

New Issue: **Louisville Water Works Board, KY**

**MOODY'S ASSIGNS Aa1 RATING TO LOUISVILLE WATERWORKS (KY) \$80 MILLION WATER REVENUE BONDS**

**AFFECTS \$118 MILLION OF OUTSTANDING PARITY DEBT**

Water/Sewer  
KY

**Moody's Rating**

| <b>ISSUE</b>                            | <b>RATING</b> |
|---|---------------|
| Water System Revenue Bonds, Series 2006 | Aa1           |
| <b>Sale Amount</b>                      | \$80,000,000  |
| <b>Expected Sale Date</b>               | 06/21/06      |
| <b>Rating Description</b>               | Revenue       |

**Opinion**

NEW YORK, Jun 12, 2006 -- Moody's Investors Service has assigned a Aa1 rating to the Louisville Water Company ( KY's) \$80 million Water System Revenue Bonds, Series 2006. Concurrently, Moody's has affirmed the outstanding Aa1 rating, affecting \$117.8 million in outstanding parity debt. The high quality rating is based on a long-term trend of well managed financial operations - including strong debt service coverage despite recent draws on working capital, a regionally important service area economy, and a manageable debt profile.

**STRONG LEGAL PROVISIONS**

The bonds are secured by a first lien on pledge revenues (which excludes capacity fees) of the water system, and the flow of funds requires monthly debt service set asides be made prior to revenues being released to the operating fund. The debt service reserve requirement is equal to one-half of maximum annual debt service and may be satisfied with either cash or a surety. Rates are required by the indenture to provide 1.3x coverage of debt service. The annual dividend payment, which the flow of funds dictates be paid after debt service, funding of the depreciation account and operations, (more fully described below) is required by the indenture to be budgeted annually thereby assuring debt service coverage well in excess of the rate covenant.

**LONG-TERM TREND OF WELL MANAGED FINANCIAL OPERATIONS, INCLUDING AMPLE DEBT SERVICE COVERAGE**

Conservatively managed financial operations, including timely periodic rate increases, result in a long-term trend of favorable system operating ratios and strong debt service coverage. Over the last few years, the district's operating ratio has remained below the comparable median at about 46% and annual debt service coverage has not been below 5 times (5.4x senior lien debt service coverage in fiscal 2005; exclusive of \$15.8 million in capacity charges which are not pledged). While working capital has declined significantly as a result of cash financing of capital projects, \$15 million of the current issue will reimburse the system for prior capital expenditures and bolster net working capital (which was \$5.1 million or 4.8% of operating revenue in fiscal 2005). The high debt service coverage ratio stems from management's policy to fund a majority of capital needs on a pay-go basis and the required annual dividend payments to Louisville/Jefferson County Metro Government ("Metro", GO bonds rated Aa2). The dividend payment, which exceeded \$16 million in 2005, is legally subordinate to debt service payments and directly results in budgeting for high coverage levels. The district has annually raised rates over the past decade to maintain these financial strengths, and anticipates 5% annual increases over the next five years. Moody's believes system financial operations will remain strong for the foreseeable future given management's favorable financial policies, the expectation of continued moderate service area growth, and the expectation of a manageable amount of future debt.

**REGIONALLY IMPORTANT SERVICE AREA ECONOMY**

Metro is a major regional economic center with modestly expanding population. Economic strength is demonstrated by above average wealth levels, as per capita personal income for Jefferson County was

135.5% of the state average (1999 data). The county's unemployment rate is typically below that of the state, and was modestly so in March 2006 at 6.3% versus 6.4% for the state. The system provides water to 290,000 accounts of which the majority (83%) are residential. Growth is both number of accounts and system usage has approximated a modest 1% per year over the last five years. Moving forward, growth is expected to continue at this pace. Water is provided outside of the county's boundaries to parts of Oldham and Bullitt Counties as well as approximately 49,000 people in surrounding counties (on a wholesale basis). The company has no significant concentration in top water customers, with the largest customer paying a modest 1.5% of 2005 revenues.

