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Summary:

Yorba Linda Water District, California; Water/Sewer

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Yorba Linda Wtr Dist rfdg rev bnds		
Long Term Rating	AA+/Stable	Affirmed
Yorba Linda Wtr Dist COP		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' long-term rating on Yorba Linda Water District, Calif.'s outstanding certificates of participation (COPs) and refunding revenue bonds. The outlook is stable.

The rating is based on our view of the district's extremely strong enterprise and financial risk profiles, which include:

- Stable, predominantly residential customer base that has very strong income levels and participates in the greater Los Angeles metropolitan statistical area (MSA);
- Ample water supply, with the district's goal of increasing its use of less expensive groundwater;
- Recent rate increases to manage revenue shortfalls from increased conservation;
- Good operational and financial management; and
- Strong historical all-in debt service coverage (DSC) and liquidity.

The district's bonds are secured by net revenues of the district's water system and ad valorem tax collections. The district also owns a sewer system, the revenues of which are not pledged to the bonds. The district currently has about $38.4 million in outstanding debt from the 2008 and 2012A COPs and a $7 million line of credit with Wells Fargo that the district expects to pay off in fiscal 2017. Bond provisions are, in our view, standard and credit neutral, with a rate covenant and additional bonds test of 1.1x annual debt service. The district does not maintain a debt service reserve for the 2012 bonds.

The district serves most of the city of Yorba Linda and portions of the cities of Anaheim, Brea, and Placentia and of unincorporated Orange County. Service area residents have access to the greater Los Angeles MSA, which provides a broad and diverse employment base. Income indicators are very strong, with median household effective buying income equal to 191% of the national level in 2014. Unemployment rates are also low, at 4.1% compared to the state (5.7%) and the nation (5.0%) as of November 2015. The customer base is stable, having increased by about 1% on average over the past five years, and is primarily residential, with residential customers accounting for 93% of total accounts. Management does not expect any significant changes to the customer base in the near term.

Residential customers currently pay a monthly service charge that is dependent on meter size and a volumetric rate. Due to ongoing drought conditions and subsequently higher conservation, the district engaged an outside consultant for a new rate study in March 2015, which resulted in the adoption of new rates for fiscal 2016. The district's base service charge more than doubled for fiscal 2016, and the rate study recommends annual base rate increases of about 10% to 11% through fiscal 2020. According to management, these increases in the base rate will allow the district to recover 40% of its costs through the fixed rate component, compared to 20% in the previous rate structure. The exact amount of base rate increases will be determined through an annual review process. Due to the recent rate increase, the district was served a petition for a Writ of Mandate by the Yorba Linda Taxpayers Assn. challenging the fiscal 2016 rate increase. However, at the end of January, the petition was denied by court order, and management indicated that it is confident in its position regarding the rate increase.

Based on our operational management assessment (OMA), we view the district to be a '2' on a scale of 1-6, with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well aligned, even if some challenges exist. The OMA of good includes ample water supply from both groundwater sources and imported water from the Municipal Water District of Orange County (MWDOC), which obtains water from the Metropolitan Water District of Southern California (MWD). Groundwater extraction is managed by the Orange County Water District (OCWD). In 2013, the district was able to have the remaining 25% of its territory annexed into OCWD territory, which provides the district with additional groundwater pumping capacity. This will allow the district to maximize its groundwater allocation and to reduce its reliance on more expensive imported water. Management also indicated that they have an integrated asset management program and is in the process of updating its Urban Water Management Plan. Pursuant to state conservation mandates, the district was required to achieve a 36% conservation target. As of December 2015, the district had achieved nearly 38% in conservation, and with the recent conservation mandate extensions, there may be some readjustment to the targets.

The district's coverage has been maintained at strong levels by regular rate increases, even through the recent drought conditions. Operating revenues declined by about 5.3% to $27.8 million in fiscal 2015 compared to $29.0 million in fiscal 2014. However, due to lower water demand, operating expenses consequently declined by about 7% to $23.0 million in 2015 compared to $24.9 million in 2014. This resulted in coverage of 2.5x on the district's debt in 2015. From our new criteria, we calculate an "all-in" coverage metric that considers imputed debt service that is implicitly passed on to the district from its water suppliers. The implicit debt service is estimated by considering the proportion of each supplier's revenues that the district represents. In the case of OCWD, the district has, on average, represented about 3.74% of replenishment revenues, while for MWDOC, the district represents about 4.8% of the pass-through costs from MWD. We estimate an all-in coverage of 1.7x for the district in 2015, which we view as strong. Although there may be some decline in coverage due to a revenue shortfall from conservation measures, the projections show coverage levels remaining strong if the proposed rate increases are implemented.

The district's liquidity has been consistently strong during the past few years. Unrestricted cash at the end of fiscal 2015 was $27.4 million, or about 432 days' of operating expenses, up from nearly $24.0 million at the end of fiscal 2014. We expect some decline in liquidity due to the district's plans to pay off the letter of credit principal in fiscal 2017. However, given the proposed rate increases and capital improvement plan (CIP) expenditures, we do not expect a significant decline in liquidity during the two-year outlook horizon.

The current five-year CIP calls for about $13.5 million in expenditures, with major projects including pump station upgrades and two well projects. The district does not anticipate issuing any additional debt for its CIP, as the proposed rate increases included capital expenditures in the rate structure. The district's debt-to-capitalization ratio is moderate, at 25% at the end of fiscal 2015.

Based on our financial management assessment (FMA), we view the district to be a '2' on a scale of 1-6, with '1' being the strongest. An FMA of good indicates that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. The government maintains many best practices deemed as critical to supporting credit quality, particularly within the finance department. The FMA of good includes reasonable assumptions in the rate study forecast and regular reporting of budgetary performance to the board. The district also maintains long-term financial and capital plans that are updated regularly, and it has adopted formal investment and liquidity policies, although it does not have a formal debt policy.

Outlook

The stable outlook reflects our expectation that district will continue to make the appropriate actions to support its strong financial metrics while addressing its CIP. We also expect the district to increase its use of less expensive groundwater supply and to reduce its exposure to more expensive imported water going forward. Although there is some ongoing contention with the recent rate increases, we believe the district has limited exposure to rescinding its current rates.

Upside scenario

We could raise the rating if the district is able to successfully recover from any revenue shortfall resulting from reduced water use and to sustain its historically strong coverage and financial metrics as well as reduce its reliance on imported water.

Downside scenario

Although not anticipated, if the district is unable to keep its recently implemented rates and financial metrics erode, we may lower the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- 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

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.