STANDARD & POOR'S RATINGS SERVICES

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Summary:

Monte Vista Water District, California; Water/Sewer

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Table Of Contents

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Summary:

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Credit Profile		
Monte Vista Wtr Dist rev COPs		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' long-term rating on Monte Vista Water District, Calif.'s water revenue certificates of participation (COPs). The outlook is stable.

The rating reflects our view of the district's:

- Built-out service area that participates in the Inland Empire economy and the Los Angeles metropolitan area economy;
- Stable and primarily residential customer base with little concentration among the leading retail customers;
- Diverse water supply mix that is derived primarily from local sources and provides management with operational flexibility;
- Moderate service rates, which provide management with some revenue-raising flexibility; and
- Historically strong debt service coverage (DSC) performance that is supported by a similarly strong liquidity position.

These strengths are partially offset, in our view, by the service area's high unemployment rates and average income levels.

We view the certificate provisions as adequate. The certificates represent an interest in installment payments secured by the net revenues of the district's water system. The district's obligation to make the installment payments is absolute and unconditional, and is on parity with two loans. The district has covenanted to fix, prescribe, and collect rates and charges such that net revenues will provide at least 1.25x coverage of annual debt service. The certificate provisions also include an additional bonds test of 1.25x annual debt service including debt service on the additional bonds. A debt service reserve fund was not provided for the 2010A COPs; however, we believe that liquidity risks are mitigated by the district's practice of maintaining a strong liquidity position.

The district is located about 35 miles east of downtown Los Angeles in southwestern San Bernardino County. The service area encompasses about 9.6 square miles and includes the City of Montclair, a portion of the City of Chino, and adjacent unincorporated portions of the county. The district estimates the service area population at about 53,076, and forecasts the population will rise to 68,000 at buildout. Montclair, accounts for about 57% of the service area, and is representative of the overall service area, in our view. Montclair has experienced high unemployment during the past 36 months, with rates ranging from 9.0% to 13.6%; most recently, the unemployment rate stood at 9.6% for August

2013 (not seasonally adjusted). The city's unemployment rates typically track slightly lower than the county's (10.0% for August 2013), but higher than the state and national rates (8.8% and 7.3% for August 2013, respectively). The city's median household effective buying income is 97% of the national median, which we consider average.

The district serves a stable, primarily residential, and very diverse retail customer base. The customer base grew at an average annual rate of just 0.7% during the past decade to 11,935 accounts for fiscal year 2013. Given that the service is already largely built out, we anticipate that future changes to the retail customer base will be modest and be driven primarily by infill development or redevelopment. Residential accounts number 10,302 and make up about 86% of the retail customer base. The district has just one wholesale customer, the City of Chino Hills, and we understand that Chino Hills' water system has a similar customer base profile. When excluding Chino Hills from the district's leading customers, we calculate that the leading 10 customers contributed about 13.3% of total operating revenues in fiscal year 2013, which we view as very diverse. Chino Hills alone contributed about 19.7% of total operating revenues in fiscal year 2013; however, we do not view the revenue concentration from Chino Hills as a material credit risk given that the district prices water to Chino Hills with only a minimal margin, and that the district's operating expenses are expected to decrease commensurately with reductions in wholesale water sales.

Water sources consist of groundwater, imported surface water, water from the San Antonio Water Company, and recycled water. Groundwater pumped from the Chino Basin represents about 77% of water supply and is sourced from 13 district-owned wells with a combined capacity of 32 million gallons per day (mgd). The Chino Basin is an adjudicated groundwater basin with specified allocations to various parties based on the basin's operating safe yield, which is determined by the Chino Basin Watermaster. Imported surface water from the State Water Project is obtained through the Water Facilities Authority (WFA), a joint powers authority of which the district is a member, and represents about 11% of water supply. The district owns a capacity interest of 19.4 mgd in the Aqua de Lejos Water Treatment Plant operated by WFA. The district is also entitled to about 800 acre-feet of water per year through ownership of San Antonio Water Company (SAWCO) shares, which represents about 8% of water supply. SAWCO water is currently delivered to the district through the City of Upland's water system pursuant to a wheeling agreement. Recycled water is purchased from the City of Montclair for landscape irrigation and groundwater recharge, and represents about 3% of water supply.

