S&P Global
Ratings

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Summary:

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

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Credit Profile		
US$96.405 mil wtr rev bnds (Western Mun Wtr Dist) ser 2020A due 10/01/2050		
Long Term Rating	AA+/Stable	New
US$39.125 mil wtr rev bnds (Western Mun Wtr Dist) ser 2020B due 10/01/2042		
Long Term Rating	AA+/Stable	New
Western Mun Wtr Dist WTRSWR		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Western Municipal Water District Facilities Authority, Calif.'s series 2020A and taxable series 2020B water revenue 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 district is issuing the series 2020A bonds to finance approximately $25 million of capital improvements to the district's water and sewer system, and will also be used to refund all or portions of the existing series 2010B, 2012A and 2016A bonds. The district is considering de-risking a portion of its variable rate portfolio with fixed-rate debt. In addition, the district may terminate its interest rate swap (series 2012A) in connection with the 2020B issuance if market conditions warrant. We view the bond provisions as credit neutral. 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. 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 (RSF) to demonstrate compliance with the rate covenant as required. We note that the district last used RSF transfers in fiscal 2011. While management has chosen not to establish a debt service reserve fund for the 2020 bonds, the district's financial profile, including very strong liquidity, precludes any credit risk.

Credit overview

The rating reflects our opinion of the district's general creditworthiness including its very strong financial risk profile. The strength of the system's financial metrics provides a strong cushion, in our view, to mitigate short-term disruptions from the COVID-19 related recession. S&P Global Economics acknowledges that the measures to contain COVID-19 have pushed the economy into recession. We believe the district's revenues may decline somewhat for fiscal 2020 or beyond, though ultimately our expectation is that management will continue to manage the system and maintain strong coverage levels. The system, as of fiscal 2019, also has over 400 days cash on hand, which we believe provides sufficient cushion against short-term disruptions. Additionally, management has instituted its contingency plans to ensure minimal disruptions in service provided. While we continue to monitor events related to COVID-19, we do not anticipate them affecting the district's ability to maintain budgetary balance and pay debt service costs given the strong coverage and liquidity position. For more information, see our articles "COVID-19's Potential Effects In U.S. Public Finance Vary By Sector" (published March 5, 2020, on RatingsDirect), "All U.S. Public Finance Sector Outlooks Are Now Negative" (published April 1, 2020), and "An Already Historic U.S. Downturn Now Looks Even Worse" (published April 16, 2020).

The ratings reflect our view of the district's:

- Service area participation in the broad and diverse Riverside-San Bernardino-Ontario metropolitan area economy, with a large customer base, including wholesale and retail customers in western Riverside County;
- Track record of annually reviewing and adjusting service rates to produce consistent financial performance;
- Very strong liquidity position, with unrestricted cash and investments representing over 400 days of operating expenses in the past three fiscal years; and
- Robust planning efforts that ensure that operational and financial requirements are well aligned, including resource management and sustainability, which is supported by strong financial management practices and policies.

In our view, the preceding credit strengths are partly offset by the district's borrowing plans to fund the capital improvement program (CIP); however, we recognize the district's strategic actions to improve local supply reliability, and reduce its reliance on imported water. The stable outlook reflects our opinion of the district's strong service area characteristics coupled with its operational and financial flexibility, thereby producing financial metrics consistent with the current rating level. During the two-year outlook horizon, we anticipate that the district will continue to adjust service rates -- including an extension of the pass-through provisions, which we view as a credit strength -- to generate strong all-in debt service coverage (DSC) while maintaining its very strong liquidity. In addition, we anticipate the very strong financial profile could withstand a short-term decline in revenue from challenges, particularly uncertainty related to COVID-19, and the recession.

Environmental, social, and governance (ESG) factors

Overall, we believe that management has mitigated most of the district's ESG-related risk by adopting, adhering to, and adjusting its operating and financial policies and procedures. We view the district's environmental, social, and governance factors as not being significantly different from those of its peers. The district has a strong management practices and policies, including long-term capital and financial planning, which mitigates governance risks when compared to peers. Management also provides a framework for making a number of investments across its facilities and distribution network to reduce the system's environmental risks. The district has been recently investing in local supply reliability, including enhancing groundwater and recycled water, which somewhat mitigates drought related risks in the region. The district plans to make capital investments to further improve local supply reliability to 50% in the future. The district's pass-through of wholesale costs and retail budget-based rate structure ensures cost recovery by passing through imported water costs, and insulates water sales reduction during droughts. We understand the district will continue recommending updates to its future rate plans to meet revenue sufficiency in the near future, and we do not anticipate this will significantly increase affordability pressures or social risks.

