

# RatingsDirect®

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## Summary:

# Vallecitos Water District, California; Water/Sewer

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### Credit Profile

US\$53.0 mil wtr & swr rev rfdg bnds ser 2015 due 06/01/2036

|                         |            |     |
|-------------------------|------------|-----|
| <i>Long Term Rating</i> | AA+/Stable | New |
|-------------------------|------------|-----|

#### **Vallecitos Wtr Dist wtr & wstewtr**

|                          |                  |          |
|--------------------------|------------------|----------|
| <i>Unenhanced Rating</i> | AA+(SPUR)/Stable | Upgraded |
|--------------------------|------------------|----------|

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services has raised its rating on Vallecitos Water District, Calif.'s enterprise debt to 'AA+' from 'AA'. The upgrade reflects the district's trend of strong financial performance and the potential for a more diversified water supply. At the same time, Standard & Poor's has assigned its 'AA+' rating to the district's series 2015 water and wastewater enterprise refunding revenue bonds. The outlook is stable.

The rating also reflects our view of the district's:

- Service area economy that participates in the deep and diverse San Diego metropolitan area economy;
- Stable, primarily residential, and very diverse customer base;
- Manageable five-year capital improvement plan (CIP) totaling \$63.4 million that is completely cash funded;
- Strong historical debt service coverage (DSC) that we anticipate will remain strong; and
- Strong liquidity position that management forecasts will remain strong.

In our view, the above strengths partially offset the district's relatively high rates and current reliance on imported water supplies, the cost of which has, and continues to increase. Bond proceeds will be used to refund the district's series 2005A certificates of participation (COPs). The COPs are payable from installment payments secured by the net revenues of the district's water and wastewater systems. Bond provisions are adequate, in our view, and include a 1.15x rate covenant and a 1.15x maximum annual debt service additional bonds test.

Vallecitos Water District is a retail water and wastewater utility serving a service area that encompasses San Marcos, as well as small portions of Escondido and Carlsbad. The current service area population is about 97,000. The local economy participates in the deep and diverse San Diego metropolitan area economy. We consider the service area's income indicators to be strong; San Marcos' median household effective buying income was 113% of the national level in 2014. The district serves a stable, primarily residential, and very diverse customer base. Residential customers comprise more than 90% of water and wastewater connections. They also make up about 67% of water demand and 83% of wastewater flow. We consider the customer base to be very diverse, given that the 10 leading water customers account for about 12% of water sales and the 10 leading wastewater customers historically have accounted for about 8% of wastewater billings.

The district is currently 100% reliant on San Diego County Water Authority for water supply, but is in the process of diversifying its water supply to include desalination water from the Poseidon facility and treated water from Olivenhain Municipal Water District. Although the district produces recycled water at its Meadowlark Water Reclamation Facility, it does not operate a recycled water system and instead sells the recycled water to neighboring entities. During the past 10 years, water consumption, and therefore water purchases, has declined by almost 20%. The district has planned for reduced conservation and its projections indicate continued strong financial performance.

Water and wastewater rates are relatively high (nationally) on a combined basis, in our opinion. The water rate structure is composed of a fixed rate based on water meter size, \$31.42 per month for a 5/8" water meter, and several commodity tiers, which range from \$2.62 to \$6.95 per hundred cubic feet (HCF) of usage. We calculate the current monthly bill for 10 HCF of water usage as high at just under \$100.00. The district's rate plans include rate increases of 5% to 7% through fiscal 2017, and the adopted rate ordinance also includes an automatic pass-through for increases in wholesale water costs. Wastewater rates for single-family residential customers are a fixed monthly charge. The monthly rate is currently \$38.99.

The district's five-year CIP totals \$63.4 million and is composed of a variety of renewal and replacement projects. Management has indicated that no additional debt will be needed to address these projects.

The system's financial performance has been historically strong, in our opinion, and, based on management's five-year forecast, we anticipate that performance will remain strong during the forecast period. During the past five fiscal years, senior-lien DSC ranged from 2.0x to more than 4.5x. When including the district's subordinate-lien private placement loan with Union Bank as part of total DSC, we calculate total DSC during this five-year period at between 1.8x and 4.2x. Financial projections show a continuation of very strong coverage of at least 3.0x of all obligations. The projections appear to be reasonable, as management has detailed estimates for water supply costs and treatment expenditures.

The district's liquidity position is strong, in our view, and management forecasts cash balances to remain strong. During the past five years, liquidity has ranged from 212 days of operating expenses to more than 350 days. Most recently, it stood at 356 days, which we consider strong, based on fiscal 2014 results. Management forecasts liquidity will remain strong through fiscal 2020.

## **Outlook**

The stable outlook reflects our view of the district's stable customer base and demonstrated willingness to adjust rates. During the two-year outlook period, we anticipate that management will continue to adjust rates to offset increases in wholesale water rates and to provide additional funding for the district's upcoming CIP. A further upgrade is unlikely in the near term. A downgrade is also unlikely, but could occur if actual financial results were significantly lower than current and projected levels.

## **Related Criteria And Research**

### **Related Criteria**

- 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: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

### **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, April 2, 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

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