S&P Global
Ratings

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Summary:

Hot Springs, Arkansas; Water/Sewer

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Credit Profile		
US$25.0 mil Wastewtr Rfdg Rev Bnds ser 2017 dtd 08/24/2017 due 12/01/2037		
Long Term Rating	A/Stable	New
Hot Springs wastewtr		
Long Term Rating	A/Stable	Affirmed
Hot Springs wastewtr (ASSURED)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings assigned its 'A' long-term rating to Hot Springs, Ark.'s series 2017 wastewater refunding revenue bonds. At the same time, S&P Global Ratings affirmed its 'A' rating on the city's existing wastewater revenue bonds. The ratings reflect, in our opinion, the combination of a strong enterprise and financial risk profiles. The outlook is stable.

The enterprise risk profile reflects our view of the wastewater system's:

- Weaker economic indicators, with below average median household effective buying incomes (EBIs);
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Average residential bill based on percentage of median household effective buying income (MHHEBI), with average poverty rates; and
- Standard operational management assessment (OMA).

The financial risk profile reflects our view of the wastewater system's:

- Consistently strong all-in debt service coverage (DSC);
- Fluctuating liquidity levels during the past five years, as evidenced by unrestricted cash and investments ranging from $3.2 million to $701,000 or from 135 days to 35 days of operating expenses from fiscals 2012 to 2016;
- Moderate debt level with unknown capital needs; and
- Standard financial management assessment (FMA).

Officials plan to use bond proceeds to refund the series 2009 for economic savings.

We view the bond provisions as weak, however credit neutral. The wastewater system's net revenues secure the bonds. Hot Springs has covenanted to set rates and charges such that net revenues are at least sufficient to meet operations and maintenance and debt service requirements. The system may issue additional bonds if it achieves a 1.1x net revenue test on existing and proposed bonds; the test can include rate adjustments. Additionally in lieu of a cash debt service reserve the bonds will have a debt service insurance policy.

Enterprise Risk

Our assessment of the wastewater system's enterprise risk profile is strong, reflecting our view of the standard operational management framework and average a bill based on below average income levels.

The city of Hot Springs is in southwest Arkansas, approximately 55 miles southwest of Little Rock. The local economy centers on tourism due to the city's natural hot spring, downtown historic district, and national park. Income levels are adequate in our opinion, but below average, with MHHEBI at only 70% of the national level. We characterize the customer base as diverse based on revenue concentration with the top 10 customers representing 6.2% of 2016 revenue; however we consider weak economic base MSA characteristics.

For residential customers, the city indicated the average water bill is $37.45 based a 5,000 gallon bill within city limits. As a percentage of MHHEBI, the 5,000 gallon wastewater bill is about 1.4%, which we consider average. The county poverty rate is 18.7%. The city reviews its rates annually and last raised rates in January 2017; as of Nov. 5, 2013, the city passed the current rate ordinance, which increases rates 3% per annum; the city maintains rate autonomy.

Consistent with our criteria "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the wastewater system to be very low or '1' the most favorable assessment possible on a six-point scale, with '1' being the best.

Based on our operational management assessment, we view the wastewater system as a '4' on a six-point scale with '1' being the strongest. An assessment of "standard", in our view, implies average alignment between the system's operational characteristics and management. The system provides wastewater service to more than 26,300 customers. The wastewater system has adequate treatment capacity (12.85 million gallons per day or mgd) to meet daily demand and has addressed the consent order to reduce overflows from peak volumes. The city expects to be compliant with the consent administrative order in 2017. Furthermore the city informally reviews succession planning.

Financial Risk

Our assessment of the wastewater system's financial risk profile as strong reflects our view of the city's strong all-in coverage, good liquidity position, moderate debt level and standard financial management framework.

The city's financial performance has been strong in our view, and we anticipate that it will continue to be strong going forward. All-in debt service coverage (DSC) ranged from 1.20x to 1.48x during the past five years, and most recently stood at 1.38x, which we consider strong, based on unaudited 2016 results. Coverage dipped in fiscal 2014 due to increased salaries and operating expenses. Otherwise, operating revenues and operating expenses grew in step with each other during the past five years to maintain strong coverage well above the rate covenant of sufficiency. Based on management's pre-approved rate increases we anticipate all-in DSC to improve or remain at current levels, which we view as good.

Liquidity has fluctuated as cash reserves were spent on planned capital projects. During the past five years, unrestricted cash and investments ranged from $701,000 to $3.2 million, from 31 days to 135 days' of operating expenses. Based on unaudited fiscal 2016 results, the unrestricted cash and investments at fiscal year-end stood at $3.1 million, equivalent to 135 days. Management indicated informal plan on maintaining roughly $2 million in unrestricted cash going forward.

Currently, we consider the system's debt-to-capitalization ratio moderate at 59.1%, with nearly $72.5 million of wastewater debt outstanding in fiscal 2016. The city has no immediate debt plans and no current capital projects beyond the capital improvement plan (CIP) finishing up this year. The city has contracted with a firm to complete a new master plan to identify capital needs through 2040 that will be completed by the end of fiscal 2018. Based the conclusions in the master plan and discretion of the board, the city could have future debt needs. As of fiscal 2015, the net position of liability percentage was 79.14%, which we view as credit neutral.

Based on our FMA, we view the city as a '4' on a six-point scale, with '1' being the strongest. A FMA of "standard" indicates we deem financial practices sustainable, but not comprehensive. The city internally reviews budget-to-actuals monthly and is presented to the board. Management does not produce short term financial projections beyond the budget but management reviews projections with the rate study. The city follows a formal investment policy that mimics the state statues. Management also produces annual audited financial statements that comply with generally accepted accounting principles (GAAP). The city indicated it has no formal debt management policy or liquidity policy but stated an informal liquidity goal of $2 million.

Outlook

The stable outlook reflects our anticipation that during the next two years the city will implement its adopted rate increases and maintain liquidity as they identify future capital needs. Additionally, we believe that maintaining consistently good to strong all-in DSC is credit strength.

Upside scenario

We don't anticipate a rating increase in the outlook period based on unknown capital needs. We would consider raising the rating once a master plan is completed identifying future capital needs and once the city is able to strengthen both its all-in DSC and liquidity to establish a trends similar to higher-rated peers while codifying polices similar to peers we could raise the rating.

Downside scenario

If additional debt plans stress the all-in DSC metric or unrestricted liquidity is maintained below its informal target, we could take a negative rating action.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.