

RatingsDirect®

Summary:

Western Municipal Water District Facilities Authority, California Western Municipal Water District; Joint Criteria; Water/Sewer

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Summary:

Western Municipal Water District Facilities Authority, California

Western Municipal Water District; Joint Criteria; Water/Sewer

Credit Profile

US\$52.06 mil adj rate wtr rev rfdg bnds (Western Mun Wtr Dist) ser 2016A due 10/01/2020

Long Term Rating AA+/Stable New

Western Mun Wtr Dist WTRSWR

Long Term Rating AA+/Stable Affirmed

Western Mun Wtr Dist Facs Auth, California

Western Mun Wtr Dist, California

Western Mun Wtr Dist Facs Auth (Western Mun Wtr Dist) wtr rev bnds (tax-exempt)

Long Term Rating AA+/Stable Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Western Municipal Water District Facilities Authority, Calif.'s series 2016A adjustable rate water revenue refunding bonds issued for Western Municipal Water District. At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the district's parity-lien revenue bonds and the 'AAA' long-term component of our dual rating on the authority's series 2012A adjustable rate water revenue refunding bonds. The 'A-1' short-term component of the dual rating remains unchanged. The outlook on the fixed-rate bonds is stable.

The ratings reflect our view of the district's:

- Large customer base, including wholesale and retail customers in western Riverside County;
- History of raising rates, which has partly offset the decline in the volume of water sales related to the ongoing drought in recent years; and
- Strong liquidity position, with unrestricted cash and investments representing about 326 days of operating expenses at the end of fiscal year 2015.

These credit strengths are partly offset, in our view, by the district's additional borrowing plans to fund the capital improvement program.

The authority is issuing the series 2016A bonds to advance refund in full its series 2009B water revenue bonds.

We view the bond provisions as adequate. The bonds are payable from installment payments that are secured by the district's net revenues. The district's obligation to make the installment payments from the pledged revenues is

absolute and unconditional and may not be abated. As of June 30, 2015, the district had \$144 million of existing parity revenue bonds. Key bond provisions include a rate covenant set at 1.1x annual debt service and an additional bonds test set at 1.1x maximum annual debt service. The district may include transfers from a rate stabilization fund to demonstrate compliance with the rate covenant. We understand that the district does not intend to provide a debt service reserve fund for the series 2016A bonds.

The district is located in western Riverside County and encompasses about 527 square miles, including the communities of Jurupa, Rubidoux, Riverside, Norco, Corona, Lake Elsinore, Canyon Lake, Temecula, and Murrieta. The service area's population is estimated by the district to be about 920,000, which is about 40% of the county's total population. The service area population grew at an average annual rate of 3.4% between 2000 and 2010, but growth in subsequent periods has averaged about 1.0%. The district provides three services: water for wholesale customers, water for retail customers, and sewer service for a small subsection of the retail service area. Western Riverside County is part of the larger Southern California regional economy, and residents have access to diverse employment opportunities. We view the service area's income levels to be good based on the county's median household effective buying income, which was 102% of the national median for 2014.

Wholesale water customers account for about 70% of the district's water sales by volume and 65% of water sales by revenue. The district's leading wholesale customers are:

- Elsinore Valley Municipal Water District (33% of wholesale revenues),
- Rancho California Water District (32%),
- City of Corona (21%), and
- City of Norco (9%).

The retail water system provides service to about 23,700 accounts, mostly in its Riverside service area, but also in its Murrieta and Rainbow (near Temecula) service areas. Growth in retail water customers during the past four years has been about 0.5% annually. Residential customers account for about 94% of the district's retail water customers. We consider the retail water customer base to be diverse based on the leading 10 customers accounting for about 16% of retail water sales. The district provides wastewater collection and treatment to about 8,300 accounts within portions of its retail service area. Growth in sewer customers during the past four years has been about 0.5% annually.

The district's water supply is primarily provided by the Metropolitan Water District of Southern California (MWD). For fiscal year 2015, the district purchased about 68,773 acre-feet of water from MWD, which represented about 83% of the district's 83,000 acre-feet of total water sources. The balance of the water supply is purchased from the city of Riverside, pumped from groundwater wells, or brackish groundwater treated at the district's Arlington Desalter. The district also has a recycled water supply produced from its wastewater treatment plant. The district is working to develop new water sources through its participation in the Riverside-Corona Feeder conjunctive use project, which will enable the district to take advantage of diversions from the Santa Ana River during periods of high flow. The district has also joined the Chino Desalter Authority to participate in an expansion of the authority's desalination plant.

Wholesale water sales averaged about 61,400 acre-feet for fiscal years 2011 through 2014 but declined by 10% to about 56,500 acre-feet for fiscal year 2015. Similarly, retail sales declined by about 13% to 24,400 acre-feet for fiscal year 2015. We understand that the decline in water sales was driven by drought-related water conservation, and the

district anticipates that total water sales will decline by an additional 18% to about 66,600 acre-feet for fiscal year 2016 as customers further reduce demand to comply with statewide mandatory water conservation targets.

