STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Summary:

Portland, Oregon; Water/Sewer

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Summary:

Portland, Oregon; Water/Sewer

Credit Profile		
US$200.0 mil second ln swr sys rev bnds ser 2014B		
Long Term Rating	AA-/Stable	New
US$100.0 mil first ln swr sys rev bnds ser 2014A		
Long Term Rating	AA/Stable	New
Portland first lien wtr & swr		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Portland 2nd lien swr		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to Portland, Ore.'s approximately $100 million series 2014A first-lien sewer system revenue refunding bonds. Standard & Poor's also assigned its 'AA-' long-term rating to the city's nearly $200 million series 2014B second-lien sewer system revenue bonds. Finally, Standard & Poor's affirmed both its 'AA' long-term and underlying rating SPUR) on the city's outstanding first-lien sewer system revenue bonds and its 'AA-' long-term rating and SPUR on the city's outstanding second-lien sewer system revenue bonds. The outlook is stable.

Both ratings are supported, in our view, by the system's:

- Broad service area, which anchors the larger Portland regional economy;
- Very diverse customer base, with low concentration in any one customer;
- Completion of major capital improvements during the past two decades, which have substantially reduced combined sewer overflows; and
- History of raising rates annually to support increasing expenses.

These strengths are partly offset by our view of the system's:

- Only adequate debt service coverage and low fixed charge coverage in fiscal 2011 and 2012, though fiscal 2013 showed improvement; and
- Additional debt needs to finance the system's capital program.

Portland is issuing the series 2014A first-lien bonds to refund about $101 million in series 2004A first-lien bonds outstanding. It is issuing the 2014B second-lien bonds to provide about $207 million in proceeds for capital projects.

The first-lien bonds are secured by a pledge of revenues from the city's sewer and stormwater system. The second-lien bonds are also secured by a pledge of net revenues but are subordinate to the first-lien bonds. A rate covenant requires the city to generate at least 1x debt service coverage on first-lien bonds and second-lien bonds excluding rate stabilization fund withdrawals and 1.20x on first-lien bonds and 1.10x on first- and second-lien bonds including any withdrawals. The first lien has a pooled reserve, funded at the lesser of maximum annual debt service (MADS), 125% of average annual debt service, and 10% of original proceeds. The second-lien bonds are secured by separate reserves, with the 2014B second-lien bonds having a reserve funded at the lesser of MADS, 125% of average annual debt service, and 10% of original proceeds. After this issuance, the system will have about $766 million in first-lien bonds and $1.0 billion in second-lien bonds outstanding. The system also has $18 million in loans outstanding, primarily from the state, which are subordinate to first- and second-lien debt.

Portland has a population of about 592,000 and anchors a regional metropolitan population of about 2.3 million. The city is the largest in Oregon and second largest in the Pacific Northwest after Seattle. The area has a diversified economy with concentrations in technology, transportation, manufacturing, tourism, higher education, and health care. We view median household effective buying income as adequate, at 89% of the national median. The unemployment rate in the city was 6.0% in April 2014, compared with 6.6% for the state.

The system includes the city's sanitary sewer and stormwater collection, conveyance, and treatment system within the city's boundaries. In older portions of the city, the sewer and stormwater collection systems are combined. The combined system represents about 37% of the overall collection system, with separated systems covering the remainder. Wastewater is treated at the city's two treatment plants -- the 100 million gallon per day (mgd) Columbia Boulevard Wastewater Treatment Plant and the 8.3 mgd Tyron Creek Wastewater Treatment Plant. The system serves about 180,000 accounts. We view the customer base as very diverse, with the top 10 customers representing only 5% of operating revenue in fiscal 2013.

The combined sewer and stormwater system in parts of the city have historically led to combined sewer overflows (CSOs) during wet weather events, although the completion of the CSO Control Program in 2011 has reduced these substantially. The program included construction of three large pipes to collect combined sewage and to transport it to an expanded treatment plant. The city also implemented smaller projects to further reduce stormwater entering the sewer system. In our view, completion of this program reduces regulatory risk, although the system's operations are still subject to numerous federal and state regulations.

The city has a history of increasing rates annually to support system expenses and debt service. Residential customers pay a sewer rate based on winter water use and a stormwater rate based on impervious surface area. Currently, a residential customer using 1,000 cubic feet of water and with 2,000 square feet of impervious surface would pay about $93 per month, which we view as moderately high. According to the city, the average bill is lower at about $65. Sewer rate increases have been between 6% and 9% annually during the past five years, while stormwater rate increases have been between 2% and 9% annually. In its projections, the city is assuming wastewater and stormwater rate increases of about 4% annually. The sewer and stormwater rates are combined with the city's water bill, allowing for water shut-off for prolonged delinquencies. Customers also pay an additional harbor fund charge on their utility bills, which the city uses to fund its efforts related to the Portland Harbor Superfund site. Currently this charge is about 4 cents per 100 cubic feet of winter water use and 10 cents for each 1,000 square feet of impermeable surface.

