

**MOODY'S ASSIGNS Aa2 RATING AND STABLE OUTLOOK TO METROPOLITAN ST. LOUIS SEWER DISTRICT'S (MO) \$85 MILLION TAXABLE WASTEWATER SYSTEM REVENUE BONDS (BUILD AMERICA BONDS – DIRECT PAY), SERIES 2010B**

**Aa2 RATING AND STABLE OUTLOOK APPLIES TO \$344 MILLION OF SENIOR LIEN SEWER REVENUE DEBT, INCLUDING CURRENT OFFERING**

Moody's Investors Service has assigned a Aa2 rating and stable outlook to the Metropolitan St. Louis Sewer District's (MO) \$85 million Taxable Wastewater System Revenue Bonds (Build America Bonds – Direct Pay), Series 2010B. Concurrently, Moody's has affirmed the Aa2 rating and stable outlook on the district's outstanding senior lien sewer debt. The Metropolitan St. Louis Sewer District has \$344 million in outstanding senior lien sewer revenue debt, including the current offering. Secured by a senior lien on the net revenues of the district's wastewater system, the current bonds represent a portion of \$275 million of debt capacity that was authorized by voters in August 2008 to fund improvements and expansions to the sewer system. Assignment of the Aa2 rating and stable outlook reflects the system's large and diverse service area, which encompasses the City of St. Louis (general obligation rated A2/stable outlook) and most of St. Louis County (general obligation rated Aaa/stable outlook); satisfactory financial operations that benefit from the district's independent rate setting authority; ample debt service coverage; debt levels that are expected to significantly increase to fund extensive capital improvements needed to address Combined Sewer Overflow (CSO) and Sanitary Sewer Overflow (SSO) issues; and satisfactory legal covenants.

**LARGE AND DIVERSE SERVICE AREA ENCOMPASSES CITY OF ST. LOUIS AND MOST OF ST. LOUIS COUNTY**

The Metropolitan St. Louis Sewer District (MSD) is the nation's fourth largest wastewater system, with 1,928 miles of combined sewers and a customer base of approximately 430,000. MSD's service area encompasses 525 square miles and includes the entirety of the City of St. Louis and 90% of St. Louis County. More than 75% of total accounts and 65% of total billings are attributable to customers in the County. The user base is diverse with the top 10 customers accounting for only 5.8% of fiscal 2009 billings. The system's top customer, InBev Anheuser Busch (senior unsecured rated Baa2/stable outlook) accounted for 3.1% of fiscal 2009 billings. MSD officials do not expect the recent merger of Anheuser Busch and InBev to impact the wastewater system's operating revenues in the foreseeable future. The system operates seven treatment facilities covering the Mississippi, Missouri, and Meramac River watersheds and has adequate capacity. The system is permitted to handle 423 million gallons of flow per day, which exceeds the system's 2008 maximum level of 395 million gallons per day.

The St. Louis regional economy is sizeable and diverse. Considerable institutional stability exists in the healthcare sector, with BJC Healthcare (revenue rated Aa2/stable outlook) as the area's top employer. The area is also home to multiple education institutions, as well as corporate headquarters such as Monsanto, Edward Jones, Express Scripts and Enterprise Rent-A-Car. However, economic pressures exist. The region's prolonged trend of population and property valuation growth have recently reversed due in part to the economic recession. Additionally, Chrysler Corporation closed its St. Louis plant in 2009. Chrysler was the system's fifth largest customer, representing \$700,000 in revenue in fiscal 2009. MSD officials plan to offset the lost revenue through various revenue enhancements and expenditure controls. The system may also be impacted by defense industry pressures at Boeing Co. (senior unsecured rated A2/negative outlook), which is the area's second largest employer and the wastewater system's sixth largest user. Despite these challenges, Moody's believes the size and diversity of the regional economy support the system's Aa2 ratings.

**SATISFACTORY FINANCIAL OPERATIONS BENEFIT FROM DISTRICT'S INDEPENDENT RATE SETTING AUTHORITY; AMPLE DEBT SERVICE COVERAGE**

Moody's expects the district's sound financial operations will continue due to management's demonstrated willingness and ability to adjust rates as needed to provide for strong debt service coverage. Although coverage has dropped from levels in the early 2000s as MSD has issued additional debt, it remains strong. Senior lien debt service coverage was 4.5 times in fiscal 2008 and 5.8 times in fiscal 2009. Debt service coverage on all debt, including subordinate lien State Revolving Loan Fund (SRF) debt, is also sound at 2.3 times in fiscal 2008 and 3.1 times in fiscal 2009. The district's financial projections through fiscal 2012 (which incorporate expected debt issuance and rate increases) show similar levels of coverage, with senior lien debt service coverage projected to range between 5.3 times and 5.8 times, and debt service coverage

on all debt to range between 2.9 times and 3.6 times. The district's fiscal 2009 net working capital represented a robust 235% of operations and maintenance expenditures. Fiscal 2009 operating revenues equaled \$210 million (wastewater system revenues only) and have increased annually since fiscal 2002 due to rate increases and modest increases in billable flow with the exception of a slight drop in fiscal 2007 when service charges dropped largely due to water conservation programs enacted by some of MSD's largest customers.

