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Summary:

Talladega, Alabama; Water/Sewer

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Summary:

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Credit Profile

US\$4.855 mil wtr and swr rev warrants ser 2015 due 09/01/2045

Long Term Rating

A+/Stable

New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' rating and stable outlook to the city of Talladega, Ala.'s series 2015 water and sewer revenue warrants. At the same time, we affirmed our 'A+' rating on the city's parity revenue warrants, of which there is approximately \$16.2 million outstanding. The outlook is stable.

The rating reflects our opinion of the general creditworthiness of the city's waterworks and sanitary sewer system, which includes its:

- Very strong financial risk profile, including robust annual debt service coverage as well as cash reserves;
- Stable service area economy that, while characterized by below-average income indicators, has rebounded well from the recession; and
- Limited capital needs, with no additional borrowing planned for at least the next five years.

A first-lien pledge on the net revenues of the city's water and sewer system secures the bonds. Additional liquidity is provided by a debt service reserve funded in the amount of maximum annual debt service (MADS). We understand bond proceeds will be used to fund a variety of approved capital projects, and that no current or identified upcoming projects are being driven by any kind of regulatory mandates.

Talladega, with a population estimate of 16,100, is in Talladega County, about 50 miles southeast of Birmingham, and 105 miles west of Atlanta. The local economy is primarily based on manufacturing and light industry, including nearby Honda Manufacturing of Alabama. The city is also home to Talladega International Superspeedway and the Motorsports Hall of Fame, which provide significant regional tourism that especially spikes surrounding race dates. Income for the area is low, with median household effective buying income at just 58% of the national average. The unemployment rate for December 2014 was 5.5%, besting both the state's and nation's.

The system provides service to just under 6,500 metered accounts throughout the city as well as some wholesale service outside the corporate city limits. The wholesale services are not tied to formal long-term contracts and are billed solely based on volumes sold. Even with the wholesale service provision, Talladega's top 10 customers accounted for a diverse 17% of fiscal 2014 revenues. The recession did take a toll on the city, as the number of metered accounts actually shrank by several hundred. However, economic development efforts by city leaders as well as the overall recovery have helped stabilize the employment base. Educational institutions and regional health care also lend stabilizing presences to the employment base.

The city's raw-water supply is ample diverse, by way of both Talladega Creek surface water and five deep wells; two

additional wells – one new and one replacement – are currently being brought into service and will enhance total supply by another 1 million gallons per day. The groundwater sources alone have a total pumping capacity of almost 6 million gallons per day (mgd), well above the all-time peak day demand. The city also has rights to divert water from Talladega Creek to a city owned and operated 4-mgd surface water treatment plant. Although the city does have a drought management contingency plan, management reports that even during the worst of the 2012 drought that no mandatory water conservation measures were necessary. The city has also made good progress in reducing nonrevenue water through aggressive leak detection and water audit programs funded from the annual budget. The distribution system's meters are all relatively new. Continuing to reduce nonrevenue water remains a focus of the capital improvement plan. Wastewater treatment is provided by a central plant with a permit that was just renewed in 2015. There were no substantial changes to the permit requirements that would necessarily lead to additional capital requirements or higher operating costs.

The system's financial performance remains strong, including strong debt service coverage (DSC) and liquidity. Unaudited DSC estimates for fiscal 2014 were, in our opinion, strong at 2.45x, or 1.59x if treating transfers as an operating expense. This performance remains consistent with historically robust levels. Transfers out to the general fund remain limited, related to garbage services provided by the general government. The water department provides the customer accounts and billing services, collects the charges, then remits them to the general fund less administrative expenses. The limits on transfers have also helped the system grow its liquidity; the \$7.8 million in unrestricted cash and equivalents for fiscal 2014 is more than three times that of fiscal 2009 and equivalent to more than a year and a half of operating expenses. Officials have no plans to make any significant drawdowns on liquidity.

The city council has sole rate-setting authority. Rates are adjusted based on the consumer price index annually each October. Despite the regular adjustments, a current combined bill for water and sewer stands at \$68.50 based on Standard & Poor's universal assumption of 8,000 gallons of both water and sewer residential service, a level we deem as still affordable at 3.4% of median household effective buying income.

Bond provisions include a 1.25x rate covenant and a 1.25x MADS additional bonds test. A debt service reserve equal to MADS provides additional liquidity.

Outlook

The stable outlook reflects Standard & Poor's opinion that the system will continue to maintain a strong financial profile, which removes any pressure on the rating. We believe that the system's customer base has stabilized and that plans to fund capital projects with working capital, coupled with a willingness to adjust rates, will keep DSC and liquidity strong. Given the area's weak economic indicators, upward rating potential is possible but it may be beyond our two-year outlook horizon.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Dec. 10, 2014

Ratings Detail (As Of March 17, 2015)

Talladega wtr & swr

Unenhanced Rating

A+(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

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