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Ratings

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Summary:

Rowland Water District, California Puente Basin Water Agency; Water/Sewer

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Puente Basin Water Agency; Water/Sewer

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Long Term Rating	AA-/Stable	Upgraded
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California Spl Dist Assn Fin Corp (Rowland Wtr Dist) COP		
Long Term Rating	AA-/Stable	Upgraded
Puente Basin Water Agency, California		
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Puente Basin Wtr Agy (Rowland Wtr Dist) wtr		
Long Term Rating	AA-/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AA-' from 'A+' on Rowland Water District, Calif.'s series 2014A water revenue refunding bonds, and Puente Basin Water Agency's 2012 series A water revenue bonds, issued on behalf of the district. The outlook is stable.

The rating reflects, in our opinion, the combination of very strong enterprise and financial risk profiles.

We raised the rating based on the district's improved financial position and approved service rate adjustments through January 2021, which we believe will enable it to maintain a strong financial performance. The district's recent financial performance has outperformed its previous forecast. In addition, to reduce its reliance on imported water, the district has entered into various agreements for both non-potable and potable water supplies. We understand that the district has purchased groundwater rights from neighboring groundwater basins and will continue making progress towards its water supply diversification projects in the future.

The enterprise risk profile reflects our view of the district's:

- Participation in the broad and diverse Los Angeles metropolitan area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Primarily residential customer base with moderately affordable service rates in the context of the service area's strong income levels and above-average county poverty rates; and
- Good operational management practices and policies.

The financial risk profile reflects our view of the district's:

- Improved all-in debt service coverage (DSC) metrics in recent years due in part to an approved rate plan through fiscal 2021;
- Historically strong liquidity position, with over 250 days' of unrestricted cash for the past five audited fiscal years, which we believe is sustainable in the near future;
- Moderate leverage level based on a debt-to-capitalization ratio of about 39%, and no additional debt plans in the near term; and
- Good financial management practices and policies.

We view the bond provisions as credit neutral. The bonds are secured by the net revenues of the district's water system. Covenants include a rate covenant set at 1.10x annual debt service and an additional bonds test set at 1.10x maximum annual debt service. For the purpose of the additional bonds test, the district may include an allowance for additional net revenues derived from connections that were served for less than the full test period, and an allowance for additional net revenues related to any increase in service charges that were in effect for less than the full test period. Debt service reserve funds are not provided for the series 2012A or 2014A bonds.

At the end of fiscal year 2018, the district has about $18 million in existing debt from its series 2014A bonds and about $17.8 million in existing 2012 series A debt issued by Puente Basin Water Agency on behalf of the district.

Enterprise Risk

The district's service area encompasses about 17 square miles and includes various unincorporated areas of southeastern Los Angeles County, including portions of Rowland Heights, La Puente, Hacienda Heights, the city of Industry, and the city of West Covina. As of 2017, the district estimated its service area population to be approximately 60,000. About 3,600 housing units in a master-planned community may be developed in the future, but the project is currently inactive; otherwise, growth is primarily related to infill development, with service area buildout projected by 2030. Median household effective buying incomes (MHHEBIs) for the cities within the service area range from 100% to 137% of the national median, with Rowland Heights at 117% of the nation, which we consider strong. The customer base is stable, primarily residential, and diverse. The water system has about 13,900 service connections, and growth has been relatively flat during the past five fiscal years. Residential customers make up about 83% of connections and about 55% of water sales revenue. We consider the customer base to be diverse, with the leading 10 customers accounting for about 11.8% of total operating revenues; the leading customer, Morningstar Foods, accounts for about 3.1% of total operating revenues on its own.

We view the district's market position to be strong based on its moderately affordable service rates, particularly relative to the area's strong income levels, and slightly above-average county poverty rate. The residential rate structure includes a fixed monthly base rate and a volumetric rate per hundred cubic feet (ccf) of estimated water usage. The district reports that a typical residential customer has an average monthly baseline consumption of roughly 13 ccf. Based on this level of usage, we calculate that the typical monthly water bill is currently $71.1 in fiscal 2018, which is equivalent to about 1.5% of MHHEBI when annualized. The county poverty rate as reported by the U.S. Department of Agriculture is 18.7%, which we understand makes the water system rates less affordable for a portion of the district's customer base. The district adopted the current rate structure based on an updated five-year rate study in December 2016. The rate study recommended a 7.5% annual revenue increase from fiscal years 2017 through 2019, and a 5% annual revenue increase for each of the subsequent years through 2021 (for potable water). The rate study also projects a 12% annual revenue increase to recycled water rates through 2021. To improve revenue stability, the board approved these rate increases, with the goal of increasing the fixed portion of operating revenues.

