

RatingsDirect®

Summary:

Monte Vista Water District, California; Water/Sewer

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| US\$22.235 mil rev certs of part ser 2024A due 10/01/2054 | | |
| Long Term Rating | AA/Stable | New |
| Monte Vista Wtr Dist rev COPs | | |
| Long Term Rating | AA/Stable | Affirmed |

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to Monte Vista Water District, Calif.'s anticipated \$22.2 million series 2024A certificates of participation (COPs).
- At the same time, we affirmed our 'AA' long-term rating on the district's water revenue bonds.
- The outlook for all ratings is stable.

Security

Bond proceeds will be used to address a number of projects, including 1, 2, 3-trichloropropane (TCP) in the districts' groundwater and pre-treatment for per- and polyfluoroalkyl substances (PFAS), improvements of wells, and water storage. The COPs are secured by a pledge of water system revenues and the district's share of the San Bernardino County 1% ad valorem property tax payable solely from net revenues. We view the certificate provisions as credit neutral. The COPs represent an interest in installment payments secured by the district's water system. The district's obligation to make the installment payments is absolute and unconditional and is on parity with existing loans. The district has covenanted to fix, prescribe, and collect rates and charges so that net revenues will provide at least 1.25x coverage of annual debt service, and require an additional bonds test of 1.25x annual debt service. A debt service reserve fund will not be provided for the series 2024A COPs, but we believe that liquidity risks are mitigated by the district's practice of maintaining a strong liquidity position.

Credit overview

The rating is anchored by the district's very strong financial performance, supported by its comprehensive long-term planning and strong management team, as well as a very strong enterprise risk profile, with sufficient future capacity its customer base.

Monte Vista's all-in debt service coverage (DSC), has historically been extremely strong over the past four years, with the exception of an unseasonably wet year in 2023 decreasing water sales. Our calculation of all in coverage includes the district's 1% property tax revenues, and our fixed costs calculation for imported water from the State Water Project. Forecasts indicate the district will resume its robust coverage of 2.45x DSC in 2024, and ultimately trend around 1.5x DSC through 2028 accounting for the layering of series 2024A debt service and increases in water supply

costs. The district projects liquidity will remain above \$30 million over the next five years (or 430 days cash worth of operating expenses). Management's five-year forecast accounts for a trend in decreased water sales, due to conservation measures and periodic wet years, which is offset by decreased pumping and treatment expenses, and by its tiered rate structure with approved rate increase through 2027. The customer service population is expected to reach about 66,000 in the year 2024, which is also factored into operating cost and capacity assumptions. Rates are expected to remain affordable given the rate structure of residential rates that include a base rate and tiered volumetric rates, that capture higher costs for high usage, and any costs incurred to extract water above the district's permitted annual allotment determined by its shares of water rights. We view management's forward-looking approach, and revenue supportive rate structure capturing the potential for weather-driven fluctuations, as a credit strength.

The district has a \$68 million capital plan through fiscal years 2024-2028, which includes debt proceeds from this issuance and proposed financing of Water Infrastructure Finance and Innovation Action [WIFA] (estimated \$30.3 million), state revolving fund loans (SRF) and grants. Monte Vista's five-year capital improvement plan (CIP) is geared towards maintaining reliable and quality water supply, and includes facility and reservoir rehabilitation projects, upgrading groundwater wells, and pipeline replacement. The district continues to address elevated levels of 1,2,3-TCP and the presence of PFAS in its groundwater wells. In the past, the district has received settlement funds to help fund 1,2,3-TCP treatment at certain wells and is continuing to pursue funding from responsible parties to finance planned 1,2,3-TCP treatment installations. Using proceeds of this issuance it will implement a dual-treatment process at the wellhead to treat and reduce contaminant levels. The district is party to a class-action settlement to resolve claims against manufactures 3M and Dupont for damages relating to PFAS contamination in public water systems' drinking water; the settlement amount the district will receive is unknown at present. Given the system's diversified and sufficient water supply, and regular testing to ensure regulatory compliance standard of it drinking water, we believe management is effectively addressing operational risks, which is reflected in our Operational Management Assessment (OMA) of a good.

Other credit factors include our view of the water system's:

- Built-out service area that participates in the Riverside-San Bernadino-Ontario metropolitan statistical area (MSA) economy, with minimum household effective buying income (MHHEBI) of 104% of the national average, and mostly residential customer base;
- Board-approved rate increases--8% annually for through fiscal 2027, with a monthly residential bill that is expected to remain affordable given incomes levels and county poverty rate;
- Good operational and financial management practices and policies that we view as in line with those of peers, including long-range CIPs, sufficient treatment capacity, regular budget updates to the council, and routine public outreach;
- All-in DSC that has been mostly extremely strong for the past three years, in conjunction with liquidity and reserves of \$34 million at fiscal year-end 2023 or 700 days cash worth of operating expenses; and
- Increasing leverage with debt-to-capitalization ratio at 37% after the 2024 issuance, which will continued to be pressured given its substantial near-term debt plans.

Environmental, social, and governance

We view Monte Vista Water District's environmental factors as being elevated given the limitations of the regional water supply frequently subject to drought conditions, and costly nature of importing water. However, we view the district as actively addressing these risks by maintaining a diverse water portfolio mix, continued investment in adjudicated water, prioritizing water storage within its basin for future consumption, and implementing more aggressive treatment of 1,2,3-TCP and PFAS. We view social risks as neutral with our analysis, based on the monthly average bill affordability.

We view governance as credit supportive because of the system's strong management, planning, and practices. This is reflected in management's focus on long-term water resource management and maintenance of a drought management plan. With a forward-looking water supply and asset-management plan that includes climate modeling, management feels it has adequate supply and treatment capacity to meet the district's long-term needs.

