North Davis Sewer District, Utah

Rating

Long-Term IDR	AAA

Outlooks

Long-Term IDR	Stable

New Issue

$18,000,000 Sewer Revenue Bonds	AAA

Sale Date

The bonds are scheduled to sell via negotiation on February 27.

Outstanding Debt

General Obligation Refunding Bonds	AAA
Sewer Revenue Bonds	AAA
Sewer Revenue Refunding Bonds (Taxable)	AAA

Applicable Criteria

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (January 2024)

U.S. Water and Sewer Rating Criteria (March 2023)

Related Research

Fitch Rates North Davis Sewer District, UT's Bonds 'AAA'; Outlook Stable (February 2024)

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The 'AAA' Issuer Default Rating (IDR) and bond ratings reflect the district's exceptionally strong financial profile, in the context of its very strong revenue defensibility and operating risk profiles, both assessed at 'aa'. The financial profile is supported by extremely low leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), which was 1.8x in fiscal 2022 (FYE Dec. 31). Leverage is anticipated to remain comfortably below 5.0x for at least the next five years and continue supporting the existing rating.

Revenue defensibility is reflective of the long-term unconditional service contracts, supported by the strong Purchaser Credit Quality (PCQ) of the four largest purchasers. The district's operating risk profile is characterized by a historically very low operating cost burden, a very low life cycle ratio, and capital spending that Fitch Ratings expects will remain in excess of annual depreciation costs.

The current capital improvement plan (CIP) is expected to be slightly smaller than previous years but still robust. After the current issuance, the district is not anticipated to issue debt through at least fiscal 2026. Absent a material change to the CIP and funding plan, the financial profile is expected to remain consistent with the 'aaa' assessment beyond the next five years.

Security

The sewer revenue bonds are payable from net revenues of the system, including impact fees. General obligation (GO) bonds are secured by a pledge of the district's ad valorem taxes, unlimited as to rate or amount.

Key Rating Drivers

Revenue Defensibility — 'aa'

Very Strong Purchaser Credit Quality, Very Strong Revenue Source Characteristics: Revenue defensibility is supported by purchasers that exhibit very strong credit quality. The four largest members include the cities of Layton, Roy, Clearfield, and Syracuse, which together accounted for nearly 80% of the district's revenue in fiscal 2022. These four purchasers are considered in assessing the very strong PCQ. The district has contract provisions that allow for full cost recovery and the unlimited reallocation of costs across users. Additionally, the district retains independent legal ability to raise rates without external approval.

Operating Risk — 'aa'

Very Low Operating Cost Burden, Moderate Investment Needs: In fiscal 2022, the system's operating cost burden was considered very low at $2,455 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was very low at 28% in fiscal 2022. Annual capital spending relative to depreciation is robust, reflected in the five-year average of 290% as of fiscal 2022. Planned capital spending for the next five years should be in line with historical depreciation, allowing for stability in the currently very low life cycle ratio.

The fiscal years 2023-2027 CIP is expected to be around $103 million, which is somewhat lower than historical spending. Over the past couple of years, the district has been focusing its capital spending on the Gilbert Bay project. This project will relocate the district's discharge point to Gilbert Bay in the Great Salt Lake. The completion date of the project is expected to be in fiscal 2024. As a result, capital spending after fiscal 2024 is expected to decrease, as the district's CIP starts to focus on smaller expansion and improvement projects for the existing system.

The CIP is expected to partially funded with the current issuance and existing funds from district's 2021 issuance. The remainder of the CIP will be funded on a pay-go basis.

Financial Profile — 'aaa'

Leverage to Decline Despite Additional Debt: The district had extremely low leverage of 1.8x as of fiscal 2022. This falls in line with historical performance that has ranged from 1.8x to 2.9x annually since fiscal 2018. The liquidity profile is neutral to the overall assessment, with current days cash on hand of 135 and coverage of full obligations (COFO) of 3.2x. Fitch-calculated total debt service coverage was 3.2x in fiscal 2022.

The Fitch Analytical Stress Test (FAST) considers the potential trend of key ratios in a base case and stress case over a five-year period. The stress case is designed to impose capital costs of 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case scenario, the leverage ratio is expected to decrease over the next five years from 1.2x in fiscal 2024 to around 0.4x in fiscal 2027. In the stress case, the leverage ratio is projected to also decrease from 1.4x to just over 0.7x during the same period. Liquidity is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- An increase in leverage sustained above 5.0x in Fitch's base and stress cases.
- A downward revision in the revenue defensibility assessment, driven by a material deterioration in the PCQ.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- The rating is at the highest level on Fitch's scale and cannot be upgraded.

