Summary:
Lehigh County Authority, Pennsylvania; Water/Sewer

Primary Credit Analyst:
Erin Boeke Burke, New York + 1 (212) 438 1515; Erin.Boeke-Burke@spglobal.com

Secondary Contact:
Theodore A Chapman, Farmers Branch (1) 214-871-1401; theodore.chapman@spglobal.com

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Rationale

S&P Global Ratings has revised its outlook to stable from negative on the Lehigh County Authority (LCA), Penn.’s series 2013 water and sewer revenue bonds related to the city of Allentown concession and affirmed its ‘A’ rating on the debt. The rating reflects our opinion of the concession system’s strong enterprise and financial risk profiles.

The outlook revision back to stable is the result of the credit-neutral resolution of several significant risks within the last year. These include the following:

- LCA refinanced its December 2018 series C bond payment by means of direct placement with Fulton-Lafayette bank. Based on our review of the loan agreement, this private placement does not pose exceptional liquidity risk to bondholders.

- The Lehigh County board approved the extension of the concession charter to 2062 (the LCA and Allentown lease agreement term ends August 7, 2063). This improves LCA’s flexibility to issue new debt as-needed for capital improvements and restructure outstanding debt during the life of the lease.

- Allentown’s injunction to block LCA from switching from quarterly to monthly billing (which would increase concession revenues) was denied. The city has appealed the ruling and management decisions about rate-setting and frequency are pending, but we believe that the risk that LCA will not be able to generate revenues needed to support the financial health of the concession has been reduced.

There are still several significant ongoing issues, whose resolution could have affect the rating in the future. These include the following:

- Ongoing negotiations with the City of Allentown about rate-setting, the frequency of billing, and the historical revenue calculations for municipal wastewater service provided by Allentown. The status of these negotiations is subject to a non-disclosure agreement and we do not anticipate any public announcement for several months.

- LCA is considering moving to monthly from quarterly billing for its Allentown customers. Depending on how or if this new structure is implemented, it could have negative credit implications for either our analysis of future financial performance if the billing remains quarterly or our view of rate affordability if the billing is switched to monthly. We understand that a switch to monthly billing would generate additional revenues that would potentially offset future borrowing needs, but that maintaining affordability within the city is a concern for management.

- Ongoing litigation and appeals pertaining to the above topics, which may be obviated if there is a negotiated
• Development of a regional wastewater management plan in coordination with 12 other utilities, which must be approved by the Pennsylvania Department of Environmental Protection. We believe that the overall risk to Allentown concession bondholders is mitigated because under the terms of the lease agreement, the city must pay for the costs of capital investments required to meet regulatory requirements by remitting payments to the trustee. However, a significant unfunded capital plan could pressure financial performance by necessitating a drawdown of cash or the issuance of significant additional debt.

LCA filed continuing disclosure notices related to the release of its 2017 and 2018 audited financial statements due to changes in GASB reporting requirements. The 2019 financial statements were released on time, but there was a delay in continuing disclosure regarding operating data. Management has implemented several changes in accounting and does not anticipate future disclosures to be delayed. While past delays are currently not a negative credit event, we will look for future disclosures to ensure that the financial statements are not being delayed for any additional reasons.

The bonds are secured by a pledge of revenues under the concession agreement, defined as all revenues derived from the operation of the concessioned system. Such revenues include service charges from all users net of any payments from a municipal customer allocated to its share of administrative order bond debt service, which are not secured by a pledge of the trust estate under the 2013 indenture.

LCA operates the Allentown water and sewer systems under a long-term lease as its City Division. It also operates Suburban Division water service areas which are primarily in western and northern Lehigh County, including all or portions of 15 municipalities and one in Northampton County. It also owns wastewater collection and transportation facilities in western and northern Lehigh County.

Allentown, with a population of 121,621, is in Lehigh County in the Allentown-Bethlehem-Easton MSA, which we consider to be broad and diverse. It has a median household effective buying income of 72% of the national level. The county unemployment rate was 4.1% in June 2019, higher than the national rate of 3.8%.

The city is about 60 miles north of Philadelphia, and maintains its own employment base. Leading employers in the county include:

• Lehigh Valley Hospital & Health Network (17,098 employees),
• St. Luke's Hospital & Health Network (13,567), and
• Air Products & Chemicals (2,200).

**Outlook**

The stable outlook reflects the stability of concession financial performance despite ongoing issues. The outcome of ongoing negotiations with the city could be credit impactful depending on how they affect concession revenue-generating capacity; however, given the recent legal decisions supporting LCA's ability to generate necessary revenues, we believe that these effects could be neutral or positive, as well as negative.
Downside scenario
If ongoing negations and legal disputes affect management’s ability to operate the concession at the current level of operational and financial performance, we could lower the rating. We believe this is most likely to occur as a result of deferring changes to rates and billing needed to generate revenue, or the identification of significant capital needs above what is funded in the current capital improvement program.

Upside scenario
Upward rating potential is limited during the outlook period as a result of ongoing uncertainties. However, in the long run, if the concession is able to significantly increase certainty about its operational and financial performance as it funds needed capital improvements, we could potentially raise the rating.

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings’ public website at www.standardandpoors.com. Use the Ratings search box located in the left column.