Outlook

The stable outlook reflects our view that the strong management team will execute on planned rate increases and will continue to pass through imported water costs and implement budget adjustments that promote revenue predictability and stability.

Downside scenario

We could lower the rating should there be a sustained material deterioration in cash or coverage beyond our view of management's projections.

Upside scenario

We could raise the rating if the district's economic metrics improve, combined with the utility improving its cash position to levels that are in line with those of higher-rated peers.

Credit Opinion

Enterprise risk

The district is about 40 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. Montclair accounts for about 57% of the service area and is representative of the overall service area, in our view. Residential accounts make up 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 7% of total operating revenues in fiscal 2023, which we view as very diverse. Chino Hills contributed about 21% of total operating revenues in the same year. However, we do not view the revenue concentration from Chino Hills as a material credit risk given that the district prices water to the city 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 (SAWCO), and recycled water. Imported water purchases from the SWP through the Inland Empire Utilities Agency and the Metropolitan Water District of Southern California have become a larger proportion of the overall water supply mix over time. In 2013, the ground water wells provided 77%, whereas in 2023 it was 57%. Based on management's forecasts of the next four years the water supply will remain fairly consistent with the current water source mix (57% groundwater, 35% Water Facilities Authority (WFA), 6% SAWCO, and 2% recycled water), but requiring about two million acre-feet less than the historical water demand trends. The district's rate structure includes provisions to automatically pass through imported water cost increases as well as charges from the Chino Basin Watermaster. We consider the district's ability to automatically pass through these costs a key credit strength.

Groundwater pumped from the Chino Basin represents about over half of water supply and is sourced from 10 district-owned wells with a combined capacity of 21 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 SWP is treated at the WFA, a joint powers authority of which the district is a member and represents about 44% of water supply. The district owns a capacity interest of 19.4 mgd in the Aqua de Lejos Water Treatment Plant operated by WFA. It is also entitled to about 674 acre-feet of water per year through ownership of SAWCO shares, which represents about 6% of water supply. We understand that SAWCO's wells are not contaminated with 1, 2, 3-TCP. SAWCO water is currently delivered to the district through the City of Upland's water system in accordance with a wheeling agreement. Recycled water is purchased from the City of Montclair for landscape irrigation and groundwater recharge, and represents about 2% 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 was 24,078 acre-feet of banked water at fiscal year-end 2023. 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 9,681 acre-feet of water to its customers in fiscal 2023, with about a 70%-30% split between retail sales and wholesale sales.

Water rates are moderate, in our view. The average residential bill is approximately \$43.45 a month for a usage of about 14 hundred cubic feet (HCF) of water service, which represents less than 0.8% of MHHEBI, a level that we consider affordable. The district uses 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; its last rate study was completed in September 2023. The rate structure also includes provisions to pass through cost increases from Metropolitan Water District of Southern California and Chino Basin Watermaster. The district collects service charges on a bimonthly basis, and it can discontinue water service for delinquent accounts.

Financial risk

Our assessment of the system's financial risk profile as very strong reflects the district's historically extremely strong all-in DSC and very strong liquidity, combined with a strong financial management framework. All-in coverage is our internally adjusted DSC metric that we believe best tracks the use of every dollar of the utility's operating revenues, regardless of lien position, accounting treatment, or ultimate purpose. It also incorporates recognition of fixed costs, which we define as certain long-term reoccurring items that are debt-like in nature, even if legally treated as operating expenses. For the district, we include fixed costs associated with the SWP. We also adjust net revenues to remove

non-cash expenditures related to Governmental Accounting Standards Board Statements Nos. 68 and 75. Based upon our analysis of management's forecast which includes our fixed cost, we expect DSC to be more than 2.0x in 2024-2025 and trend at around 1.5x DSC in 2026-2028.

Monte Vista Water District, California--Economic and financial data

| | | Fiscal year-end | | | Median (AA) |
|---|--------|-----------------|--------|--------|-------------|
| | | Most recent | 2023 | 2022 | |
| Economic data | | | | | |
| Water customers | 10,647 | | | | 20,180 |
| Sewer customers | -- | | | | 19,840 |
| MHHEBI of the service area as % of the U.S. | 104.0 | | | | 109.0 |
| Unemployment rate (%) | 4.7 | | | | 3.6 |
| Poverty rate (%) | 13.5 | | | | 9.5 |
| Water rate (6,000 gallons or actual) (\$) | 43.5 | | | | 37.0 |
| Sewer rate (6,000 gallons or actual) (\$) | 0.0 | | | | 45.0 |
| Annual utility bill as % of MHHEBI | 0.8 | | | | 1.1 |
| Operational Management Assessment | Good | | | | Good |
| Financial data | | | | | |
| Gross revenues (\$000s) | | 20,499 | 26,691 | 23,079 | 24,568 |
| Total operating expenses less depreciation (\$000s) | | 17,960 | 17,947 | 17,505 | 15,080 |
| Net revenues available for debt service (\$000s) | | 4,060 | 9,043 | 6,454 | -- |
| Debt service (\$000s) | | 2,093 | 2,095 | 2,096 | -- |
| S&P Global Ratings-adjusted all-in DSC (x) | | 1.5 | 2.8 | 2.1 | 2.3 |
| Unrestricted cash (\$000s) | | 34,445 | 38,852 | 36,507 | 23,872 |
| Days' cash of operating expenses | | 700 | 790 | 761 | 584 |
| Total on-balance-sheet debt (\$000s) | | 27,162 | 28,430 | 29,673 | 38,873 |
| Debt-to-capitalization ratio (%) | | 24.2 | 25.2 | 28.1 | 26.3 |
| Financial Management Assessment | Strong | -- | -- | -- | Good |

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

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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