STANDARD & POOR'S RATINGS SERVICES
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Summary:

Castaic Lake Water Agency, California; Joint Criteria; Water/Sewer

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Table Of Contents

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Summary:

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Credit Profile		
US$57.355 mil rev bnds ser 2016A due 06/30/2047		
Long Term Rating	AA/Stable	New
Castaic Lake Wtr Agy JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Castaic Lake Wtr Agy WTRSWR (AMBAC) (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Upper Santa Clara Vy Jt Pwrs Auth, California		
Castaic Lake Wtr Agy, California		
Upper Santa Clara Vy Jt Pwrs Auth WTRSWR		
Long Term Rating	AA/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its underlying rating (SPUR) to 'AA+' from 'AA' on the Castaic Lake Water Agency, Calif.'s senior-lien certificates of participation (COPs). At the same time, Standard & Poor's raised its long-term rating and SPUR to 'AA' from 'AA-' on the agency's subordinate-lien COPs. Standard & Poor's also assigned its 'AA' long-term rating to Upper Santa Clara Valley Joint Powers Authority, Calif.'s series 2016A revenue bonds, issued on behalf of the agency. Finally, Standard & Poor's affirmed its 'AAA/A-1+' rating on the agency's series 2008A subordinate-lien variable-rate refunding revenue COPs. The outlook, where applicable, is stable.

The raised ratings reflect our opinion of the extremely strong credit quality of the Castaic Lake Water Agency's largest retail purveyor, the Santa Clarita Water Division (SCWD), which is wholly owned by the agency, and our assessment of SCWD's ability to cover the agency's fixed costs. Moreover, the second-largest purveyor, the Valencia Water Company (VWC), was also acquired by the agency in 2012, but is operated as separate enterprise pending litigation regarding its acquisition. At the conclusion of the litigation, management would like to explore converting VWC into a public agency, including a possible merger with SCWD, which we would also view as a positive credit factor. Additional support for the raised rating is provided by the agency's robust liquidity position, consistent debt service coverage, and well-delineated financial policies, which address any contingent liabilities.

The long-term component of the series 2008A COP rating is based jointly (assuming low correlation) on the ratings on the obligor, Castaic Lake Water Agency, and the letter of credit (LOC) provider, Wells Fargo Bank N.A. The short-term component of the rating is based solely on the rating on the LOC provider. The LOC expires on May 6, 2016.

We have applied the primary criteria to determine the entity's general creditworthiness (underlying rating) and have applied this rating to the senior-lien issues, and also assigned a rating that is one-notch lower to the subordinate-lien issues. The senior lien is closed; however, no debt service will be paid on the outstanding senior lien bonds until Aug. 1, 2021.

The ratings further reflect our view of the agency's:

- Broad and diversified service territory located in northwestern Los Angeles, as demonstrated through the service area's very strong income levels;
- Rate structure that recovers a significant portion of the district's imported water costs and operating expenses through fixed charges and dedicated property taxes, which enhances revenue stability;
- Adequate water supplies, including 140,089 total acre-feet of banked and exchange water; and
- Sustained strong overall financial risk profile, even with rising wholesale water supply costs and plans for additional debt-financed capital expenditures.

We understand the 2016A bonds are being issued to fund $37 million in capital improvements to the agency's wholesale water system, and prepay the outstanding $36 million series 2006A revenue COPs.

We view the bond provisions as adequate. The series 2016A bonds are secured by a second lien on the wholesale water system's net revenues, on parity with the agency's existing subordinate-lien COPs. The agency's debt obligations also include senior COPs that are secured by a closed first lien on the wholesale water system's net revenues. We understand that the agency is not providing a debt service reserve fund for the series 2016A bonds.

