FITCH RATES NORTH DAVIS SEWER DISTRICT, UT'S REVS 'AA+'; OUTLOOK STABLE

Fitch Ratings-San Francisco-03 February 2016: Fitch Ratings has assigned an 'AA+' rating to the following North Davis Sewer District, Utah's (the district) sewer revenue bonds:

--$15 million series 2016.

Bond proceeds will fund the district's ongoing capital improvement program, including significant investments in its network of collection mains, and to pay cost of issuance.

In addition, Fitch affirms the following ratings:

--$114.7 million outstanding sewer revenue bonds;
--$30.1 million outstanding general obligation (GO) bonds.

The Rating Outlook is Stable.

SECURITY
The revenue bonds are payable from net revenues of the district's sewer system (the system), including impact fees.
The GO bonds are payable from an unlimited ad valorem tax levy on all taxable property within the district.

KEY RATING DRIVERS

STRONG SUBURBAN SERVICE AREA: The ratings reflect the district's role as a regional wholesale provider of essential sewer services to seven cities and unincorporated areas within the economically resilient Salt Lake City metropolitan area.

HEALTHY FINANCIAL PERFORMANCE: All-in debt service coverage (DSC, including both GO and revenue bond debt service) has averaged 1.3x over the three years ended fiscal 2014 and is forecast to increase over the next five years. Liquidity is very strong with 1,252 days cash on hand at the end of fiscal 2014.

SOLID RATE DISCIPLINE: The district's board has raised rates as needed to provide strong financial performance and to fund significant investments in the sewer system. Rates remain quite low relative to incomes.

MIXED DEBT RATIOS: Debt was high at 77% of net plant assets and somewhat elevated at 9.3x funds available for debt service (FADS) at the end of fiscal 2014. Debt is likely to remain high relative to net plant assets over the next several years; however, rate increases and rapid amortization are likely to push debt-to-FADS to moderate levels very rapidly.

ADEQUATE CAPACITY: The district has sufficient treatment capacity to accommodate growth through 2025 after the expansion and upgrade of its treatment plant several years ago.

GO STRENGTHS: The above-average GO rating is also supported by the district's broad and diverse tax base, the strength of the unlimited-tax GO pledge, and a low level of tax-supported debt.

RATING SENSITIVITIES

FINANCIAL PERFORMANCE KEY: The ratings are most sensitive to changes in financial performance and debt levels. Forecast increases in debt service coverage and free cash to depreciation could lead to upward movement of the ratings, but decreases from current levels could put downward pressure on the ratings.

CREDIT PROFILE

The district provides wholesale sewer treatment services to approximately 215,000 people in a primarily suburban residential customer base located about 35 miles northwest of downtown Salt Lake City. The service area covers 82 square miles primarily in northern Davis County and also southern Weber County. The district's wholesale contracts with seven cities (Clearfield, Clinton, Layton, Roy, Sunset, Syracuse, and West Point) account for the majority of its revenues and flows. The contracts expire on Dec. 31, 2062 (subsequent to the bond maturity) and allow for rates and charges to be reviewed annually.

SOLID COVERAGE AND FINANCIAL PERFORMANCE

Financial performance is healthy and improving. All-in DSC improved to a healthy 1.4x in fiscal 2014 from a more modest 1.2x in fiscal 2013. The coverage increase pushed free cash to depreciation up to a very healthy 109% in fiscal 2014 from 49% in fiscal 2013. Coverage is well below the levels typically seen in 'AA+' rated water and sewer issuers; however, the utility's very stable revenues and strong free cash to depreciation suggest it has less need for excess coverage than utilities with more volatile revenues. Extremely stable property taxes provided 40% of total revenues in fiscal 2014, while sewer fees (which are dominated by flat per household charges) provided 45% of revenues.

Fitch's coverage calculations include debt service and taxes related to the district's GO bonds, diluting coverage significantly from indenture compliant coverage calculations that show DSC rising of 2.5x in 2014 and averaging 1.9x across the forecast horizon. Fitch takes a more conservative approach to coverage to reflect the district's use of operating revenues to cover GO debt service and to take account of the full debt profile, not just revenue bonds.

