



# Assessing the Creditworthiness of Municipal Water Utilities

## *Executive Summary*

Raftelis Financial Consultants, Inc., a well-known, highly regarded consultancy serving the water utilities industry, prepared the attached primer. It reviews the key metrics and financial considerations that credit analysts generally use to evaluate the creditworthiness of municipal water and wastewater utilities. While this report focuses on municipal water systems, we believe that non-municipal water systems will also be interested in the results because credit analysts assess their creditworthiness in much the same way as they do municipal water systems.

In preparing this document, Raftelis' analysts drew on their years of experience and expertise as rate and financial consultants to municipal utilities in order to provide insight and perspective on what they regard as industry best practices used in assessing creditworthiness as well as on what they see as red flags symptomatic of credit problems. We think that Raftelis' primer serves as an excellent overview for helping water utility executives, and others, to understand the key issues and considerations that underpin creditworthiness and credit ratings. In fact, many of the recommended metrics and financial considerations have parallels in non-government water systems.

Following are Raftelis' three major recommendations for what municipal water and wastewater utilities can do to improve their creditworthiness and ratings:

**Lesson #1:** In pursuit of a strong credit profile, water utilities should utilize proactive, effective financial management practices that anticipate liquidity needs, set specific reserve fund policies, and revenue targets to address those liquidity needs, and proactively adjust their rates so as to achieve those revenue targets.

**Lesson #2:** Debt service coverage (DSC) is the most important metric for assessing creditworthiness. In calculating the relevant DSC ratios, utilities must conform to the prescribed definitions of revenues and expenses as specified in their bond/lender documents. Moreover, the utilities must integrate these calculations into their financial planning and management processes.

**Lesson #3:** In assessing a utility's creditworthiness, credit analysts will examine the utility's non-financial risks, including a community's economic health, customer diversity, and demographic trends. Hence, when utilities set their financial goals as well as in their standard financial and capital planning practices, they should use prudent, conservative, and realistic assumptions about these non-financial, economic risks. ■