Based on our operational management assessment, we view the district to be a '2' on a six-point scale, with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well aligned, even if some challenges exist. The district currently purchases its potable water supply from the State Water Project via Three Valley Municipal Water District (TVMWD), which is the local member agency of the Metropolitan Water District of Southern California (MWD). The primary source of imported water is from MWD's Weymouth Treatment Plant in La Verne. The district has not entered into formal agreements for service with either TVMWD or MWD, but instead relies on guaranteed service up to specified capacity at the district's three turnouts. Based on the district's 2015 urban water management plan, the district does not anticipate any water shortages due to increased demands, provided that TVMWD and MWD can continue to meet the design flows. During the past four fiscal years, treated water purchased declined by an aggregate 12% to roughly 10,100 acre-feet in fiscal 2017, from 11,500 acre-feet in fiscal 2014, driven by drought conditions and increased conservation messaging and water restrictions.

To reduce its reliance on imported water, the district has entered into various agreements for both nonpotable and potable water supplies. With regard to nonpotable supply, the district previously entered into an agreement with the city of Industry to purchase up to 1,600 acre-feet per year of recycled water with a goal of 3,500 acre-feet per year for full build out. With regard to potable supply, the district entered into a 25-year water production and delivery agreement with La Habra Heights County Water District and Orchard Dale Water District for delivery of about 2,000 acre-feet per year. The district also entered into a production and 30-year delivery agreement with California Domestic Water Co. for the delivery of about 5,000 acre-feet of potable water. According to management, the district is making progress towards completing its water supply diversification projects, and we understand the district has identified certain pieces of infrastructure that have to be built or enhanced to capitalize on the full deliveries of these projects.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Financial Risk

The district's recent financial performance has been better than previously forecast by the district, and we anticipate the financial performance to remain good-to-strong due in part to the approved rate plan through fiscal 2021. Based on the district's audited fiscal 2016 and 2017 financials, we calculate all-in DSC of about 1.45x and 1.57x for these periods, respectively, and these metrics have outperformed the roughly 1.2x that management previously forecast for these respective periods. We attribute the improved results primarily to lower-than-forecast water supply expenses, and the revenue increase from the new rate plan that became effective in March 2017. All-in coverage is our internally adjusted DSC metric that that treats certain recurring financial obligations as if they were debt, such as imputing fixed debt charges from TVMWD, even if legally treated as an operating expense. Using management-provided estimates for fiscal 2018, we calculate all-in coverage of roughly 1.5x. Based on the rate study forecast and approved rate plan through fiscal 2021, we anticipate all-in coverage to be mostly in line with the district's recent financial performance. The district is not reliant on growth-related connection fees, given that the service area is mostly built out. In addition to water revenues, the district is authorized to levy a property tax. Property tax collections totaled $337,000 for fiscal

2017, less than 2% of total revenues.

The district has maintained consistently strong liquidity levels during the past five fiscal years, in our opinion. The most recently reported unrestricted cash and investments was about $12.9 million, equivalent to 276 days of operating expenses, at the end of fiscal 2017. We understand that there was a slight reduction in the fiscal 2017 reserve balance (from $17 million or 386 days of cash in fiscal 2016) due in part to a one-time pre-purchase of cyclic water storage inventory in the neighboring groundwater basin. The district chose to pre-purchase about 6,000 acre-feet of water at discounted prices that will be available to be utilized in future years. Based on estimates for fiscal 2018, we anticipate that cash reserves increased to about $16 million or 321 days of operating expenses during that period. This balance includes amounts in designated reserves established pursuant to a formal reserve policy, including an operating reserve with a target balance equal to 25% of operating expenses and a rate stabilization fund that management believes is adequate to respond to significant extraordinary expenses, or a temporary reduction or disruption in revenues.

The district's five-year capital improvement plan (CIP) is manageable in our view. The projected cash-funded capital spending will be roughly $12.4 million in the next five years through 2023 (or about $2.5 million in annual capital spending). The district does not currently have any additional borrowing plans, and its debt-to-capitalization ratio is moderate in our view, at about 39%. The current CIP consists of primarily renewal and replacement projects, and mainline replacement and water supply projects. The district participates in the California Public Employees' Retirement System and has been making its necessary annual employer contributions.

Based on our financial management assessment, we view the district as a '2' on a six-point scale, with '1' being the strongest. In our view, financial practices and long-range planning are generally good or strong, and revenue and expense assumptions are reasonable. The district prepares five-year financial forecasts in conjunction with rate studies and bond financings. The district also annually updates its long-term capital plans. We understand that the district has adopted policies related to investments and reserves. The district's budget and audited financial statements are easily available on its website.

Outlook

The stable outlook reflects our view of the district's diverse, primarily residential customer base and ample supply capacity. During the two-year outlook period, we anticipate that the district's implementation of its new multiyear rate schedule, as approved by the district board, will support the district's strong financial performance.

Upside scenario

Although we anticipate limited upward rating mobility within the two-year outlook horizon, we could take a positive rating action if the district demonstrates a sustainable track record of outperforming projections, such as completing local water supply projects and materially reducing water supply costs.

Downside scenario

Although currently not anticipated, we could take a negative rating action if the district water supply costs substantially increase, resulting in pressured coverage metrics or a substantially weaker liquidity position.

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.