#### AMPLE WATER SUPPLY

The Ohio River is the company's primary sources of water. Treatment is provided at two plants with a combined capacity of 240 MGD as compared to an average daily usage of 131 MGD (in 2005). The company's B.E. Payne plant has 60MGD capacity currently and will move to riverbank filtration (project in preliminary stages) in 2008 with a treatment capacity of 60 MGD as well. Studies are underway regarding providing advanced treatment at the company's Crescent Hill plant, which is almost 100 years old.

#### MANAGEABLE DEBT POSITION

Significant use of pay-go capital funding has resulted in a below average debt ratio of approximately 16% as of fiscal year-end December 31, 2005. Moody's expects debt levels to remain manageable despite the company's sizable \$407 million 2006-2010 capital improvement program given the expectation of significant cash financing. The company expects to next issue debt in fiscal 2008 (\$x million currently expected).

Type of System: Water supply, treatment, and distribution

Operating ratio, FY 2005: 46%

Senior Lien Debt service coverage, FY 2005: 5.41

Total debt service coverage, FY 2005: 5.26

Debt ratio, FY 2005: 16%

Payout of principal (10 years): 45%

Debt Outstanding, including current issue: \$198 Million

#### Analysts

Robyn Kapiloff  
Analyst  
Public Finance Group  
Moody's Investors Service

Bill Leech  
Backup Analyst  
Public Finance Group  
Moody's Investors Service

#### Contacts

Journalists: (212) 553-0376  
Research Clients: (212) 553-1653

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**Primary Credit Analysts:**

Scott D Garrigan  
Chicago  
(1) 312-233-7014  
scott\_garrigan@  
standardandpoors.com

**Secondary Credit Analysts:**

Jeffrey Panger  
New York  
(1) 212-438-2076  
jeff\_panger@  
standardandpoors.com

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**Louisville and Jefferson Cnty Metro Govt, KY**

**Credit Profile**

US\$80 mil Louisville wtr co wtr sys rev bnds  
ser 2006 due 11/15/2015-2034 AA+  
Sale date: 21-JUN-2006

| <b>UPGRADED</b>          | <b>To</b> | <b>From</b> |
|--------------------------|-----------|-------------|
| Outstanding wtr rev bnds | AA+       | AA          |
| Outstanding wtr rev bnds | AA+(SPUR) | AA          |
| <b>OUTLOOK:</b>          | STABLE    |             |

**Rationale**

Standard & Poor's Ratings Services raised its long-term and underlying rating (SPUR) on Louisville and Jefferson County Metro Government, Ky. Board of Water Works' revenue bonds to 'AA+' from 'AA'. Standard & Poor's also assigned its 'AA+' rating to Louisville and Jefferson County Metro Government's \$80 million water system revenue bonds series 2006.

The higher rating reflects the county's:

- Comprehensive financial and capital planning, which is expected to help support the water works with excellent liquidity, debt service coverage, and capital management; and
- Large amount of reserve funds, which substantially increase liquidity.

Long-term planning includes a 20-year facilities plan, a five-year capital improvement plan, financial modeling of both five and 10 years in length, risk management, and corporate governance policies. All of these planning tools are integrated with financial policies that include the following:

- To maintain at least two months of operating cash on hand,
- To fully fund depreciation (by covenant in the bond resolution), and
- To set rates sufficient for net revenues to be no less than 130% of maximum annual debt service (MADS).

The calculation of net revenues is also net of depreciation (because of the covenant to fully fund depreciation); this policy is also set by covenant in the bond resolution.

Other credit factors that support the rating include:

- A stable and diverse service area economy,
- Sufficient water supply to meet demands,
- Strong financial operations, and
- Strong legal provisions.

These factors are mitigated by a large five-year capital improvement program totaling \$431 million to be funded from internally generated funds, capital contributions, and debt. Although the water works is managing its capital program very well, the large amount of improvements to be made limits the rating.

Payment of debt service is secured with the net revenues of the water system.