Stable Outlook

Downside scenario

We could take a negative rating action if the district materially spends down its cash reserves or if the district's financial performance significantly and unfavorably deviates from its forecast. In addition, any unexpected economic or financial shock from the dampening effects of the COVID-19 pandemic and the recession, which could significantly disrupt the system's operations, or any unanticipated and extraordinarily large change in the CIP that could alter related financial metrics, could present downward pressure on the rating or outlook at any time.

Upside scenario

S&P Global Economics projects it may be 2022 before credit conditions fully return to pre-pandemic levels. Therefore, due to the current recession, we do not anticipate raising the rating during the two-year outlook horizon.

Credit Opinion

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 973,000, which is about 40% of the county's total population. The service area in western Riverside County has seen modest growth in the past decade, and the district currently projects that it will serve a population of approximately 1.4 million by 2040. The district is an essential service provider of water and wastewater services in the area, and 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 107% of the national median.

Wholesale water customers account for about 72% of the district's water sales by volume and approximately 68% of water sales by revenue. The district's leading wholesale customers are:

- Elsinore Valley Municipal Water District (37% of wholesale sales revenues),
- Rancho California Water District (24%),

- City of Corona (23%), and
- City of Norco (9%).

The retail water system provides service to about 24,371 connections, 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 averaged about 0.8% 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 18% of retail water deliveries and 8% of water sales revenues. The district provides wastewater collection and treatment to about 8,836 accounts within portions of its retail service area. Growth in sewer customers during the past four years has averaged about 1.6% annually.

The district's water supply is primarily provided by the Metropolitan Water District of Southern California (MWD). For fiscal year 2019, the district purchased about 65,725 acre-feet of water from MWD, which represented approximately 81% of the district's 81,142 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's operational management indicates a favorable alignment of operations and organizational goals. Management is focused on securing a diversified long-term water supply to serve the existing and likely future customer base, with a goal to improve local supply reliability to 50% in the future. Some its strategic actions listed below in the recent past have reduced the district's reliance on more expensive imported water.

- Addition of a new well in the Murrieta service area and acquired groundwater rights in the San Bernardino Basin;
- Participation in the Chino Basin Desalter Authority's expansion of the authority's desalination plant, and capture of local storm water in the Victoria Recharge Basin to boost production in its existing Arlington Desalter;
- Completion of the La Sierra Pipeline and Sterling Pump Station: This project improves interconnectivity with the Arlington Desalter and the Chino Basin Desalters to store water in the Sterling Reservoir;
- Partnership with the city of Riverside to deliver surplus local supplies under a cooperative agreement; and
- The Santa Ana River Conservation and Conjunctive Use Program: This program includes creation of a groundwater bank and the implementation of water conservation measures to generate surplus groundwater storage. The district's share of groundwater storage is 36,000 acre feet of the 180,000 acre feet of available storage that will be created through this program.

The wastewater collected at the district's service area southeast of Riverside is treated at its 3 million-gallon per day (mgd) tertiary wastewater treatment plant, while wastewater collected near Norco is treated at the Western Riverside County Regional Wastewater Authority (WRCRWA) tertiary treatment plant. The district owns 1.93 mgd of capacity in WRCRWA's 14 mgd facility. Wastewater collected in the Murrieta service area is treated by the regional Santa Rosa Water Reclamation Facility, of which, the district is allocated about 20% of the primary and secondary capacity (or one mgd) in the facility. Wastewater revenues represented about 11% of total operating revenue in fiscal year 2019.

The district has a manageable CIP, in our view, to accomplish its goal to improve local supply reliability. During the next five years (through fiscal 2024), it is planning to spend approximately $125 million on capital projects. The majority of the projects (about 78%) are related to system reliability, asset replacement and system improvements. We understand that the district anticipates funding 30% of the capital program through borrowing from the issuance of the 2020 bonds, state loans, and a line of credit with the balance paid from governmental grants, current revenues and reserves.

