

RatingsDirect®

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

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Western Municipal Water District Facilities Authority, California

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Western Mun Wtr Dist jointcrit		
<i>Long Term Rating</i>	AAA/A-1+	Affirmed
<i>Unenhanced Rating</i>	AA+(SPUR)/Positive	Affirmed
Western Mun Wtr Dist ws		
<i>Long Term Rating</i>	NR	
Western Municipal Water District Facilities Authority, California		
Western Municipal Water District, California		
Western Municipal Water District Facilities Authority (Western Municipal Water District) wtr rev bnds (Western Mun Wtr Dist) ser 2020B due 10/01/2042		
<i>Long Term Rating</i>	NR	
Western Mun Wtr Dist Facs Auth (Western Mun Wtr Dist) wtr		
<i>Long Term Rating</i>	AA+/Positive	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA+' long-term rating on Western Municipal Water District Facilities Authority, Calif.'s series 2020A water revenue bonds, issued for Western Municipal Water District (WMWD).
- At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the WMWD'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 is positive.
- The positive outlook reflects the potential for the rating to be improved within the next several years if management continues to be successful in achieving water source diversity and redundancy, both of which are key credit considerations for a higher rating. Counterbalancing this is our view that management will need to balance these goals with the prospects of additional capital costs and the need for additional rate revenues in order to finance these costs.
- We removed the ratings on both the series 2009B bonds, because the bonds have been defeased, and the 2020B bonds, because they did not sell.

Security

We view the bond provisions as credit neutral. The 2020A 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 on all of WMWD's revenue bonds include a rate covenant set at 1.1x annual debt service and an additional bonds test set at 1.1x maximum annual debt service (MADS). 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 the 2011 fiscal year.

Credit overview

As imported water provided by the Metropolitan Water District of Southern California (MWD) has increased in cost and experienced significant fluctuations in state water project (SWP) allocations in recent years, WMWD has lowered its reliance on direct MWD purchases to about 50% of its delivered and produced water for its retail customers. Our positive outlook reflects the one-in-three likelihood that the rating could improve over the next several years if WMWD is able to roughly maintain or lower this percentage without undue cost increases for additional storage, transmission, or supply enhancements.

Because we consider WMWD's revenue base to be diverse, distributed between retail and other operating revenues (about 40%), wholesale water purchases (35%), and ad valorem property taxes (15%), our rating reflects application of our retail water and sewer utility criteria. WMWD serves about 25,000 retail water accounts, 9,000 retail wastewater accounts, and eight wholesale customers in western Riverside County. Its retail customers include those within 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 just under one million.

The ratings reflect our view of the district's:

- Robust planning efforts, ensuring that operational and financial requirements are well-aligned, including resource management and sustainability, supported by strong financial management practices and policies;
- Track record of annually reviewing and adjusting service rates to produce consistent financial performance, although typical monthly residential charges of about \$125 for water and \$51 for wastewater are elevated, in our view, because of the 2,900 cubic feet of monthly average water usage (on average, the district increases retail rates by 2%-4% annually);
- Strong and sustainable financial performance, with WMWD continuing to generate financial margins that exceed 3x debt service coverage and maintain unrestricted liquidity exceeding 500 days' cash (or about \$210 million at the fiscal year ending June 30, 2022)--we consider these metrics sustainable as long as management continues to automatically pass along MWD imported water cost increases to its customers and is successful at sourcing local water at a competitive cost; and
- Manageable capital improvement plan (CIP), in our view, with continued system improvements and reliability projects. Through fiscal 2027, WMWD is planning to spend \$92.7 million on capital projects, and we understand that the district anticipates funding just over 20% of the capital program through borrowing from a line of credit with TD Bank, N.A. and most of the remaining with cash generated through operations.

Environmental, social, and governance

The primary credit risks revolve around the district's ability to manage environmental factors. We consider the environmental risk slightly higher, given its location in Southern California and the region's inherent water supply scarcity and seismic exposure. In particular, its imported water supply--both the SWP and the Colorado River--remains susceptible to environmental scrutiny and risks related to climate change, rising temperatures, and shifting

precipitation patterns. While the district's local groundwater basins are either adjudicated or lower-priority unadjudicated basins, the basins have evidence of both natural and industrial contaminants, like per- and polyfluorinated substances (PFAS). Drought management planning is robust; the district has a low unaccounted for water rate of less than 1%, which indicates aggressive leak detection procedures, and has drought rates that may be applied during declared drought stages.

The district has strong management practices and policies, including long-term capital and financial planning, which mitigates governance risks when compared with 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 while consistently investing in local supply reliability and enhancing groundwater and recycled water. The district's pass-through of wholesale costs and retail budget-based rate structure ensures cost recovery by passing through imported water costs, and helps insulate the district's financial performance from variances during droughts and imported water cost increases. We understand the district will continue recommending updates to its future rate plans, but we do not expect this will significantly increase affordability pressures or social risks.

Outlook

Downside scenario

We do not anticipate lowering the rating during the two-year outlook horizon, as long as management produces financial metrics that are consistent with or exceed historical trends. However, any unexpected economic or financial shocks, which could potentially significantly disrupt the system's operations, or any unanticipated or extraordinarily large change in the CIP that could alter related financial metrics, could present downward pressure on the rating or outlook.

Upside scenario

The rating could be raised within the next several years if management continues to be successful achieving water source diversity and redundancy, both of which are key credit considerations for a higher rating. If affordability challenges mount given the current economic headwinds, we would also seek to understand how WMWD is incorporating additional affordability tools; this is especially important, in our view, given the high imported water costs that management passes on to its ratepayers.

Credit Opinion

The district's water supply is primarily provided by the Metropolitan Water District of Southern California. For fiscal year 2023, the district purchased 10,598 acre-feet of retail water supply from MWD, which represented 47% of the district's acre-feet purchases for its retail customers. The balance of the water supply is either purchased from the Elsinore Valley Municipal Water District (EVMWD), the city of Riverside, or Eastern Municipal Water District, pumped from groundwater wells, or is brackish groundwater treated at the district's Arlington Desalter. The district also has a recycled water supply produced from its wastewater treatment plant. Some of its strategic actions in the recent past, as listed below, have reduced the district's reliance on more-expensive imported water:

- Potable groundwater rights with EVMWD extending through 2040;
- Partnership with the city of Riverside to both deliver surplus local supplies and wheel leased water to WMWD through the city;
- Participation in the Chino Basin Desalter Authority's expansion of the authority's desalination plant and WMWD-owned infrastructure that links the desalters to the Inland Empire Utilities Authority's brine line;
- Addition of a new well in the Murrieta service area and acquired groundwater rights in the San Bernardino Basin;
- 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 for groundwater banking and conservation coordination measures to generate surplus groundwater storage.

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 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.

At the end of fiscal year 2022, 22% of the district's revenue-backed bonds were variable-rate debt hedged with a floating-to-fixed-rate swap, but WMWD also has an outstanding variable line of credit for \$20 million that is being used to finance capital projects. The swap on the district's 2012A bonds, as of June 30, 2022, had a mark-to-market value of \$1.6 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 decrease, 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 the 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.

Rating above the sovereign

The rating on WMWD is above the sovereign because all revenue is locally generated. WMWD has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all the entity's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues and allows the rating to exceed that of the U.S. overall.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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