combined basis, sewage treatment and collection charges are still affordable, at less than $65 a month, or 1.1% of MHHEBI. Starting in fiscal 2020, the agency began billing for its sewer service on the Placer County, Nevada County and El Dorado County property tax rolls, payable in two installments on Dec. 10 and April 10. Each of these counties are on the Teeter Plan, which we believes provides revenue stability. Previously, the agency direct#?billed and collected each account separately, on Jan. 1 and July 1.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Based on our operational management assessment (OMA), we score the utility a '2' on a six-point scale on which '1' is the strongest. From an asset adequacy perspective, the agency is well positioned as the plant is expected to continue to operate at below 75% peak capacity over the next decade, which we view favorably since the agency will not need to invest in capacity related infrastructure until 2031. We understand that the agency uses both supervisory control and data acquisition control system (SCADA) and a geographic information system database (GIS) for tracking the maintenance and condition of the system's assets.

The agency has engaged an outside consultant to evaluate its existing facilities and expected future flows and loads; to evaluate alternatives for upgrades and improvements to meet future facilities needs through a 25-year planning cycle; and, to recommend schedules and cost estimates for selected capital improvements. The agency indicates that the assessment, which is expected to be completed in April 2020, is not anticipated to materially alter current capital needs projections.

We consider the agency's treatment system assets to be to a certain degree drought resilient, however, portions of the service area have been designated very high fire hazard severity zones by CalFire, which is a credit risk. A significant wildfire could cause an economic disruption and thus negatively influence the financial position of the agency. Moreover, we believe that protracted declines in tourism due to climate change (or more extreme cycles of drought) could be impactful to the agency's revenue base.

Financial risk profile

On balance, the agency's financial performance has been very strong during the past five fiscal years, in our view, and we believe this level of performance will be sustainable in the future. The agency's revenue base is diverse, with 71% coming from service charges, 20% from the agency's share of the Placer County, Nevada County, and El Dorado County's 1% general tax levy, 5% connection fees and 5% other. Based on the audited financial statements, we calculate that coverage ranged between 1.2x and 1.8x during the past five years. Historical metrics have been variable due to the impact on operating margins from the receipt of one-time connection fees (which ranged from a low of $1.0 million to a high of $2.6 million) and operating expenses that have fluctuated between $11.3 million and $13.8 million) due to one-time charges for professional services.

Management's forecast indicates coverage rising from 1.4x in fiscal 2010 to levels we consider very strong (over 1.5x through 2024). We consider the forecast, which was prepared in conjunction with an outside rate consultant, to be reasonable and achievable, although it assumes 4% per annum rate increases starting in fiscal 2022 that have not been approved. The forecast also incorporates a modest decline in future connection fee revenue to about $1 million per year and a reduction in one-time professional service expenditures (upon the expected completion of a rate study, organizational assessment and master plan later this year). The forecast also assumes cost savings associated with the shift to billing on the property tax roll as well as operating cost savings associated with planned discretionary payments averaging roughly $2.5 million per year over the next five years to fully pay off the agency's unfunded actuarial liability with CalPERS.

At the end of fiscal 2019 (unaudited), the agency reported about $25.8 million in unrestricted cash. In addition, the agency maintains about $22.5 million in designated capital reserves that can legally be used for debt service. When combined, the agency has roughly 1,284 days of operating cash on hand, which we view as extremely strong. Liquidity (excluding capital reserves) has been over 700 days' of operating cash in the past five years, which we consider a key credit strength. Based on management's forecast and planned capital spending, we anticipate that the agency's liquidity position will remain very strong, although we understand that a portion of these accumulated reserves are deployed for capital projects through the end of the forecast period.

We view the agency's leverage position as modest, based on a debt-to-capitalization ratio of about 23.1% at the end of fiscal 2018. Over the next five years, management estimates a total of $17.5 million in capital improvements, primarily for renewal and replacements. Management expects to fund capital improvements on a pay-as-you-go basis and does not anticipate issuing additional debt in the near future.

Based on our financial management assessment (FMA), we view the agency to be a '2' on a six-point scale, with '1' being the strongest. An FMA of strong indicates that practices are strong, well embedded, and likely sustainable. The agency maintains many of the best practices deemed critical to supporting credit quality, and these are well embedded in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. This includes maintaining long-term financial and capital plans as well as prescriptive and detailed formal investment and debt management policies. The agency also produces regular financial reporting.

Outlook

The stable outlook reflects our view that the agency's customer base and rate structure will continue to promote revenue stability, leading to the maintenance of very strong financial metrics during the two-year outlook period. Given the agency's lack of regulatory or growth-related capital needs, we do not expect any major operational issues. However, we could improve our FMA and OMA assessments if management is able to implement its forecasted rate increases without negative public sentiment or political pressure and the consultant's organizational assessment is completed without a meaningful shift in future capital or operating requirements.

Upside scenario

We do not anticipate raising the rating during the outlook horizon given tourism employment sector concentration in the service area. Any potential for an upgrade, which would most likely be beyond our outlook horizon, would be based on significantly stronger income and economic indicators and evidence that the agency's financial metrics could withstand a protracted decline in tourist activity.

Downside scenario

Given the historical and projected financial performance, we do not anticipate taking any negative rating action. There would likely need to be a significant deterioration in either coverage or liquidity levels before a downward rating action would occur.