

Research Update:

Nashville & Davidson County Metropolitan Government, TN Series 2025 Water And Sewer Bonds Rated 'AA'; Outlook Is Stable

May 16, 2025

Overview

- S&P Global Ratings assigned its 'AA' long-term rating to the Nashville & Davidson County Metropolitan Government, Tenn.'s (Metro Water) estimated \$451.9 million series 2025 water and sewer revenue refunding bonds.
- At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and 'A-1+' short-term rating on the system's extendible maturity water and sewer revenue commercial paper (CP) notes.
- The outlook, where applicable, is stable.

Rationale

Security

The series 2025 bond proceeds will be used to convert \$400 million of CP notes outstanding to long-term debt, while also refunding a portion of existing debt for interest rate savings.

The series 2025 bonds are secured by a first-lien pledge of net revenues of the government's waterworks and sanitary sewer system, which does business as Metro Water System. The senior lien's main characteristics include a rate-stabilization fund, the use of which can be considered when calculating the rate covenant and additional bonds test (ABT), and that the direct-pay subsidies received under the American Recovery and Reinvestment Act of 2009 incentive programs can be used to reduce the debt service payment for the purposes of calculating those same ratios. Additional bonds might be issued if historical debt service coverage (DSC) is at least 1.2x maximum annual debt service (MADS). The rate covenant requires annual coverage of at least 1.2x senior- and subordinate-lien debt service and 1.00x of all obligations (including the subordinate lien). The senior lien is expected to remain the working lien for future capital market debt, as well as for refunding CP notes.

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Metro Water also maintains authorization for up to \$400 million in existing CP notes, which are secured by a second-lien pledge of the net revenue of the government's waterworks and sanitary sewer system and are used to provide interim financing for various capital projects. The short-term CP ratings are based on Metro Water's long-term general creditworthiness, reflecting our view of its financial reserves and its ability to tap capital markets to refinance its CP notes with long-term debt. We also consider Metro Water to have a sufficient liquidity position to cover interest payments, although interest can be capitalized into new notes until paid off or refinanced.

As of June 1, 2024, Metro Water had about \$1.5 billion in senior-lien bond, \$30.2 million of senior-lien state loans, and \$256.0 million subordinate CP notes outstanding.

The payment in lieu of taxes (PILOT) to the Nashville & Davidson County Sports Authority (AA-/Stable), which totaled \$14.1 million in fiscal 2024, comes after system debt service. Aside from the sports authority PILOT, which is a key revenue supporting the authority's bonds, the flow of funds is otherwise closed, as it was under the old resolution.

Credit highlights

The 'AA' rating is anchored by Metro Water's historically steady financial profile and forecast, which indicates the water system will achieve consistently healthy operating margins and strong liquidity balances through 2030. The system's ample water supply, recent and planned resiliency-focused system improvements, and ongoing economic expansion provides additional rating support.

We consider the system's revised rate structure, which was introduced in January 2020, includes a tiered rate structure, which we consider credit supportive as it helps stabilize revenue against fluctuating demand due to weather, or economic factors. Although management has not completed a third-party, cost-of-service study since 2019, the council recently approved annual rate increases allowed at the greater of 2% or the percentage of change in the CPI Urban Index (CPI-U). The potential for additional rate increases beyond this threshold would require a new cost-of-service study. Given these parameters, as current projections assume 5% annual increases in net income, a slowdown in economic growth or material increase in operating or capital costs could compress future financial metrics absent additional rate increases.

Like many of its peers, Metro Water has faced higher operating and debt costs due to modernization needs, regulatory requirements, and climate-resilience investments. Based on our assessment of Metro Water's performance metrics, including non-revenue water loss (water that is billed and for which no payment is received) and the number of water main breaks per 100 miles of pipe, we believe the system faces elevated risk related to aging infrastructure and challenges related to deferred maintenance.

We consider Metro Water's \$3.2 billion capital improvement plan (CIP; through fiscal 2030) to be substantial, of which approximately 65% will be debt funded. Nevertheless, certain projects in the CIP are non-deferable and are subject to regulatory deadlines that are related to a consent decree to eliminate sanitary sewer overflows. Metro Water's non-mandated capital projects include process improvements and capacity additions to its two water treatment plants, as well as biosolids enhancements and capacity increases at its Dry Creek sewer treatment plant. However, current projections indicate that annual debt service costs could rise to about \$140.4 million in 2030 from about \$86.9 million in fiscal 2024, which we consider moderate.

Metro Water Services provides retail water and sanitary sewer services to more than 225,000 metered accounts across the City of Nashville (population 712,334) and the majority of Davidson County, growing at 1% per year. The system also provides sewer treatment to several suburbs on a wholesale basis, mostly by way of long-term contracts. In our view, economic development across a variety of industries support Metro Water's long-term financial position.