While MSD's rate-setting process includes a Rate Commission comprised of community groups that recommend rates to the board, MSD's board has ultimate rate-setting authority and can set rates at odds with the Commission's recommendations. MSD most recently enacted a 13% rate increase effective for the final 7 months of fiscal 2008. Additional rate increases of 2.4%, 4.7%, and 4.3% are planned for fiscals 2010, 2011, and 2012, respectively. The system's current rates are average for comparably sized peers, although future rate increases tied to CSO and SSO work are expected to be substantial. Favorably, MSD officials are already preparing the public for the scope of future capital needs and the likely impact on customers.

#### DEBT LEVELS EXPECTED TO SIGNIFICANTLY INCREASE; EXTENSIVE CAPITAL IMPROVEMENTS NEEDED TO ADDRESS CSO AND SSO ISSUES

Moody's believes the district's present debt profile is manageable with a fiscal 2009 debt ratio of 17%. However, debt levels are expected to significantly increase in the next several decades. In August 2008, 76% of district voters authorized the issuance of \$275 million in revenue bonds to fund a variety of capital projects, including increasing the system's wastewater treatment capacity by building a new treatment plant and expanding and improving existing plants. To date, the district has issued \$146 million of the authorized debt, including the current issue. Officials expect to issue the remaining \$129 million in two installments: \$78 million in subordinate lien SRF loans in 2011 and \$51 million in senior lien bonds in 2012. MSD has kept debt ratios manageable through considerable pay-go financing, with approximately 47% of capital project costs cash funded, a ratio that officials expect to maintain with future projects.

Over the longer term, Moody's expects the system's debt levels to significantly increase in order to address CSO and SSO issues. In June 2007, the United States Environmental Protection Agency (EPA) and Missouri Department of Natural Resources (DNR) filed a lawsuit against the district due to violations of the Clean Water Act. The violations were related to CSO and SSO events. CSO events are largely tied to infrastructure in the central city and inner-ring suburbs while SSO events are found throughout the suburban areas of the system. In July 2008, MSD and the EPA entered into discussions, and in March 2009, mediation. In September 2009, the district submitted a wet weather control plan to EPA to address the CSO issue. The EPA is currently reviewing the plan, although the exact review timeframe is not known. MSD also plans to submit a SSO plan to EPA within the next three years. Early estimates indicate the plan will cost approximately \$3.8 billion to fund wastewater system improvements, with an additional \$2.2 billion for possible stormwater system projects. The EPA has historically required that plans be implemented over 20 years, although the MSD plans assume a 25 year to 30 year project timeline. MSD has begun addressing some work tied to CSO and SSO issues such as expanding wet weather capacity at treatment plants, but Moody's believes the liabilities incurred as a result of EPA litigation will significantly add to the district's capital needs. Favorably, the district's practice of cash funding a portion of capital projects should mitigate future debt levels, and MSD's demonstrated willingness and ability to increase rates should provide for a continuation of healthy debt service coverage. All of MSD's outstanding debt is in fixed rate mode, and the district is not a party to any interest rate swap agreements.

#### SATISFACTORY LEGAL PROVISIONS

Moody's believes that the legal provisions outlined in the master and supplemental bond ordinances provide satisfactory security for bondholders. Debt service on the current bonds is secured by a senior lien on the net revenues of the wastewater system and are on parity with the system's Series 2004A, 2006C, and 2008A wastewater revenue bonds. Net revenues are defined as gross operating revenues of the wastewater system less operating and maintenance expenditures. Pledged revenues explicitly exclude stormwater system revenues. The rate covenant calls for net revenues to provide at least 1.25 times annual debt service coverage on all senior lien bonds and 1.15 times debt service coverage on all debt. An additional bonds test calls for net revenues to equal a strong 1.25 times MADS on all senior lien debt and 1.15 times MADS on all debt for either 12 consecutive months during the most recent 18 month period or in the financial forecasts for the next three fiscal years. The debt service reserve requirement is the lesser of 10% of the principal on

the senior lien bonds; MADS on senior lien debt; or 1.25 times average annual debt service on senior lien debt. The district will fund the debt service reserve with bond proceeds.

#### KEY STATISTICS

Type of system: Sewage collection and treatment

2009 estimated service area population: 1.4 million

Fiscal 2009 customer base: 427,205

Fiscal 2009 net working capital: \$376 million

Fiscal 2009 operating revenues: \$210 million (excludes stormwater system revenues)

Fiscal 2009 operating ratio: 64%

Fiscal 2009 debt ratio: 17%

Fiscal 2009 debt service coverage: 5.83 times (senior lien); 3.06 times (all debt)

Post-sale sewer revenue debt outstanding: \$344 million (senior lien); \$529 million (all debt)

#### RATING METHODOLOGIES AND LAST RATING ACTION

The principal methodology used in rating the current issue was Analytical Framework for Water and Sewer System Ratings, which is available on [www.moody.com](http://www.moody.com) in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

The last rating action for the Metropolitan St. Louis Sewer District was on October 15, 2008, when the Aa2 rating and stable outlook on the district's senior lien sewer revenue debt was affirmed.