Louisville and Jefferson County Board of Water Works operates Louisville Water Company (LWC), which serves a large and diverse customer base over a large geographic and economic base. The company serves more than 290,000 customer accounts within Louisville and its surrounding areas, with slightly more than 80% of them residential customers. Diversity of rate payers is demonstrated by the 10 leading customers accounting for just 6% of total revenues. The service area economy has remained stable, growing slowly over the past five to 10 years. A significant health care, insurance, finance, and government presence remains to aid stability to the area, and the unemployment rate of 5.7% for Louisville in 2005 was on par with the state but above the national average.

Water supply and treatment capacity is sufficient to meet LWC's current and near-term projected needs. The LWC has an intake capacity of 420 millions of gallons per day (mgd) and a 240 mgd combined treatment capacity at its Crescent Hill and B.E. Payne treatment facilities. In 2005, the maximum and average daily pumpage for the company's facilities was 205 mgd and 131 mgd, respectively.

Over the past four audited years from 2002-2005, cash has been reduced for capital spending but debt service coverage has improved in each year. Historically, LWC would issue debt for capital projects, build up current cash reserves during the time when bond proceeds were being spent, and then draw cash reserves down for additional capital spending until the next bond issue occurred. Incorporated within the series 2006 bond proceeds are reimbursements for previous capital expenditures to moderate the swings in cash and reserve balances.

For this reason, from 2002-2005, combined operating and reserve fund cash has been drawn down. Unrestricted days' cash at Dec. 31, 2005, which is the low point in the company's cash position, totaled 18 days (incorporating operating expenses and water services, rendered in lieu of taxes paid to Louisville), while an additional \$8.5 million was available in a depreciation fund and an infrastructure replacement fund. Debt service coverage has increased over that same time period to a high 5.3x, excluding depreciation and non-cash capital losses. LWC has projected debt service coverage, on the same basis, to exceed 3.2x in all years through 2010 while maintaining 60 days' unrestricted cash and increasing its depreciation reserve each year.

The legal provisions for the bonds are strong. Security for payment of debt service is based on net revenues of the system. The bond resolution stipulates that, as the sole stockholder in the company, the city of Louisville is to receive a dividend payment from LWC that totals 60% of net income; payment of the dividend is subordinate to all operating expenses and debt service on the bonds. A debt service

reserve has been established that is equal to 50% of pro forma MADS. Rates are set such that net revenues are not less than 130% of pro forma MADS. In addition, the additional bonds test stipulates that net revenues in the fiscal year prior to issuing the bonds must be at least 1.3x pro forma MADS, adjusting for rates in place at the time that the additional bonds are issued.

### ***Outlook***

The stable outlook reflects the stability provided by the primarily residential customer base, the below-average water rates, and the historically strong financial operations. The outlook also reflects the system's ability to generate sufficient funds to fund the capital program requirements.

### ***Rates***

The Louisville Water Co.'s residential user water rates are generally low but about average when compared with other 'AA' category water systems. As of Jan. 1, 2006, monthly rates for Jefferson county residents totaled \$19.56 per 1,000 cubic feet, and the average monthly bill in 2005 was reported at \$16.43. All financial projections assume a 5% annual increase in rates to sustain cash balances, debt service coverage levels, operating expenses, and capital financing through 2010.

A board of directors approves water rates. The board is vested with all of the authority and privileges; exercises all of the franchises; and has possession, control, and management of all of the company property. The metropolitan government's mayor appoints the six members of the board to staggered terms. The board has a long history of approving rate increases. Overall, rates have increased between 2.5% and 6.5% per year since at least 1990.

### ***Management***

Long-term financial and capital planning is accomplished through several planning documents. LWC is able to take these requirements into account for planning purposes because LWC has rate, depreciation fund, and dividend payment covenants written into its bond resolution. The company makes use of a 20-year facilities plan, a five-year capital improvement plan, and financial modeling of both five and 10 years in length (with the five-year plan used as a more definite financing plan compared to the 10-year plan).

LWC also has risk management and corporate governance policies. A key feature of risk management is succession planning, which can help to minimize the operational risk from turnover in key positions. Internal controls such as regulatory needs assessment, institutionalized management practices, and inventory of asset condition all help to stabilize the company's operations.

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