The district's wholesale rates are based on MWD's water rates (currently $1,078 per acre-foot for tier 1 treated water), plus service and 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 (using 1,900 cubic feet of water). In May 2010, the district adopted pass-through provisions allowing it to annually adjust rates to pass through increases in wholesale water rates, and energy costs. We view this flexibility in implementing rate increases as a credit strength and anticipate the practice of incorporating pass-through provisions will be extended during the district's next rate-setting process. The district most recently implemented a 5.5% rate increase in January 2020, and has initiated a new cost-of-service rate study that would likely take effect in July 2021.

The monthly wastewater rates vary by service area, ranging from $42 to $72. On average, the district increased rates by 2% annually for the majority of retail customers since 2018. Management reports that there have not been any material payment delinquencies by the customer base.

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 a cumulative 25% in fiscal years 2017 and 2018, respectively, partly driven by implemented rate increases and a rebound in water demand post the drought conditions. Operating revenues declined by about 8% in fiscal 2019 due in part to lower demand from wet weather conditions; this reduction was offset by a corresponding decrease in water purchase expense. The district is not reliant on new service connections for financial performance, with growth-related capacity fees that peaked in fiscal 2019 at roughly $7 million (5% of total revenues). Property tax revenues continue to be an important source of non-operating revenue for the district, at about $23.6 million for fiscal 2019 (about 18% of total adjusted revenues). We also believe that the district's financial performance is stabilized by its diverse revenue stream--including property taxes --that insulates revenues from conservation and other factors impacting demand, and partly mitigates any concentration risk from wholesale customers.

We calculate an "all-in" coverage metric that considers imputed fixed debt service costs that is implicitly passed on to the district from its wholesale water suppliers, based on the contractual relationship with MWD and other external parties. For our calculation of all-in DSC, we also exclude capital grant revenues. We calculate that all-in debt service coverage (DSC) during the past three fiscal years exceeded 2x, and was about 2.9x for fiscal 2019. Based on management's forecast, which we believe incorporates reasonable assumptions and COVID-19 related effects, we anticipate that all-in DSC will generally be strong during the forecast period through fiscal 2024, with all-in DSC at least 1.9x within the next five years. We performed additional stress scenarios, including management's base case and more extreme scenarios that includes a 5%-10% decline in revenues in the next two years, and we calculate all-in DSC will continue to remain above 1.5x, levels we consider strong.

We view the district's liquidity position as very strong in part to serve as a natural hedge against its variable-rate debt exposure. As of June 30, 2019, unrestricted cash and investments totaled $141 million, equivalent to 431 days of operating expenses. Liquidity continued to remain very strong at about $166 million at the end of February 2020. Based on management's forecast, liquidity is anticipated to remain very strong at no lower than 400 days through fiscal 2024. We consider the district's leverage, based on debt-to-capitalization ratio, as moderate, at about 40%. The district participates in the California Public Employees' Retirement System and has been making its necessary annual employer contributions. We view the pension and other post-employment benefit costs as credit neutral to the debt and liabilities profile.

The management team in our view maintains most of the best practices deemed critical to supporting credit quality and these are well embedded in the system's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. This includes regular budget monitoring and reporting, a well-defined cost of service study that supports the district's financial forecast, a comprehensive debt policy, and an adopted reserve policy that we believe supports strong liquidity levels and articulates the rationale for maintaining its various reserves.

Currently, about 23% of the district's revenue-backed bonds are variable-rate debt hedged with a floating-to-fixed-rate swap. As of May 14, 2020, the mark-to-market value of the swaps (which hedge $31 million in variable-rate debt) was a negative $9.6 million. With the district's very strong cash balance, we do not view its interest rate exposure to be a material credit weakness. However, should the district's unrestricted cash reserves significantly decline, we would reassess our opinion of the district's interest rate exposure from variable-rate debt. In addition, we view the district's debt optimization strategy and plans to de-risk a portion of its variable rate portfolio with fixed-rate debt (as part of this 2020 debt issuance) as credit positive. Given the rating level, strong management practices, and very robust transparency and disclosure, we view the district as having strong market access, all of which support the district's credit quality.

Ratings Detail (As Of June 3, 2020)		
Western Mun Wtr Dist wtr rev rfdg bnds		
Long Term Rating	AAA/A-1+	Current
Unenhanced Rating	AA+(SPUR)/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