The district is allowed to store water in the Chino Basin for future use, and the balance in the district's groundwater storage account increased to 22,568 acre-feet of banked water at the end of fiscal year 2013 from 16,072 acre-feet at the end of fiscal year 2011. This change was driven primarily by a one-time purchase of 4,000 acre-feet of water production rights from the City of Upland in fiscal year 2011. According to the district, its goal is to maintain one year of production in storage; current storage levels are in excess of this goal. The district delivered 16,546 acre-feet of water to its customers in fiscal year 2013, with about a 60-40 split between retail sales and wholesale sales. The share of wholesale sales declined beginning in fiscal year 2011 as the City of Chino Hills shifted its water supply mix and reduced its purchases from the district to 6,765 acre-feet from 10,149 acre-feet the preceding year.

Water rates are moderate, in our view, and have been adjusted annually since 1998. The district utilizes a budget-based water rate structure that includes a bimonthly readiness-to-serve charge based on water meter size and four rate tiers whose thresholds are set based on budgeted indoor and outdoor use. The rate structure also includes provisions to pass through cost increases from Southern California Metropolitan Water District, Southern California Edison, and Chino Basin Watermaster. We understand that the typical district residential customer uses 1,600 cubic feet of water per month, and currently pays $44.63 per month. Using our benchmark monthly usage of 1,000 cubic feet, we calculate a current bimonthly bill of $62.02, or a monthly-equivalent $31.01. The approved rate schedule continues through fiscal year 2015, and includes rate increases of about 3% to 4% effective Jan. 1, 2014 and Jan. 1, 2015. The district collects service charges on a bimonthly basis, and we understand that the district can discontinue water service for delinquent accounts. Management reports that there have not been any material payment delinquencies by the customer base.

Planned capital improvement projects during the next five years are manageable. The district's capital improvement plan includes about $13.5 million in spending during the five-year period from fiscal year 2014 through 2018. Major projects are planned for pipeline replacement, pump station rehabilitation, well rehabilitation, construction of an emergency intertie, and renovation of the district's administrative offices. Management anticipates that these projects will be funded on a pay-as-you-go basis; however, the district could potentially borrow for a portion of the renovation project depending on the cost of borrowing.

The district's financial performance has been strong, and we anticipate that it will continue to be strong based on management's forecast. Based on audited results, we calculate that DSC has been no less than 2.69x during the past three fiscal years, and was most recently 4.81x for fiscal year 2012. Based on unaudited data, we estimate DSC for fiscal year 2013 at 3.21x. We understand that management's calculation of DSC excludes a portion of audited source of supply expense related to purchased water that was stored for future use. Management reports that it may change its accounting practices to record these types of water purchases as an asset on the statement of net position to be expensed in the period in which the water is used, in lieu of the current practice, which is to expense the water purchase in the period during which the purchase occurs. When excluding these one-time water purchases, we calculate DSC improving to 5.34x for fiscal year 2012 from 3.44x for fiscal year 2010; most recently, DSC stood at 3.36x for unaudited fiscal year 2013. The district's financial performance was unusually strong in fiscal year 2012 due to lower source-of-supply costs; however, this expense is expected to return to historical levels in management's forecast. Based on management's forecast, we anticipate that DSC will remain near 3x during the next three fiscal years, and then improve to more than 5x in fiscal year 2017 after the district makes its final installment payment to the WFA and annual debt service requirements decline.

The district has historically maintained a strong liquidity position, and we anticipate that liquidity will remain strong based on our review of management's forecasts. During the past three audited fiscal years, the district has maintained unrestricted cash balances equivalent to at least 297 days of operating expenses including $13.6 million, or 501 days, at the end of fiscal year 2012. Most recently, management reports an unaudited fiscal year 2013 unrestricted liquidity position of $13.8 million, or 416 days. We understand that the district's policy requires the maintenance of a 25% operating reserve, as well as an emergency reserve of $1 million to $4 million, among other reserve designations.

Outlook

The stable outlook reflects our view of the district's built-out service area and its flexible water supply that does not significantly rely on imported water sources. During the two-year outlook period, we anticipate that the district will continue with regular system improvements and determine a financing plan for the main office site renovation project -- including whether any additional borrowing will fund the project. We also anticipate that the district will implement the approved rate increases for fiscal years 2014 and 2015 and determine a direction for future rates. The district's financial strength and operational flexibility balance some of the service area's weaker indicators, and therefore we do not anticipate taking either a positive or negative rating action during the outlook period.

Related Criteria And Research

- 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
- U.S. State And Local Government Credit Conditions Forecast, Oct. 1, 2013

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