The system pays a utility license fee to the city's general fund, which has previously been capped at $12.8 million annually but as of fiscal 2014 can be up to 5% of revenues. The city projects paying $13.9 million for fiscal 2014.

After declining for several years, the system's coverage of total debt service improved in fiscal 2013. Operating revenues were $283.8 million in fiscal 2013, up 9.8% from the previous year. Operating expenses excluding depreciation and the utility license fee were up 7.8%, totaling $104.1 million. Net revenues provided debt service coverage on the first lien of 1.84x, on the first- and second-lien of 1.23x, and on total debt service of 1.21x in fiscal 2013, as calculated by Standard & Poor's. Total debt service coverage is up from 1.10x in fiscal 2012 and 1.06x in fiscal 2011, as calculated by Standard & Poor's. Fixed charge coverage of debt service and utility license fee payments made to the city was 1.12x in fiscal 2013, up from 1.01x in 2012 and 0.98x in fiscal 2011. In its rate covenant coverage calculations, the city excludes certain operating costs from the audit that it considers to be capital and includes deposits and excludes withdrawals from the rate stabilization fund, among other adjustments. The city also includes revenue collected from the harbor fund charge (but does not include the operating expenses for which the charges are used to fund efforts related to the Superfund site). Under this methodology, the city reported first- and second-lien combined coverage of 1.30x in fiscal 2013 and 1.29x in 2012.

Under the city's projections, operating revenues increase annually due largely to anticipated rate increases. Debt service also increases due to this issue and future planned issuance. The city is currently planning a $192 million bond issue in fiscal 2017 and a $199 million issue in fiscal 2019. The city is projecting combined debt service coverage of around 1.3x annually on the first- and second-lien bonds, as calculated under the rate covenant, not taking into account rate stabilization fund transfer activity. We view the projections as reasonable. However, under Standard & Poor's debt service coverage calculations, coverage could be lower due to the differences in adjustments described above.

The system ended fiscal 2013 with a liquidity position we view as good, though it has declined during the past four years. Unrestricted cash and investments totaled $26.9 million as of June 30, 2013, representing about 94 days of operating expenses on hand. Liquidity improved to $57.3 million as of June 30, 2014, based on unaudited financials. Liquidity was as high as $77.6 million or 325 days as of fiscal-year-end 2009.

The city is projecting to end fiscal 2014 with an improved unrestricted cash and investment balance of $42.6 million.

The system's five-year capital improvement program through fiscal 2019 totals $593 million including capitalized overhead. The largest category of projects (62%) covers maintenance of the collection system and pump stations. The remainder covers wastewater treatment system improvements (20%), surface water management improvements (13%), and system expansion (5%). CSO projects were previously the major focus of the system's capital improvement plan, but these facilities are now completed. In the system's financial projections, the city is planning to issue additional debt in fiscal 2016 ($192 million), and fiscal 2019 ($199 million).

Additional capital spending could be required in the future related to a Superfund site along the Willamette River. The city is one of the potentially responsible parties and has helped fund investigations and assess cleanup options at the site. The cleanup plan has not been finalized, and alternatives being considered by the Environmental Protection Agency vary widely in estimated costs. There is also uncertainty as to the city's proportionate responsibility for covering these costs and what portion of that would be paid from the wastewater and stormwater system. Funding for the city's current Superfund site efforts come from the separate harbor fund charge on customers' bills. This revenue and the associated expenses are accounted for in a separate fund in the city's financial statement.

Outlook

The stable outlook reflects our anticipation that the city will continue increasing rates to cover its increasing operating expenses and increasing debt service. In fiscals 2011 and 2012, the system provided near-1x coverage of debt service and utility license fees, although coverage improved in 2013. If fixed charge coverage were to fall below 1x or if liquidity were to fall substantially during the next two years, we could lower the ratings. If coverage of debt service and the utility license fees were to improve, and if in our view the coverage levels are sustainable going forward, we could raise the rating.

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, July 8, 2014

Ratings Detail (As Of July 23, 2014)		
Portland second lien swr sys		
Long Term Rating	AA-/Stable	Affirmed
Portland swr 1st lien		
Long Term Rating	AA/Stable	Affirmed
Portland swr sys		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Portland 2nd lien swr		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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