

RatingsDirect®

Summary:

Portage, Indiana; Water/Sewer

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Summary:

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Credit Profile

US\$6.245 mil sewage wks rev bnds ser 2016 due 10/01/2035

Long Term Rating A+/Stable New

Portage WS

Long Term Rating A+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'A+' rating and stable outlook to Portage, Ind.'s series 2016 sewage works revenue bonds and affirmed its 'A+' rating, with a stable outlook, on the city's existing sewage works debt.

The rating reflects, in our opinion, the combination of very strong enterprise risk and financial risk profiles.

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

- Service area participation in the broad and diverse Chicago-Naperville-Elgin metropolitan statistical area (MSA)—however, access is not as immediate as municipalities closer to Chicago;
- Primarily residential and diverse customer base;
- Generally affordable rates in the context of the service area's income at about 1.1% of median household effective buying income; and
- Good operational management practices and policies.

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

- Very strong all-in debt service coverage (DSC), coupled with strong system liquidity;
- Planned additional debt, which could pressure DSC;
- High debt-to-capitalization ratio;
- Manageable capital improvement needs, which the city expects to address with additional debt issuance and future cash outlays; and
- Standard financial management practices and policies.

Officials intend to use series 2016 bond proceeds to fund improvements to the stormwater management facilities and the utility's and city's administrative offices.

The bonds are secured by, and payable from, net revenue of the city's sewage works system. We consider bond provisions credit neutral, including a sufficiency rate covenant, an additional bonds test set at 1.25x maximum annual debt service, and a debt service reserve funded at the least of the three-prong test.

Portage is in Porter County on the southern tip of Lake Michigan. The sewer system serves a primarily residential service area with a population estimate of 38,000. Medical equipment manufacturer Stryker Instruments (2,300 employees) and pharmaceutical manufacturer Pfizer (2,100) are the city's leading employers. In our view, Portage

median household effective buying income is good at 104% of the national level. Unemployment has historically been above the state's and nation's averages; unemployment was 6.9% for April 2016, more than the state's 4.8% and nation's 4.7%. Residents also benefit from the city's participation in the broad and diverse Chicago MSA. The Chicago South Shore & South Bend Railroad and interstates 90 and 94 connect Portage to Chicago, roughly 45 miles away.

We believe the sewer system has a strong market position based on a natural monopoly in its service area and affordable service rates that provide management with revenue-raising flexibility. Management adopted a rate increase, effective June 2016, which was the first sewer rate increase since 1996. Rates increased to a flat \$32.50 monthly, and a provision exists to increase the rate by 50 cents each year on Jan. 1 beginning in 2017 until the city passes an ordinance ceasing the increases. In addition, the system charges customers a flat stormwater utility rate of \$11.50 monthly with a provision to increase rates by 25 cents each year on Jan. 1 beginning in 2017 until the city passes an ordinance ceasing the increases. Combined, we consider this rate affordable in the context of the service area's good income based on the annual bill representing about 1.1% of the city's median household effective buying income.

Our view of the system's good operational management further supports its enterprise risk profile. Based on our Operational Management Assessment, we view the city as a '2' on a scale of '1'-'6', with '1' being the strongest and '6' the weakest. The sewer collection system has adequate capacity for average and peak demand, and the system does not currently face any regulatory infractions. The system's peak capacity of about 4.95 million gallons per day (mgd) is sufficient to treat average daily flow of 3.5 mgd. The system can handle a 15-mgd peak flow, using a flow equalization basin at the plant. Management indicates it will fund improvement projects with a portion of the 2016 bonds, increasing treatment capacity to 5.13 mgd. System officials review rates annually. However, prior to June 2016, the system had not increased sewer rates since 1996. Management has adopted an emergency management policy for unexpected operational disruptions.

During the past three fiscal years, ended Dec. 31, all-in DSC has fluctuated. Yet, all-in DSC remained strong, in our opinion, at 1.7x in fiscal 2013, 1.6x in fiscal 2014, and 1.9x in fiscal 2015. We note our calculation of debt service stems from financial statements provided by the city's consultant, which normalize operating requirements on a pro forma basis. Based on projections provided by the city's financial consultant, following its recent sewer and stormwater rate increases, DSC will improve to more than 2x over the next few years, even as debt service increases following the issuance of the 2016 bonds. The rate covenant calls for net revenue to provide annual DSC of 1x

The system's liquidity is good, in our view. Management indicates the system's capital improvement, operations, revenue, stormwater operations, project, lift station, and medical funds are legally unrestricted money. In aggregate, these funds increased to \$2.8 million, or 164 days' operating expenses, in fiscal 2015 from roughly \$1.8 million, or 113 days', in fiscal 2013.

Management indicates the 2016 bonds will fund a majority of large capital-need items planned over the next five years. In addition, management intends to issue an additional \$3.75 million of state revolving fund debt for treatment plant work. Management indicates it does not currently have additional debt plans after the next state revolving fund debt.

Based on our Financial Management Assessment, we view the city as a '4' on a scale of '1'-'6', with '1' being the

strongest and '6' the weakest. Revenue and expense assumptions are reasonable, and management provides interim financial reporting to the city council through quarterly reports. The city's adopted formal reserve policy for the sewer system stipulates a minimum of 60 days' cash on hand and a best practice of 180 days'. Management does not currently maintain long-term financial projections, and a five-year running project list guides capital needs. In addition, the city reports its audits on a cash basis, relying on financial consultants to present financial reports that normalize operating requirements on a pro forma basis.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the system will likely maintain, at least, strong DSC and liquidity. We believe Portage's participation in the Chicago MSA economy supports the outlook.

Upside scenario

We could raise the rating if the utility were to maintain or exceed historical financial performance as the city issues additional utility debt to fund capital projects.

Downside scenario

We could lower the rating if either DSC or liquidity were to deteriorate significantly, coupled with management failing to implement corrective actions through rate increases or managing operating expenses.

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

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 19, 2016
- U.S. Municipal Water Utilities: No News is (Probably) Good News; The Outlook is Stable, Jan. 20, 2016

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 the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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