The rating further reflects:

- The underlying economic strength and diversity of the customer base within Nashville and the bulk of Davidson County, with no dependency on any of its key retail customers for operating revenue.
- Projected water and sewer rates that we generally consider affordable relative to Davidson County's median household effective buying income (MHHEBI), which stood at 100% of the national average in 2024; we benchmark our assessment of rates based on an average bill of \$73.54, or 1.5% of MHHEBI in Davidson County.
- The system's maintenance of more than \$123 million in reserves, which we consider very strong reserve (as of June 30, 2024).
- Healthy projected all-in DSC metrics exceeding 2.0x that despite being forecast to decline modestly during the next five years will likely remain at levels that we consider very strong. We consider the system moderately leveraged based on a 42.3% debt-to-capitalization ratio.
- Given the funded status of the city's pension plans and strategies to manage future costs, we do not believe pension and other postemployment benefits (OPEB) liabilities present a material risk to Metro Water's debt and contingent liability profile.
- Good financial management practices, indicating, in our view, a high degree of internal financial controls and management policies.

Environmental, social, and governance

We think the sewer system's direct environmental risks are substantial, as it is subject to a deadline-certain regulatory mandate to reduce sewer spills by September 2028 and to complete its long-term control plan by December 2031. Wastewater is treated at four plants throughout the service area, although the primary plant has a capacity of 250 million gallons per day (mgd) compared with a peak flow of 330 mgd.

The water system has an unlimited water supply via the Cumberland River, with no financial obligations to the Army Corps of Engineers or Tennessee Valley Authority for water rights. As a result of flood damage in 2010, the water system has been hardened to prevent delays returning to full service during flooding events. It has ample existing treatment capacity by way of two plants, each with 90 mgd capacity, well above peak day demand of 116.5 million gallons in fiscal 2024. Metro Water has a well-defined drought-management plan and overall has demonstrated professional and apolitical decision-making toward the utility system. However, based on the age of the system, Metro Water has above-average real water losses (leaks) equal to more than 30% of pumped water, which we consider very high.

The rate structure includes a "lifeline" rate but not an explicit customer assistance program that would target those with a lesser ability to pay, although given the generally very high collection rate we don't view this as a potential credit weakness. Governance factors are credit-supportive including the system's cyber-risk management measures, financial management targets, and rate-setting practices that support maintaining strong financial metrics.

Outlook

Any downside risk would be fueled by a weakening of the financial risk profile, either by lower-than-expected debt service coverage (DSC), more aggressive use of debt than anticipated, or an inability or unwillingness to improve operating revenues as debt service requirements increase.

Downside scenario

Although unlikely, we could lower the rating if the board does not implement revenue enhancements as necessary while it progresses through the CIP, and if coverage weakens consistently below financial projections. Due to Nashville's extreme weather events in recent years, we think the system's healthy liquidity provides a cushion against unexpected cost increases due to weather-related events.

Upside scenario

Given its additional debt needs and that it is still largely in the middle of the combined sewer overflow remediation projects, we do not see upward potential for the ratings until the control plan is substantially complete.

Nashville & Davidson County metropolitan Government, Tennessee--Economic and financial data

| | Fiscal year-end | | | | Median (AA) |
|---|-----------------|-----------|-----------|-----------|-------------|
| | Most recent | 2024 | 2023 | 2022 | |
| Economic data | | | | | |
| MHHEBI of the service area as % of the U.S. | 100.0 | | | | 110.0 |
| Unemployment rate (%) | 2.9 | | | | 3.6 |
| Poverty rate (%) | 14.0 | | | | 10.0 |
| Water rate (6,000 gallons or actual) (\$) | 32.1 | | | | 36.5 |
| Sewer rate (6,000 gallons or actual) (\$) | 50.3 | | | | 41.0 |
| Annual utility bill as % of MHHEBI | 1.5 | | | | 1.1 |
| Operational management assessment | Good | | | | Good |
| Financial data | | | | | |
| Total operating revenues (\$000s) | | 375,895 | 365,119 | 335,440 | 24,286 |
| Total operating expenses less depreciation (\$000s) | | 181,703 | 162,282 | 148,627 | 17,090 |
| Net revenues available for debt service (\$000s) | | 226,170 | 222,506 | 186,815 | -- |
| Debt service (\$000s) | | 85,859 | 85,858 | 85,867 | -- |
| S&P Global Ratings-adjusted all-in DSC (x) | | 2.6 | 2.6 | 2.2 | 2.2 |
| Unrestricted cash (\$000s) | | 123,632 | 116,327 | 123,645 | 24,667 |
| Days' cash of operating expenses | | 248 | 262 | 304 | 631 |
| Total on-balance-sheet debt (\$000s) | | 1,334,107 | 1,369,051 | 1,395,795 | 39,844 |
| Debt-to-capitalization ratio (%) | | 42.3 | 44.5 | 46.9 | 27.0 |
| Financial management assessment | Good | -- | -- | -- | Good |

**Nashville & Davidson County
metropolitan Government,
Tennessee--Economic and financial
data**

| | Fiscal year-end | | | | Median (AA) |
|----------------------|-----------------|------|------|------|-------------|
| | Most recent | 2024 | 2023 | 2022 | |
| Economic data | | | | | |

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Ratings List

New Issue Ratings

US\$454.5 mil wtr and swr rev rfdg and imp bnds ser 2025 due 07/01/2055

Long Term Rating AA/Stable

Ratings Affirmed

Water & Sewer

Nashville & Davidson Cnty Metro Govt, TN Water and Sewer System AA/Stable

Nashville & Davidson Cnty Metro Govt, TN Water and Sewer System A-1+

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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