Profile

The district provides wholesale sewer treatment services to approximately 229,000 people in a primarily suburban residential area located about 35 miles northwest of downtown Salt Lake City. The service area covers 82 square miles primarily in northern Davis County and parts of southern Weber County, UT. The district owns and operates approximately 100 miles of sewer collection lines, which convey and deliver wastewater to its treatment facility located near the shore of the Great Salt Lake in Syracuse City, UT.

The district contracts with seven of its member entities, including Clearfield, Clinton, Layton, Roy, Sunset, Syracuse, and West Point, which comprise the majority of its revenues and sewer flows. It also has contracts with, among others, the Hill Air Force Base and provides service to a small area of Kaysville and areas of unincorporated Davis and Weber counties.

The district has the authority to levy taxes on all taxable property within the district, bolstering the flexibility afforded by its ability to increase user fees without external approval. Taxes levied for operations cannot in any year exceed $0.0008 of the valuation of the taxable property in the district, while taxes levied to pay principal and interest on GO bonds have no statutory maximum.

Revenue Defensibility

Revenue Source Characteristics

The revenue defensibility assessment is supported by the strong contractual framework and the very strong credit quality of the largest purchasers. The district's contracts provide for the payment of all operating costs of the district, including debt service. Any uncollected costs under the contracts would be reallocated from the non-defaulting purchasers to ensure the district meets its 1.15x rate covenant. Fitch notes the practical limitations of any of the cities discontinuing or replacing service provided by the district given the lack of alternate sewer treatment options.

Rate Flexibility

Both the district and member cities have the independent legal ability to increase user charges without external approval. The member cities are required to set retail rates sufficient to meet their obligations under the contract and the member cities' payments under the contract constitute an operating expense of the city's retail system. The district retains ample capacity under the operation and maintenance tax cap, providing additional revenue flexibility.

The district charges a monthly service fee of around $21.50 for a single-family residential unit; this fee is passed through from the retail systems to their customers. It has been the same since fiscal 2017.

Purchaser Credit Quality

The cities of Layton, Roy, Clearfield and Syracuse are the district's largest purchasers and comprise approximately 80% of estimated 2023 user revenues. Fitch has assessed the credit quality of key issuers via the Purchaser Credit Index, which is the weighted average credit quality of the relevant purchasers. The weighted average score was 1.63 in the current review but has typically fallen below 1.5. Fitch expects it returns to that level as likely one-time events at two of the purchasers drove the modest increase.

Asymmetric Factor Considerations

No asymmetric rating factor considerations affected the revenue defensibility assessment.

Operating Risk

Operating Cost Burden

The district's operating cost burden is very low, at less than $2,500 per mg of flows treated in fiscal 2022, relative to the fiscal 2018 level of around $1,870 per mg. The metric increased year over year by just 2.2%. Although this cost is trending upward, Fitch anticipates it will remain supportive of the operating risk assessment for the long term.

Capital Planning and Management

The district's life cycle ratio was very low at 28%. This has been supported by very strong capital investment that has well outpaced depreciation over the past five years. In fiscal 2022, the five-year average capex to depreciation ratio was 292%. Capital spending is expected to decrease over the next five years from the $43.9 million spent in fiscal 2022, yet is still expected to continue outpacing depreciation.

The five-year CIP for 2023 through 2027 approximates $103 million. Over the last few years, the district's CIP has been focused on a project to address nutrient regulation. The project relocated the district's discharge site to Gilbert Bay, a more saline area of the Great Salt Lake. The project cost around $52 million and will be done this year (2024). After project completion, capital spending is expected to decrease over the upcoming years as the CIP focuses more on expanding and improving the existing system. Capital spending is expected to be partially funded with the current issuance and the remaining funds from the district's 2021 issuance. The remainder of the CIP is anticipated to funded on a pay-go basis.

Asymmetric Factor Considerations

No asymmetric rating factor considerations affected the operating risk assessment.

