S&P Global Ratings

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Summary:

Marin County Sanitary District No. 2; Water/Sewer

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Summary:

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Credit Profile		
US$9.35 mil wastewtr rev certs of part ser 2024 due 05/01/2054		
Long Term Rating	AA-/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA-' long-term rating to Marin County Sanitary District No. 2, Calif.'s $9.3 million series 2024 wastewater revenue certificates of participation (COPs).
- The outlook is stable.

Security

The series 2024 COPs are payable from installment payments secured by the district's net revenue pledge which include primarily its portion of the countywide 1% ad valorem property tax levy and sewer service charges from its customers. The district intends to use COP proceeds to fund certain sewer project improvements including pump station, force main, and sewer line improvements. Following the series 2024 COPs issue, the district will have $9.3 million in debt outstanding.

The district's property tax revenue accounts for 57% of its total revenue, and the board raised sewer service charges 40% in July 2024 to support its rising debt service obligations. It entered into an installment sale agreement with the Public Property Financing Corp. of California to finance its sewer capital projects. We understand the district will make semi-annual installment payments to the corporation prior to scheduled debt service payments.

Credit overview

Marin County Sanitary District No. 2 provides wastewater collection service to an affluent customer base (6,150 customers) in the Town of Corte Madera, 12 miles north of San Francisco. In our view, the rating reflects the district's recent willingness to rapidly raise sewer service charges over a five-year period that will more than double sewer revenue by fiscal 2027 and support its $48 million capital improvement program (CIP). Following annual sewer rate increases, we expect the district will maintain robust all-in coverage metrics, but planned drawdowns in liquidity to partly fund its capital program are a credit weakness.

The rating also reflects our assessment of the district's following credit strengths, including its:

- Primarily residential and predictable revenue stream, and stable customer base with very strong income levels that provide revenue-raising flexibility;
- Robust projected all-in debt service coverage (DSC) metrics equal to more than 3.2x through fiscal 2029; and
- Limited operational risk as a sewer collection system that outsources wastewater treatment to the Central Marin

Sanitation Agency (CMSA), a regional treatment provider.

The following factors temper our view of the district's credit strengths, including its:

- Relatively small customer base which limits its economies of scale and can pressure rate affordability across a portion of its roughly 4,500 residential accounts;
- Additional capital needs required to fund aging sewer line improvements that are projected to weaken liquidity to a nominally thin $3 million by fiscal 2026; and
- Reliance on its rate consultant to develop its long-term financial forecast and capital plan, and management's reactive rate-setting practices, in our view, reflected by sizable rate increases in the near term.

We consider the COPs legal provisions credit neutral with a rate covenant and additional bonds test equal to 1.1x annual debt service. The absence of a debt service reserve fund is not a credit weakness because we anticipate the district will operate and produce robust coverage metrics well above its legal provisions.

Environmental, social, and governance

We consider the district's environmental factors (including environmental compliance and exposure to physical risks) credit neutral. Management's 2023 sanitary sewer master plan focused on investing in pump station and force main improvements, repairing sewer lines, and reviewing vulnerabilities to sea-level rise. We understand the district's $5 million in capital improvements focused on repairing defective sewer lines over five years will satisfy its legal settlement agreement with an environmental group. Its social factors (including rate affordability) could be pressured if sizable rate increases are required beyond fiscal 2029. Despite rapid annual sewer rate increases, we believe sewer rates will remain affordable, although service costs are subsidized by the district's property tax revenue stream accounting for 41% of total revenue by fiscal 2027. We believe Corte Madera's median household effective buying income provides the district revenue raising flexibility and mitigates social risk factors. We also believe the district's governance factors (including its rate practices) are credit neutral. Key management actions include the board's willingness to implement sizable rate increase over a five-year period to support rising debt service requirements, and management's 2024 rate study which produced its financial forecast and long-term CIP.