The district's financial forecast shows all-in DSC rising to a very healthy 1.7x or above by 2018. It also shows the utility continuing to fully fund depreciation. The forecast appears reasonably conservative with revenue increases largely driven by approved rate increases. The main source of uncertainty in the forecast appears to be connection fee revenues, which vary with economic conditions. However, rates are set to provide adequate (1.2x or better) DSC even without the excess margin provided by growth.

SOLID REVENUE FLEXIBILITY

The district's board has ample revenue raising flexibility and a strong record of raising rates as needed to maintain financial performance. The board has the authority to raise rates without oversight by outside rate regulators or the local cities in the service area. The utility has generally sought and gained support of local municipalities before raising rates, helping to prevent rate controversy. The board approved a 2013 rate package that increased monthly residential sewer rates $3 annually from $9.50 a month in fiscal 2013 to $21.50 in fiscal 2017 to fund greater investment in its pipe network. Monthly bills remain very low at 0.3% of median household income (MHI) in 2016 and remain below Fitch's 1% of MHI affordability benchmark even with local collection fee charges added to bills.

The North Davis Sewer District also benefits from significant tax rate flexibility. Its GO debt service levy is significantly below debt service on the unlimited tax GO bonds, and the district's operating levy remains below the state maximum. Management estimates that it could raise about

$4 million a year by increasing both rates to the maximum. The district has no current plans to raise taxes, but the additional source of revenue flexibility is a credit strength.

EXTRAORDINARILY STRONG LIQUIDITY
Reserves are extraordinarily strong with $23.4 million, or 1,252 days cash, available at the end of fiscal 2014. The large reserve position, which includes restricted working capital, general contingency and emergency equipment replacement reserves as well as unrestricted cash and investments, offsets any concerns about short-term DSC variation. Liquidity has remained very strong for many years, averaging about twice the median for an 'AAA' rated utilities over the past five years. Liquidity is likely to remain strong due to the district board's reserve policies.

HIGH DEBT LEVELS
Debt ratios are mixed, but the debt burden is judged to be high. Long-term debt equaled $153.2 million, or $713 per capita, at the end of fiscal 2014. Debt will rise to about $160 million, or $743 per capita, after the current bond sale. Debt is expected to decline over the next five years with no further borrowing planned. Amortization is rapid with 66% of debt repaid in 10 years and 99% in 20 years. Debt is scheduled to fall to about $554 per capita or 4.8x projected FADS in 2019. However, debt is likely to remain high relative to net plant assets at over 60% in 2019.

The utility is well positioned within its capital cycle and has a solid track record of investing in the system. The 2015-2019 five-year capital plan is large at $73.4 million, or $998 per customer, reflecting continued solid investment in the system. The focus of the capital plan has shifted to its aging pipe network from treatment capacity. The utility upgraded and expanded its sewer treatment plant in 2007, and management believes it has sufficient capacity to accommodate expected growth through the next decade. Sewer flows have averaged just 58% of the utility's treatment capacity of 34 million gallons per day over the past three years.

LEGAL COVENANTS AND SECURITIES
Revenue bond legal provisions are permissive, allowing for available fund balances to be included in meeting a 1.15x rate covenant and a 1.0x maximum annual debt service additional bonds test. There is no debt service reserve fund for the 2016 bonds.

The GO bond rating takes into account certain additional factors that are included in Fitch's tax-supported criteria, but the GO rating is largely driven by the financial profile and the overall issuer default risk measured by the sewer revenue bond rating. The district's tax base is significant with an assessed value (AV) of about $9.1 billion in 2014 with a diverse taxpayer mix. AV has begun to grow again with gains of 5.9% in 2013 and 4.4% in 2014. Total direct and overlapping tax-supported debt is low at less than 2% of market value.

Contact:

Primary Analyst
Andrew Ward
Director
+1-415-732-5617
Fitch Ratings, Inc.
650 California Street
San Francisco, CA 94103

Secondary Analyst
Shannon Groff
Director
+1-415-732-5628

Committee Chairperson
Douglas Scott
Managing Director
+1-512-215-3725

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published by the end of the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria and U.S. Tax-Supported Rating Criteria this action was additionally informed by information from Creditscope.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 03 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869223

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.