

CREDIT OPINION

15 April 2022



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City of Burlington, Vermont Water Enterprise

Update to credit analysis following upgrade to Aa3

Summary

The City of Burlington, VT Water Enterprise (Aa3) has generated consistently strong financial results over the past several years. The enterprise is a small system with a stable service area, which maintains an average wealth and income profile. While the enterprise's debt burden has increased over the past several years, legal provisions remain sound.

On April 15, we upgraded the enterprise's outstanding revenue bonds to Aa3 from A1.

Credit strengths

- » Exclusive provider of water to city of Burlington
- » Independent rate-setting authority coupled with annual review of rates
- » Stable service area and ample system capacity
- » System is fully compliant with all federal and state regulations
- » Sound legal security provisions

Credit challenges

- » Managing increasing debt service costs and capital needs to address deferred maintenance
- » Maintaining solid reserves and debt service coverage with increasing debt burden

Rating outlook

Moody's does not usually assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Stability in debt service coverage and liquidity
- » Significant and sustained growth in customer base
- » Material improvement in service area income levels
- » Improved general obligation credit profile of the city

Factors that could lead to a downgrade

- » Unmitigated decline in debt service coverage or liquidity
- » Material increase in debt ratios beyond expectations
- » Declines in customer base or weakening of income levels
- » Reduced general obligation credit profile of the city

Key indicators

Exhibit 1

Burlington (City of) Water Enterprise, VT					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	20 years				
System Size - O&M (\$000)	\$5,311				
Service Area Wealth: MFI % of US median	112.64%				
Legal Provisions					
Rate Covenant (x)	1.25x				
Debt Service Reserve Requirement	DSRF funded at MADS				
Management					
Rate Management	Aa				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2017	2018	2019	2020	2021
Operating Revenue (\$000)	\$6,335	\$6,396	\$6,596	\$7,202	\$7,461
System Size - O&M (\$000)	\$4,414	\$4,549	\$4,630	\$5,121	\$5,311
Net Revenues (\$000)	\$1,969	\$1,916	\$2,150	\$2,179	\$2,227
Net Funded Debt (\$000)	\$3,478	\$4,797	\$6,397	\$6,824	\$6,586
Annual Debt Service (\$000)	\$93	\$277	\$494	\$617	\$699
Annual Debt Service Coverage (x)	21.1x	6.9x	4.4x	3.5x	3.2x
Cash on Hand	496 days	549 days	433 days	347 days	363 days
Debt to Operating Revenues (x)	0.5x	0.7x	1.0x	0.9x	0.9x

Source: Moody's Investors Service and issuer's audited financial statements

Profile

The City of Burlington (Aa3) is located in northwestern Vermont along the coast of Lake Champlain and has a population of approximately 42,550. The water enterprise serves approximately 9,300 residential commercial, industrial and institutional metered customers in the city. The system also provides wholesale water to Fire District II of the Town of Colchester.

Detailed credit considerations

Service area and system characteristics: Stable service area with average income levels

The system is the sole provider of water to customers in the Burlington, VT area. All but one of the enterprise's customers are sold water on a retail basis with Fire District II of the Town of Colchester being the system's only wholesale purchaser. The system's customer base benefits from the stability of its three largest customers: Fire District II, the University of Vermont & State Agr. Coll. (Aa3 stable), and the University of Vermont Medical Center. Collectively, these customers accounted for 20% of total revenues in 2021.

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Lake Champlain provides all of the water for the enterprise. Water supply is ample given the lake holds approximately 6.8 trillion gallons and the system's peak capacity is 10 MGD of which it uses an average of 4 MGD. Importantly, there are no limits on the amount of water the system can draw from the lake, and management reports that the system is in compliance with federal and state regulations.

Burlington's wealth and income profile is slightly above average – median family income is 113% of the national median, while median home values are a slightly stronger 131% of the nation. The poverty rate is elevated at 26% reflecting, in part, the city's large student population.

Debt service coverage and liquidity: Sound coverage projections supported by future rate increases

The enterprise's financial position should remain sound even as it increases capital expenditures based on management's demonstrated willingness to increase rates to cover growing costs. Management reviews rates on a yearly cycle and expects to continue increasing rates to cover new debt service.

Fiscal 2021 operating results reflect \$2.2 million of net revenues providing sound debt service coverage of 3.2 times. At year end, days cash on hand totaled 363 days.

Over the past decade, the water enterprise has increased rates at least seven times. Additionally, effective fiscal 2022, the city made structural changes to the rate structure, which included adding tiered pricing based on both volume used and use case (irrigation vs non irrigation). We believe these changes reflect management's close care and attention to balancing the system's financial health with the goal of providing affordable water to city residents.

Liquidity

Cash and investments at the end of fiscal 2021 represented \$5.3 million or 363 days cash on hand.

Debt and legal covenants: Debt burden will remain manageable; sound legal provisions

The enterprise has nearly doubled its debt burden since 2016, though total debt remains modest at just \$7.5 million as of the end of fiscal 2021. Upcoming issuance activity is expected to finance a portion of the enterprise's \$18 million capital improvement plan.

Bondholders benefit from sound legal provisions that include a 1.25 times rate covenant and a 1.25 times maximum annual debt service (MADS) additional bonds test. The bonds are secured by a debt service reserve account, which will be funded with bond proceeds, and is required to equal to the lesser of MADS, 125% of average annual debt service, or 10% of principal.

Legal security

The bonds are secured by a pledge of the water system's net revenues.

Debt structure

The entire debt portfolio is fixed rate.

Debt-related derivatives

The enterprise is not party to any interest rate swaps or derivative agreements.

Pensions and OPEB

The enterprise's unfunded pension and OPEB liabilities are modest. Moody's adjusted net pension liability measured just \$3 million in fiscal 2021. To the extent that the multiple-employer pension plans in which the enterprise participates experience returns on assets that fall short of their assumptions, the enterprise's required pension contribution may increase.

ESG considerations

Environmental

The system has access to an abundant supply of water at Lake Champlain. The enterprise is located within Chittenden County which is low to moderate exposure to the environmental risks we track.

Social

The median family income for customers in the service area is slightly above the US nationally. Rates are considered affordable in the local area, and collections have been strong in recent years.

Governance

Outside of a necessary City Council majority vote, management benefits from unlimited rate setting authority and rates are reviewed annually. Additionally, the enterprise maintains a five year capital improvement plan in addition to liquidity targets.

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