Castaic Lake Water Agency is a wholesale water provider located in northwestern Los Angeles County. The agency's wholesale service area encompasses about 195 square miles, including Santa Clarita and about 20 square miles of rural areas in unincorporated Ventura County, and serves a population of roughly 287,000. The service area is about 35 miles from downtown Los Angeles, and we believe that the local economy is well connected with the deep and diverse Los Angeles metropolitan regional economy. Furthermore, we consider the service area's income levels to be very strong, based on Santa Clarita's median household effective buying income, which was 149% of the national median in 2014.

The agency's customer base consists of four water retailers, including SCWD, VWC, the Newhall County Water District (NCWD), and one other water retailer that relies on the agency's wholesale water to supplement its local groundwater resources. During the past five years, water deliveries to SCWD, VWC and NCWD represented 54%, 36%, and 9%, respectively, of the agency's total water deliveries.

The agency does not maintain formal contracts with the water retailers; however, SCWD shares the same board as the agency, and VWC's board was appointed by the agency as the sole owner of VWC's stock. We understand that the agency and the NCWD are exploring the possibility of combining the two entities into a single water agency to serve the vast majority of the Santa Clarita Valley. While the plans are still preliminary, we do not anticipate that a merger between the two would have a negative impact on the agency's credit position, given NCWD's lack of outstanding debt.

Due to the impact of the drought and water conservation outreach done by the agency and the state, the district saw a 19% decrease in year-to-year water sales to 55,304 acre-feet in fiscal 2015 from 68,178 acre-feet in fiscal 2014.

Furthermore, on May 6, 2015, the state adopted emergency water-use regulations requiring SCWD and VWC to achieve a respective 32% and 24% reduction from 2013 water usage through February 2016; this required reduction has since been extended until Oct. 31, 2016. Through January 2016, we understand the cumulative water reduction for SCWD and VWC was 29.4% and 27.0%, respectively.

The agency's primary source of water supply is the State Water Project (SWP), but the agency is able to draw from other water sources when SWP allocations are low. The agency has contracted with the California Department of Water Resources (DWR) for 95,200 acre-feet annually from the SWP. However, each year DWR sets an allocation percentage based on water supply availability, and this percentage is applied to each SWP contract to determine the amount of water that will be made available to each contractor. During the past decade, the SWP allocation has ranged from 5% to 100%. Based on an announcement by DWR, we understand the agency's current water allocation is 45%.

In addition to SWP water, the agency has an agreement with Buena Vista Water Storage District and Rosedale-Rio Bravo Water Storage District to purchase up to 11,000 acre-feet annually in total, as well as water that has been banked or exchanged with other water districts. During the current drought, management anticipates using a combination of these and other minor sources of supply to meet estimated annual demand of about 29,500 acre-feet. Management reports that the agency's current water supply will likely be sufficient to meet demand through approximately 2050.

In February 2013, the board adopted a new rate structure that includes both fixed- and variable-rate components. Previously, the agency's water rates were based purely on water deliveries, and the new rate structure was developed to improve the agency's revenue stability, among other reasons. However, one of the agency's customers challenged the new rate structure. The trial court ruled against the agency in July 2014, and the agency filed an appeal in February 2015. We understand that the agency and NCWD settled the litigation, and each of the four retailers have agreed to the rate increases adopted by the agency's board on Feb. 24, 2016; the rate increases are effective April 1, 2016 for calendar years 2016, 2017, and 2018 of 9% per annum to the agency's fixed and variable rates.

Coverage of senior-lien debt service by pledged revenues was an extremely strong 5.46x for fiscal year 2014; following the maturity of the 1994 and 2004A bonds, the agency has no additional senior-lien debt service payments until fiscal 2022. The agency's coverage of total (senior and subordinate) debt service by pledged revenues has been consistent, in our view, during the past three years, ranging from 1.6x in fiscal 2013 to 1.8x in fiscal 2014, and back to 1.6x for fiscal 2015, despite a decline in water sales; this relative stability in coverage is attributable to the district's restructured rate structure, which captures a greater portion of the district's operating costs in the fixed portion of its rate structure.

