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Ratings

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Summary:

Upper Santa Clara Valley Joint Powers Authority, California
Santa Clarita Water Division; Water/Sewer

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Table Of Contents

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Credit Profile		
US$38.84 mil rfdg rev bnds (Santa Clarita Water Division) ser 2017A due 08/01/2027		
Long Term Rating	AA+/Stable	New
Castaic Lake Wtr Agy retail sys rev COPs		
Long Term Rating	AA+/Stable	Upgraded
Upper Santa Clara Vy Jt Pwrs Auth, California		
Santa Clarita Water Division, California		
Upper Santa Clara Vy Jt Pwrs Auth (Santa Clarita Water Division) wtr rev rfdg bnds		
Long Term Rating	AA+/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AA+' from 'AA' on the Upper Santa Clara Valley Joint Powers Authority, Calif.'s outstanding revenue bonds and revenue certificates of participation issued on behalf of the retail water system (Santa Clarita Water Division) of the Castaic Lake Water Agency (the agency). At the same time, S&P Global Ratings assigned its 'AA+' long-term rating to the authority's series 2017A refunding revenue bonds issued on behalf of the division. The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and an extremely strong financial risk profile. The outlook is stable.

The rating action reflects our clarity regarding the division's upcoming rate plans and financial forecast. Although the division's rate restructuring has not yet been finalized, we expect the proposed rates to take effect Jan. 1, 2018. The rate plan is predicated on a 2.0x direct debt service coverage target and maintenance of a minimum of 200 days' cash on hand. The revised rates are also intended to bolster the division's future financial metrics in the event of decline in water sales due to drought, and to allow for the automatic recovery of expenses related to any shifts in wholesale water supply or power costs.

The enterprise risk profile reflects our view of the retail water system's:

- Very strong service territory in the Los Angeles-Long Beach-Anaheim metropolitan statistical area;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Demonstrated ability and willingness to increase rates and pass through water supply costs, although, in our view, the average residential monthly bill is moderately high; and
- Good operational management practices and policies.

The financial risk profile reflects our view of the retail water system's:

- Good historical financial performance that we anticipate will be sustained based on management's forecast;
- Robust liquidity position, supported by a formal reserve policy;
- Manageable capital improvement plan (CIP) that does not require any additional borrowing; and
- Well-defined financial management practices and policies.

The authority is issuing the 2017A bonds to refinance the retail water system's existing debt obligations.

We view the bond provisions as adequate. The bonds are payable from installment payments that are secured by the net revenues of the agency's retail water system, which is operated by the agency's Santa Clarita Water Division. Bond provisions include a rate covenant set at 1.20x annual debt service and an additional bonds test set at 1.20x annual debt service. The division does not anticipate providing a debt service reserve fund for the bonds.

The division is a wholly owned subsidiary of the Castaic Lake Water Agency (CLWA). The agency is a State Water Project (SWP) contractor, and provides supplemental water to the division, the Valencia Water Company (VWC), Newhall County Water District (NCWD), and one other water retailer. Local and imported water resources in the Santa Clarita Valley are managed cooperatively between the agency and the four retail purveyors, and there is no allocation of water rights among each entity.

Although the agency also acquired the stock of VWC in December 2012, the assets of VWC have not been transferred to the agency, and VWC continues to operate as a separate legal entity from CLWA and the division. We also understand that CLWA and the NCWD are exploring the possibility of combining into a single water agency to serve the vast majority of the Santa Clarita Valley. While we understand consolidation of the various retail purveyors could provide some operational efficiency for CLWA, we do not anticipate that a merger would have a negative impact on the division's credit position, as CLWA intends to keep each entity's operations segregated, and the revenues from the other purveyors would not be pledged to repayment of the division's bonds. There is also no cross collateralization between the division and the agency's bonds.

Enterprise risk

The division provides retail water service to a population of about 124,500 and about 31,000 connections located in Santa Clarita and certain portions of unincorporated Los Angeles County about 35 miles north of downtown Los Angeles. We believe that the local economy is well connected within 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 (MHHEBI), which was 150% of the national median in 2016.

We understand the service territory is about 69% developed, and management forecasts the service area population reaching about 177,500 at build out (in 2050). Since 2013, the customer base grew at an average annual rate of about 1.8% per annum, and over the next five years, management anticipates that area will experience continued customer growth of about 1.6% annually through fiscal 2022. In light of the Santa Clarita Valley's strong economic trends, we consider management's projections conservative and reasonable.

As of Dec. 31, 2016, approximately 95% of the retail customers of the division were residential users (based on active accounts), 3% were commercial users and 2% were other users. The system's customer base is not concentrated, in our view, with the 10 leading customers, primarily homeowner associations, contributing about one-sixth of system revenues.

We view the division's market position to be good. Residential customers currently pay a fixed monthly service charge and a volumetric rate based on water usage. As a result of mandatory conservation during the drought, the division estimates the average monthly bill for single family dwelling residential customers declined from about $75.90 per month (for 29 hundred cubic feet of water usage) in fiscal 2015 to about $58.52 at present, assuming 18 hundred cubic feet of water per month. Based on the current level of usage, we view the typical monthly water bill as moderately affordable, equivalent to about 1.0% of MHHEBI when annualized. The county poverty rate as reported by the U.S. Department of Agriculture is 18.7%, which we view as moderately high, but not a material source of resistance to revenue raising given the area's very strong income levels.

