Memorandum

MIAMI-DADE COUNTY

Date: February 7, 2013

To: Honorable Chairwoman Rebeca Sosa
and Members, Board of County Commissioners

From: Carlos A. Gimenez
County Mayor

Subject: Fitch Ratings' Rating Downgrade of Miami-Dade County Water and Sewer System Revenue and Revenue Refunding Bonds

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The credit rating agency, Fitch Rating (Fitch) recently completed its standard annual surveillance credit review of the Water and Sewer Department (Department). As a result of this review, Fitch has downgraded the Department's long-term credit rating and credit outlook from ***"AA- Negative"*** to ***"A+ Stable."*** As a point of comparison, the credit rating agencies, Moody's Investor Services and Standard & Poor's, have assigned WASD bonds ratings and outlooks of "Aa2 Stable" and "A+ Stable", respectively.

Background

The Department's bonds are secured by net operating revenues (operating revenues minus operating expenses) of the water and sewer system and any funds and accounts established on behalf of the bondholders, including any investment earnings on those funds and accounts.

Attached is Fitch's report on the credit rating downgrade. The major factors that contributed to the downgrade were declining financial margins (i.e. less cushion between operating revenues and operating expenses), rate sensitivity (i.e. reluctance to raise rates) and a significant capital improvement plan that is driven by regulatory mandates and that will be substantially debt financed.

Meaning of Fitch's "A" rating

Fitch Ratings defines an "A" rated entity as having:

> *"The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings."*

A plus (+) or minus (-) sign shows relative status within the major rating categories.

If you have any questions or concerns, please feel free to contact Deputy Mayor Edward Marquez at 305-375-1451.

Attachment

cc: Robert A. Cuevas, Jr., County Attorney
Office of the Mayor Senior Staff
Commission Auditor

FitchRatings

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Fitch Downgrades Miami Dade County, FL's Water and Sewer Revs to 'A+'; Outlook Stable Ratings Endorsement Policy
01 Feb 2013 2:50 PM (EST)

Fitch Ratings-San Francisco-01 February 2013: Fitch Ratings downgrades the following Miami-Dade County bonds, issued on behalf of the county's water and sewer department:

--Approximately $1.9 billion water and sewer revenue bonds downgraded to 'A+' from 'AA-'.

The Rating Outlook is Stable.

SECURITY

Bonds are secured by a first lien on net revenues of the combined water and sewer system. A combined debt service reserve fund is required and is funded by a combination of cash funded reserves and surety policies.

SENSITIVITY/RATING DRIVERS

DOWNGRADE REFLECTS DECLINING MARGINS: Financial margins declined with no rate increases in fiscals 2012 and 2013 and increasing debt service costs related to the 2010 debt issuance.

RATE PRESSURE: Rate sensitivity is a credit concern despite the system's very low combined rates. The department's ability to finance planned debt issuance relies on annual rate increases that are projected by management to begin in fiscal 2014.

STABLE WATER SALES: Retail and wholesale water sales (retail 73%) have remained flat since 2009. The sales stability is positive given the departments required water use efficiency targets and saved water of around 8.5 mgd in 2011.

SIGNIFICANT CAPITAL PRESSURES: The department has large capital needs with multiple regulatory mandates on the sewer system that will be funded with significant additional debt issuance.

WEAK LEGAL COVENANTS: Fitch views both the 1.1x rate covenant and additional bonds test as below average.

CREDIT PROFILE

DOWNGRADE REFLECTS FINANCIAL PERFORMANCE DECLINES IN FISCAL 2012

Financial performance in fiscal 2011 was good. Debt service coverage of senior lien bonds was 2.06x but after the unscheduled, one-time transfer of $32.2 million (5.6% of revenues) to the general fund, cash flow debt service coverage (the metric preferred by Fitch) was 1.78x. All-in debt service coverage was 1.6x including subordinate state revolving fund loans and after the transfer. Liquidity was adequate at $85.6 million, or 164 days operations, including operating funds, the rate stabilization fund and the general reserve fund.

Fiscal 2012 revenues and expenditures were similar to fiscal 2011, reflecting stable rates and sales, but total debt service increased 16% over the same period, reflecting expiration of capitalized interest used in the 2010 bond financing. All-in debt service coverage fell to 1.59x in fiscal 2012. No general fund transfer was made in fiscal 2012 but $25 million was loaned to the general fund. Liquidity, based on unaudited financials, appears to have remained in line with fiscal 2011 levels.