The wastewater collected at the district's service area southeast of Riverside is treated at its 3 million-gallon per day (mgd) wastewater treatment plant while wastewater collected near Norco is treated at the Western Riverside County Regional Wastewater Authority (WRCRWA) treatment plant. The district owns 1.93 mgd of capacity in WRCRWA's 8 mgd facility. Wastewater collected in the Murrieta service area is treated by Rancho California Water District (RCWD) and Eastern Municipal Water District at RCWD's Santa Rosa Water Reclamation Facility (SRWRF). We understand that the district, RCWD, and Elsinore Valley Municipal Water District recently formed a joint powers authority, Santa Rosa Regional Resources Authority, to convert the SRWRF into a regional facility. The conversion includes an allocation of the assets and liabilities associated with the SRWRF based on capacity rights and system flows, and we understand that the district will be allocated 20% of the primary and secondary capacity in the facility. Wastewater revenues represented about 10% of total operating revenue in fiscal year 2015.

The district's wholesale rates are based on MWD's water rates (currently \$942 per acre-foot for tier 1 treated water), plus a \$20.16 per acre-foot service fee, plus an additional \$13.10 per acre-foot maintenance fee for connections to the district's gravity line.

For retail customers, the district has used a budget-based tiered rate structure since October 2011 to encourage efficient water use. Customers are allocated a water budget based on a number of factors, such as number of residents and property landscape area, and pay a tiered rate based on type of use. When customers exceed their budgeted water usage, they are charged higher tiered rates to encourage efficient water usage. We understand that a typical single-family residential customer in the district's Riverside service area pays about \$93 per month for water service. In May 2010, the district adopted pass-through provisions allowing it to annually adjust rates to pass through increases in wholesale water rates, energy costs, and operations and maintenance costs. We view this flexibility in implementing rate increases as a credit strength and anticipate that the pass-through provisions will be extended during the district's next rate-setting process. The district most recently implemented a 5.9% rate increase in January 2015, and it is currently conducting a comprehensive water rate study with public hearings anticipated to be held in May 2016.

The monthly wastewater rates vary by service area, ranging from \$36.42 to \$82.73. On Sept. 15, 2015, the district increased rates by 4% for the majority of retail customers. Management reports that there have not been any material payment delinquencies by the customer base.

The district has a manageable capital improvement program, in our view. During the next five years (through fiscal 2020), it is planning to spend about \$81.6 million on capital projects. The majority of the projects (\$47.6 million) are related to system reliability. We understand that the district anticipates funding 30% of the capital program through additional borrowing with the balance paid from current revenues and reserves.

The district's financial performance remained strong during the past three fiscal years, and we believe that it will be sustainable going forward. Operating revenues increased by 8.4% and 7.0% in fiscal years 2013 and 2014, respectively, to \$105 million, driven by implemented rate increases while water demand remained relatively stable. Although operating revenues declined by about 5.4% to \$100 million for fiscal 2015, this reduction was offset by a corresponding

decrease in water purchase expense. For fiscal 2016, the district anticipates that water sales revenue will decline by about 9.6%, but this reduction in revenue will again be largely offset by reduced water purchase expense. Property tax revenues continue to be an important source of non-operating revenue for the district, at about \$18 million for fiscal 2015. The district is not reliant on new service connections for financial performance, with connection fees of just \$570,000 for fiscal 2015.

We calculate that total debt service coverage (DSC) during the past three fiscal years ranged from 1.9x for fiscal 2015 to 2.4x for fiscal 2014. Financial performance was boosted in fiscal 2014 by a one-time capacity rights sale of \$5.1 million to Lee Lake Water District related to the Mills Gravity Line. Absent this capacity rights sale, we calculate that total DSC would have been about 1.9x for fiscal year 2014. For our calculation of DSC, we exclude capital grant revenues and treat the Build America Bonds subsidy as non-operating revenue rather than as an offset to debt service. When we also take into consideration certain fixed costs that the district pays to external parties, we calculate that fixed-charge coverage (FCC) during this period ranged from 1.5x for fiscal 2015 to 1.9x for fiscal 2014, a range that we consider strong. Based on management's forecast, which we believe incorporates reasonable assumptions, we anticipate that total DSC and FCC will generally improve modestly during the forecast period through fiscal 2020, with total DSC and FCC of 2.3x and 1.7x, respectively, in fiscal 2020. Improvements in coverage metrics are in part due to the restructuring.

We view the district's liquidity position as strong. As of June 30, 2015, unrestricted cash and investments totaled \$92.3 million, equivalent to 326 days of operating expenses. Based on management's forecast, liquidity is anticipated to decline to no lower than 274 days through fiscal 2020.

Outlook

The stable outlook reflects our anticipation that the district will set rates to generate strong DSC and to maintain strong liquidity. During the two-year outlook horizon, we anticipate that the district will complete its comprehensive water rate study and implement new service rates, including an extension of the pass-through provisions, which we view as a credit strength.

Upside scenario

We could take a positive rating action if the district is able to produce stronger-than-forecast coverage metrics and strengthen its liquidity position in a sustainable manner.

Downside scenario

We could take a negative rating action if coverage metrics decline or become more volatile, as was the case in preceding periods.

Related Criteria And Research

Related Criteria

- USPF Criteria: Water And Sewer Ratings, June 25, 2007
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008

- USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Wholesale Utilities, May 24, 2005
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria Update: Joint-Support Criteria Refined, Feb. 3, 2006
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 20, 2015
- U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014
- 2014 Review Of U.S. Municipal Water And Sewer Ratings: How They Correlate With Key Economic And Financial Ratios, May 12, 2014

Ratings Detail (As Of December 30, 2015)

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|--|------------------|-----------------|
| Western Mun Wtr Dist wtr rev rfdg bnds | | |
| <i>Long Term Rating</i> | AAA/A-1 | Various Actions |
| <i>Unenhanced Rating</i> | AA+(SPUR)/Stable | Affirmed |

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