The division has historically implemented timely multiyear rate increases. Management indicates that it recently completed a new rate study and expects to preapprove new rates through fiscal 2021.

We believe the proposed rate plan will strengthen the division's overall credit profile, as it would allow for the pass-through of wholesale water purchase and power supply costs, effective Jan. 1, 2018. In addition, under the proposal, we understand that a greater proportion of the division's rates would be cover under a fixed charge, which would bolster the division's operating margins in the event of a drought or other financial emergency. Also being considered is a 2% annual rate increase from Jan. 1, 2019 through Jan. 1, 2021.

We consider the division's water supply mix to be a clear credit strength, as the division has sufficient supplies (either local groundwater or wholesale purchases from CLWA) to meet its customers' needs even during severe drought conditions. Over the past five years, imported water comprised between 56% and 75% of the division's water deliveries, with the balance met with local groundwater pumped by the division. Because the reliability of the imported SWP supply is variable, when sufficient imported water is not available, the balance is met primarily with additional local groundwater, supplemental surface water imports secured by CLWA (such as under agreement with the Buena Vista Water Storage District) and water stored in water banking programs. At present, CLWA's outstanding debt obligations and capital costs are funded from dedicated property taxes and facility connection fees and not by the division's retail ratepayers.

Based on our OMA, we score the division a '2' on a six-point scale in which '1' is the strongest. Management has a formal asset management program that addresses the long-term sustainability of its infrastructure and facilities and is in the process of implementing a GIS system to capture data. Management regularly communicates its strategic goal internally and to outside parties. Rate adjustments have been timely historically, and management undertakes periodic rate studies. Drought management planning and water conservation efforts are good.

While not an immediate credit concern, in our view, the ability to secure supplemental water could be a constraining factor for the division's affordability over the long run, especially if funded by a capital charge to the division's ratepayers. Based on the division's long-term growth trajectory, we anticipate CLWA (on behalf of the division) will need to continue to expand its conjunctive use, water transfers, recycled water and water banking/storage initiatives to ensure continued potable water supply adequacy. We understand CLWA expects to add 41.8 thousand acre-feet of new supplies (for both the division and its other retail purveyors) to its 115.3 thousand acre-feet of existing supply by

2050.

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 division's financial performance has been good during the past three fiscal years despite declining water demand, and we anticipate that it will remain adequate forward. Based on the agency's audited financial statements, we calculate very strong direct debt service coverage of 3.0x, 2.1x, and 2.1x for fiscals 2014 through 2016, sequentially. Our calculation of the division's all-in coverage, which includes a portion of CLWA's debt service and fixed charges (excluding those associated with the SWP, which are covered under a separate property tax) was slightly lower but still strong, at 2.4x, 1.7x and 1,6x, over this period. Based on unaudited results for fiscal 2017, we calculate direct coverage declining to an adequate 1.4x in fiscal 2017; and all-in coverage at a thin 1.2x. Our calculation does not take into consideration a partial defeasance of about $2.3 million in annual debt service in both fiscals 2016 and 2017, wherein management utilized net revenues from the prior year to prepay the full principal and interest due in each of those years.

Even with the cash defeasances in fiscals 2015 and 2016, the division has maintained robust unrestricted cash reserves, and we view the division's liquidity to be a credit strength. Unrestricted cash most recently stood at $32.5 million as of June 30, 2017 (unaudited), equivalent to over 400 days' cash on hand.

Pro forma coverage is expected to rebound from the fiscal 2017 low point but remains slightly thinner than the division's historical metrics. Through fiscal 2021, we expect direct coverage to exceed 1.7x and all-in coverage to exceed 1.4x. We believe the five-year forecast incorporates reasonable assumptions regarding the future growth in the service area and the availability of imported water supplies. The forecast, however, also assumes a rebound in demand in fiscal 2018 following the 25% reduction in demand attributable to mandatory conservation during the recent drought; even with the rate restructuring, we believe a slower recovery in demand could impact the division's future revenues. The division, however, has no additional borrowing needs and all capital projects--totaling $31.7 million through fiscal 2021--will be funded on a pay-as-you-go basis, primarily with capacity fees and only a modest draw down of cash, such that unrestricted reserves should continue to exceed one year's operations.

We believe that the division's financial practices are strong, comprehensive, and supportive of high credit quality. Revenue and expenses assumptions are reasonable, and interim financial reporting is provided to the board and city council on a regular basis throughout the fiscal year. The long-term planning process is rigorous, and the detailed financial and capital improvement forecasts are annually updated. Financial planning and operational information is somewhat abbreviated, as the division's financial performance is reported only as a "business-type activity" in the agency's financial statements.

Outlook

The stable outlook reflects our view that, during the next two years, the division will continue to reap the benefits of an affluent and growing economic base, and that its revised rate structure will result in more predictable and stable financial metrics.

Upside scenario

We are unlikely to take a positive rating action over the next two years, given expectations for future all-in coverage and our view that the division's wholesale water supply costs will continue to rise.

Downside scenario

We could take a negative rating action if lower than anticipated water sales compromise rate-making flexibility and financial performance declines. We could also take a negative rating action if the balance of unrestricted cash and investments trends downward.

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.