

## Underwriting Approach: Utility Systems

<b>Introduction</b>	Radian reviews many factors during its evaluation of utility systems. No one factor is examined in isolation. Though a utility system may fall short in certain criteria, strengths in other areas may mitigate a concern. In general the following should be used as general guidelines.
<b>Target Market</b>	Radian provides credit enhancement for a wide range of utility systems. Many of the utilities provide some combination of Water, Sewer, Electric and Gas service to communities that are small, but stable, with strong demographics. Other utilities may be larger and experiencing a turnaround in their financial operations. In all cases, systems with limited competition that provide an essential service to their community are viewed favorably.
<b>Transaction Size</b>	The size of eligible transactions varies because Radian insures the small, underserved market as well as larger financings. Therefore, Radian considers issue sizes of \$1MM or more.
<b>Key Credit Factors</b>	<ul style="list-style-type: none"> <li>• <b>Essentiality.</b> Stable or improving usage trends are important as well as competitive position in a given market. Most utility systems are viewed favorably due to their virtual monopoly position.</li> <li>• <b>Financial performance and position.</b> Many financial ratios are calculated and examined over time and against industry and Radian portfolio norms. <ul style="list-style-type: none"> <li>– <b>Income statement.</b> Stable or improving operating and net margins.</li> <li>– <b>Cash flow analysis.</b> Adequate EBIDA to support DS and positive operating cash flow to provide funds for capital projects and cash accumulation.</li> <li>– <b>Balance sheet.</b> Strong revenue cycle management trends, good liquidity versus operating expenses and long-term debt, and moderate leverage.</li> <li>– <b>Debt position and capital plans.</b> Manageable debt service as a percent of revenues. Clearly defined and prioritized capital plans, with funding sources identified and routinely monitored.</li> </ul> </li> <li>• <b>Operational Characteristics.</b> Prefer systems that control their own supply of water, gas or electricity as well as wholesalers for other systems can be acceptable. In addition, utility systems with resource diversity and cost competitiveness are viewed favorably.</li> <li>• <b>Customer mix.</b> Critical mass of 400–500 customers with a sizeable residential component; we seek a diversified customer base, but will consider systems with customer concentration with appropriate mitigation. Data analyzed includes service contracts and pricing strategy and flexibility with a system’s larger customers.</li> <li>• <b>Service area demographics</b> are analyzed to determine the durability of utilization trends, as well as the depth of larger as well as smaller retail customers. Key data points evaluated include population, employment, and wealth and income indicators.</li> <li>• <b>Management profile.</b> The tenure and experience of a system’s management and ability to control their system’s financial and operational conditions is assessed. The ability to proactively plan a system’s future is viewed as a positive.</li> </ul>

**Security Structure and  
Financial Covenants**

- Senior lien debt is preferred; subordinate lien debt with strong DSC
- 1.10–1.25x rate covenant. The system’s rate setting mechanism and rate history is also analyzed.
- Additional Bonds Test (ABT) set above the rate covenant.
- Fully funded Debt Service Reserve Fund (DSRF).
- Flows of funds – Transfers are analyzed to ascertain the municipality’s General Fund dependence on enterprise revenues. System DSC at the rate covenant prior to transfers is preferable.

**Documentation  
Requirements**

- Draft POS
- Five years of audited financial statements
- Utilization statistics and demographic data

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