Financial Profile and FAST Analysis

The financial profile is exceptionally strong, reflecting extremely low leverage and liquidity that is neutral to the assessment. Leverage was 1.8x in fiscal 2022, down from 2.9x in fiscal 2018, as debt decreased over this period. The liquidity profile is neutral with COFO at 3.2x; COFO excluding connection fees was around 2.6x and current days cash on hand was 135 in fiscal 2022.

Fitch Analytical Stress Test

The FAST considers the potential trend of key ratios in a base case and a stress case. The base case reflects Fitch's expectation of both historical financial results and expected performance in a normal operating-cost environment, while the stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios.

The base case includes full execution of the district's CIP of around $103 million. Operating revenue is expected to increase by 1% per year, driven by customer growth. Operating expenses are anticipated to grow by almost 8% in fiscal 2023 and around 2% thereafter. Factoring in these assumptions, leverage decreases through the forward look to around 0.4x and 0.7x in fiscal 2027 in both the base and stress cases, respectively.

The liquidity profile is expected to remain neutral to the assessment, with COFO remaining above 2.0x and solid days cash on hand through the forward look.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Financial Summary

(Audited Fiscal Years Ended Dec. 31)	2018	2019	2020	2021	2022
Operating Risk					
Operating Cost Burden					
Operating Cost Burden ($/mg)	1,871	1,929	2,235	2,403	2,455
Capital Planning and Management					
Life Cycle Ratio (%)	27	30	30	29	28
Annual CapEx/Depreciation (%)	202	131	233	336	559
5-Year Average Capex/Depreciation (%)	365	240	166	211	292
Financial Profile ($000, unless otherwise indicated)					
Current Unrestricted Cash/Investments	7,171	3,311	3,451	5,684	2,982
Current Cash Available	7,171	3,311	3,451	5,684	2,982
Noncurrent Restricted Cash/Invest (Available Liquidity)	23,961	26,279	26,577	28,621	30,838
Available Cash	31,132	29,589	30,028	34,305	33,820
Noncurrent Restricted Cash/Invest (Debt Service or Debt Service Reserve)	10,858	14,561	9,660	10,085	10,470
Funds Restricted for Debt Service	10,858	14,561	9,660	10,085	10,470
Total Debt	129,960	119,102	99,195	109,125	103,110
Adjusted Net Pension Liability	3,337	4,417	3,347	2,436	429
Available Cash	31,132	29,589	30,028	34,305	33,820
Funds Restricted for Debt Service	10,858	14,561	9,660	10,085	10,470
Net Adjusted Debt	91,307	79,369	62,854	67,171	59,249
Total Operating Revs	21,565	22,065	22,427	21,925	22,579
Other Operating Expenses	7,201	7,986	8,451	8,395	8,072
EBITDA	14,364	14,080	13,977	13,530	14,507
Investment Income/(Loss)	1,474	1,780	1,029	563	1,350
Non-Operating Revenues from Taxes	10,656	10,867	11,195	11,261	10,153
Other Cash Revenues/(Expenses)	187	219	143	477	641
Capital Contributions	4,413	4,529	6,214	7,810	6,852
Funds Available for Debt Service	31,094	31,473	32,558	33,641	33,503
Pension Expense	462	635	547	94	-580
Adjusted Funds Available for Debt Service	31,556	32,108	33,105	33,734	32,922
Net Adjusted Debt/Adjusted Funds Available for Debt Service (x)	2.9	2.5	1.9	2.0	1.8
Funds Available for Debt Service	31,094	31,473	32,558	33,641	33,503
Adjusted FADS for Coverage of Full Obligations	31,094	31,473	32,558	33,641	33,503
Total Annual Debt Service	14,423	14,435	14,648	12,358	10,393
Adjusted Debt Service (Includes Fixed Services Expense)	14,423	14,435	14,648	12,358	10,393
Coverage of Full Obligations (x)	2.16	2.18	2.22	2.72	3.22
Coverage of Full Obligations Excluding Connection Fees (x)	1.85	1.87	1.80	2.09	2.56
Current Days Cash on Hand	363	151	149	247	135
Liquidity Cushion Ratio (Days)	363	151	149	247	135
All-In Debt Service Coverage (x)	2.16	2.18	2.22	2.72	3.22

Note: Fitch may have reclassified certain financial statement items for analytical purposes.
Source: Fitch Ratings, Fitch Solutions, North Davis Sewer District (UT)

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