While the bond indenture requires the agency to exclude SWP costs and the corresponding restricted property tax revenues that the agency is required to levy to pay these costs, we believe that it is important to evaluate financial performance including these revenues and expenses given their significance to the agency's operations and finances. At present, however, the agency is collecting more property taxes than its SWP fund expenditures, resulting in a surplus of $34.9 million in the SWP fund, which we view as a credit strength, given DWR's projections for rising SWP costs. We also take into consideration the take-or-pay payments under the Buena Vista Rosedale-Rio Bravo (BVR-RB) agreement, which the agency has historically treated as a capital expense rather than as an operating expense. Incorporating these factors, we calculate the fixed charge coverage (FCC) ranging from 1.3x to 1.4x between fiscals

2013 and 2015, which we view as good, particularly for a wholesale utility.

Based on management's forecast, coverage of subordinate debt service by pledged revenues (excluding the SWP costs and BVR-RB fixed charges) declines slightly from 1.6x in fiscal 2015 to 1.5x in fiscal 2017, then rises to 1.8x through fiscal 2020. We also calculate FCC of about 1.3x during this period. The forecast assumes that facility capacity fees rise to $14 million in fiscal 2019 from $8.2 million in fiscal year 2015, which is based on a study conducted by the agency in 2014. While lower than currently projected development activity could have a material adverse impact on net revenues, we believe that some stability is provided by the agency's other sources of revenue, including the dedicated property taxes, as well as the agency's strong cash position.

The agency's liquidity levels, in our view, are also very strong. The agency held unrestricted cash and investments of about $84 million, equivalent to 778 days of operating expenses, including SWP costs, at the end of fiscal year 2015. Based on management's forecast, we anticipate that the agency's unrestricted liquidity position will be maintained or grow during the forecast period. We understand the agency maintains:

- A formal reserve policy of three months of operating expenses;
- One year of annual debt service less restricted debt service reserve funds;
- Capital reserves of one year of the current pay-as-you-go capital improvement program; and
- A reserve for economic uncertainties and catastrophes equivalent to 500 days of operating expenses (based on operating expenses excluding SWP costs).

The agency maintains roughly $28 million in variable-rate debt (series 2008A COPs), which represents approximately 12% of its total debt, following this transaction.

Projects to be funded with proceeds of the series 2016A bonds include treatment plant improvements, water banking projects, recycled water enhancements, and pipeline projects. The agency has no additional debt needs until fiscal 2019, although we understand that the agency maintains a $45 million commercial paper program, which could be used for interim funding if needed. The agency capital improvement plan calls for a total of $97.4 million in debt-funded projects between fiscals 2019 and 2023, including $40.5 million for the Magic Mountain Reservoir and pipelines, $26.1 million for the recycled water system, and other system improvements.

Outlook

The stable outlook reflects our view of the agency's adequate water supply and very strong liquidity position. During the two-year outlook period, we anticipate that the agency will draw on its other water supply resources to adequately meet demand if the drought continues and SWP allocations remain low.

Upside scenario

We could take a positive rating action if all outstanding litigation is resolved, both the agency's and the retailers' financial metrics strengthen, and we believe the stronger performance level is sustainable.

Downside scenario

There would likely need to be a significant deterioration in either coverage or liquidity levels before a downward rating action would occur.

Related Criteria And Research

Related Criteria

- USPF Criteria: Wholesale Utilities, May 24, 2005
- 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: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Jan. 11, 2016
- U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014

Ratings Detail (As Of March 18, 2016)		
Castaic Lake Wtr Agy rfdg rev COPs (2001 Rfdg Proj)		
Long Term Rating	AA/Stable	Upgraded
Castaic Lake Wtr Agy COPs (2001 Rfdg Proj) (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Castaic Lake Wtr Agy		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Castaic Lake Wtr Agy certs of part ser 2006C		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Castaic Lake Wtr Agy Wtr		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.