Outlook

The stable outlook is based on our view of management's approved annual rate increases that will support its CIP and continue to produce robust all-in DSC. The district's predictable property tax revenue stream subsidizes its sewer service charges, which allows it to maintain competitive rates among regional sewer providers despite rapid rate increases.

Downside scenario

We could lower the rating or revise the outlook to negative if larger-than-anticipated capital costs or debt needs result in larger drawdowns in liquidity than projected or significantly weakens coverage below projected levels.

Upside scenario

Based on the district's capital needs, debt plans, and projected decline in liquidity well below historical levels, we do not anticipate raising the rating. If it were to establish a track record of maintaining liquidity significantly above projected levels and robust coverage as it progresses through its CIP, we could revise the outlook to positive.

Credit Opinion

Based on our view of management's financial forecast, we expect the district will maintain all-in DSC equal to at least 3.2x through fiscal 2029. In March 2024, it adopted a five-year rate increase which will more than double sewer service revenue by fiscal 2027, representing 57% of total revenue. Management intends to issue $10 million in additional debt in 2026 to fund roughly 40% of its CIP. In our view, the district's property tax revenue has been predictable, increasing 3% to 7% annually since fiscal 2019. We anticipate its debt needs will increase total debt service requirements to $1.1 million by fiscal 2027. In our calculation of all-in DSC, we include the district's debt service commitment to CMSA as a debt-like obligation. Management represents that these debt-like expenses to CMSA will remain flat through the forecast, equal to approximately $660,000.

Despite the district's robust liquidity position equal to $8.8 million or 702 days' cash on hand (DCOH), planned draws on liquidity are projected to weaken liquidity to $3 million or 187 DCOH by fiscal 2026. Although cash levels will exceed the district's $2.5 million reserve policy, we believe its projected liquidity volatility and levels do not support a higher rating based on those for 'AA' rated peers.

The district pays CMSA for sewer treatment based on wastewater volume and quality. Its average wastewater flows are 1 million gallons per day (mgd) and we do not anticipate additional CMSA debt in the near term. The district also pays CMSA its 11.7% share of debt service on CMSA's revenue bonds, plus an additional 25% debt coverage payment. CMSA is a joint powers authority formed to provide sewage treatment on a wholesale basis to participating member systems: the San Rafael Sanitation District, the Ross Valley Sanitation District, and Marin County Sanitary District No. 2 (Corte Madera). It also provides wastewater treatment services for San Quentin prison under a contract with the state.

Marin County Sanitary District No. 2, California -- Economic and financial data

		Fiscal year-end			
	Most recent	**2023**	**2022**	**2021**	**Median (AA-)**
Economic data					
Water customers					12,715
Sewer customers	5,815				12,120
MHHEBI of the service area as % of the U.S.	209.2				100.0
Unemployment rate (%)	3.7				3.6
Poverty rate (%)	7.7				10.5
Water rate (6,000 gallons or actual) ($)	0.0				39.0
Sewer rate (6,000 gallons or actual) ($)	58.2				41.0
Annual utility bill as % of MHHEBI	0.5				1.2
Operational Management Assessment	Standard				Good

Marin County Sanitary District No. 2, California -- Economic and financial data (cont.)

		Fiscal year-end			
	Most recent	**2023**	**2022**	**2021**	**Median (AA-)**
Financial data					
Gross revenues ($000s)		7,199	6,945	7,012	14,461
Total operating expenses less depreciation ($000s)		4,578	3,821	3,277	10,316
Net revenues available for debt service ($000s)		2,790	3,161	3,799	
Debt service ($000s)					
S&P Global Ratings-adjusted all-in DSC (x)		5.2	5.7	6.6	2.0
Unrestricted cash ($000s)		8,803	9,573	11,672	14,565
Days' cash of operating expenses		702	914	1,300	534
Total on-balance-sheet debt ($000s)		0	0	0	28,615
Debt-to-capitalization ratio (%)		0.0	0.0	0.0	31.1
Financial Management Assessment	Standard				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