Financial performance in fiscal 2013 will likely be in line with fiscal 2012. Department financial projections indicate all-in debt service coverage should remain around 1.5x-1.6x.

STABLE OUTLOOK REFLECTS EXPECTED RATE INCREASE

Rate increases are approved one year at a time in connection with the budget process. Despite very low combined rates of approximately $40 per month (or 1.8% of median household income), Fitch views rate flexibility of the system as limited, as indicated by no rate increases the last two years while debt service costs were escalating. Debt service costs are projected to increase again in fiscal 2016 if new debt is issued, as currently contemplated, assuming the use of capitalized interest to phase in costs. Expenditure levels are relatively fixed and much of the planned capital spending is needed to meet regulatory requirements, so Fitch views flexibility on the expenditure side as limited.

The department's most recent budget (2012-2013) included a forecast to increase retail water and sewer rates by 9% in FY14 and 6% thereafter. Management expects the upcoming budget discussion for 2013-2014 to include discussions of rate increases. Fitch expects there may be pressure to hold rates lower. The Stable Outlook reflects Fitch's belief that the county will raise rates beginning no later than fiscal 2014 in the range of these estimates in order to preserve financial margins, sufficient liquidity, and meet required capital spending.

SIGNIFICANT CAPITAL DEMANDS WILL INCREASE ALREADY HIGH LEVERAGE

The department faces a very large capital plan that is primarily driven by regulatory requirements. Water system requirements reflect a new twenty-year water use permit received in 2007 that strives to protect groundwater resources by reducing use of the department's primary water source, the Biscayne aquifer. Sewer system requirements include a 2010 amended consent order and the expected scope of a pending consent decree with the Florida Department of Environmental Protection (FDEP) that focus on sewer system treatment and collection repairs. Sewer capital needs also now reflect 2008 state legislation that requires the department to end its use of ocean outfalls for sewer effluent disposal by 2025, which will require major system redesign and investment.

The department has had some success curtailing aspects of the capital requirements, such as an amendment to its water use permit that reduced required system investment given the lower water demand profile following the recession. But overall, capital plan cost estimates in the department's multi-year plan (15 year estimates) remain significant. The department's 15 year capital plan indicates $10.2 billion in needs, reflecting substantial spending commitments and new debt outside the five-year forecast period.

Five year capital needs are projected at $1.9 billion, of which management estimates that around 70%, or $1.34 billion, will be debt financed. The balance of the five-year capital plan will be funded with state revolving fund loans (SRF), prior bond proceeds, connection fees, existing reserves, and excess operating revenues. Debt levels are already above average for the sector at $2,699 per customer and debt to net plant assets of 60%. Debt per customer may climb to $3,500 over the next five years with average annual debt per customer to be added of $352.

BROAD SERVICE AREA

The department provides water and sewer services to the entire county either through direct retail service or through wholesale water and sewer contracts with 14 and 12 municipal systems, respectively. The department also provides sewer treatment services to Homestead Air Reserve Base. The county sets wholesale rates annually to cover wholesale costs, but retail revenues, for both water and sewer services, account for the majority of department revenues at 84%. Retail customers have been stable with five-year average growth of less than 0.5% in both systems. Water sales have been stable to both groups of customers at around 85-86 billion gallons annually. The department's forecast relies on water sales of 88 billion. While the service area is showing signs of recovery and projects underway could increase usage, the department's financial forecast appears to rely on growth for purposes of rate setting.

Contact:

Primary Analyst
Kathy Masterson
Senior Director
+1-415-732-5622
Fitch Ratings, Inc.
650 California Street, 4th Floor
San Francisco, CA 94108

Secondary Analyst
Christopher Hessenthaler
Senior Director
+1-212-908-0773

Committee Chairperson
Jessalynn Moro
Managing Director
+1-212-908-0608

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's U.S. Municipal Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria' (June 12, 2012);
--'U.S. Water and Sewer Revenue Bond Rating Criteria' (Aug. 3, 2012);

--'2013 Water and Sewer Medians' (Dec. 5, 2012);
--'2013 Sector Outlook: Water and Sewer' (Dec. 8, 2011).

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
2013 Water and Sewer Medians
2013 Outlook: Water and Sewer Sector