

RatingsDirect®

Summary:

Santa Monica, California; Water/Sewer

Primary Credit Analyst:

Aaron Lee, San Francisco (1) 415-371-5066; aaron.lee@standardandpoors.com

Secondary Contact:

Paul J Dyson, San Francisco (1) 415-371-5079; paul.dyson@standardandpoors.com

Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

Santa Monica, California; Water/Sewer

Credit Profile

Santa Monica wastewtr rev rfdg bnds

Long Term Rating

AAA/Stable

Affirmed

Santa Monica (Hyperion Proj) wtr

Unenhanced Rating

NR(SPUR)

Withdrawn

Rationale

Standard & Poor's Ratings Services affirmed its 'AAA' rating on Santa Monica, Calif.'s series 2012A wastewater refunding revenue bonds. At the same time, Standard & Poor's withdrew its rating on the city's series 2005 water bonds (Hyperion Project) because the bonds were fully redeemed in fiscal 2014. The outlook is stable.

The ratings reflect our view of the wastewater system's:

- Strong service area economy that fully participates in the deep and diverse Los Angeles metropolitan area economy;
- Affordable service rates that provide management with revenue-raising flexibility;
- Limited need for additional capital spending with no plans for additional debt; and
- Strong financial metrics with strong historical total debt service coverage (DSC) and fixed charge coverage (FCC) and strong liquidity, which we expect to be sustainable.

These credit strengths are partly offset by the system's limited influence over capital expenses related to the Los Angeles Hyperion System.

The 2012A bonds are secured by a subordinate-lien on the net revenues of the wastewater system. However, as of the end of fiscal 2014, the wastewater system has no other senior-lien obligations. Legal provisions are adequate, in our view, with a rate covenant of 1.20x senior-lien and parity-lien debt service, and an additional bonds test (ABT) of 1.20x senior-lien and parity-lien debt service. The ABT is a historical test that permits revenue adjustments, for purposes of the calculation, to reflect approved changes to rates and charges that were in effect for less than the full fiscal year. A debt service reserve fund is not provided for the series 2012A bonds.

Santa Monica, with an estimated population of 92,343, is located in western Los Angeles County. The wastewater system has a service area that spans about eight square miles, and residents have access to employment opportunities throughout the Los Angeles metropolitan area. Tourism and entertainment have a strong economic presence. We consider the service area's income levels to be strong, as indicated by the median household effective buying income (MHHEBI) at 117% of the national median in 2014. Unemployment rates have historically been higher than the national rate, although they are lower than Los Angeles County and the state rate. The latest unemployment rate as of July 2015 was 6.3%.

The system's customer base is stable, primarily residential, and very diverse, in our view. Given that the service area is largely built out, its population is in a slow-growth mode. Similarly, total customer accounts are very stable, and currently stand at 16,298. The customer base is primarily residential, which represents approximately 85% of all accounts. We consider the customer base to be very diverse given that the 10 leading customers contributed just 4.2% of total revenues in fiscal 2015. Management has indicated that they do not anticipate any major changes to the customer base going forward.

Santa Monica owns and operates its local wastewater collection system, which conveys wastewater flows to the Hyperion Wastewater Treatment Plant for treatment and disposal. System flows have remained relatively stable and in fiscal 2014, the system generated an average flow of approximately 12.8 million gallons per day (mgd) and peak month flow of 14.8 mgd. Much of the city's conveyance system is relatively new, as it was essentially rebuilt following the 1994 Northridge earthquake and was designed so that projected peak flows would equate to only 75% of system capacity. Wastewater treatment is provided by the Hyperion Plant, which provides treatment services to a 600-square-mile area around the City of Los Angeles, encompassing 29 other agencies (in addition to the city). Since the Hyperion Plant has capacity to treat more than 450 mgd, the city's total treatment capacity is, for practical purposes, unlimited although the city does pay its share of operations and maintenance expenses based on flow volume and strength. Management indicates that the system is in compliance with all regulatory requirements and does not anticipate any regulatory changes that may impact the system.

Sewer service charges are based on flow, sewage strength, and a discharge factor based on customer category. Residential rates are purely volumetric based and using our benchmark water use of 1,000 cubic feet per month, we calculate a monthly bill of \$23.72. When annualized, this represents less than 1% of 2014 MHHEBI, which we view as affordable. Rates were continually increased from fiscal 2011 to 2014 and were not increased for 2015 following a review in 2014. A resolution passed in 2008 allows rates to be adjusted by the consumer price index absent any other rate or rate structure change. Customers are billed on a bi-monthly basis on the same statement along with water, sewer, refuse, water conservation, and utility users' taxes. Management indicates that there have been no significant payment delinquencies related to the system.

The system has maintained strong total DSC during the past five years with coverage levels consistently above 3x and last stood at 4x at the end of fiscal 2014. The series 2005 bonds were redeemed in 2014 and as such, the subordinate-lien series 2012A bonds are the only bonds outstanding for the system. Principal payments for the 2012 bonds do not begin until fiscal 2020. Using 2014 data and calculating future maximum annual debt service, coverage is still strong at 3.1x. When treating the city's capital payments to Los Angeles as a fixed charge, we calculate FCC of 1.8x for fiscal 2014, which we consider strong, and the unaudited results for fiscal 2015 project FCC to be 3.4x. Future FCC using 2014 data is projected to be 1.3x, which we view as good. We expect the city to maintain its strong coverage metrics through the outlook horizon.

The system has historically maintained what we consider as extremely strong unrestricted cash reserves. At the end of fiscal 2014, the wastewater fund had very strong liquidity, with approximately \$27 million in unrestricted cash and investments, equivalent to approximately 768 days' of operating expenses, down from about \$31 million or 1,149 days of operating expenses in fiscal 2013. Management had drawn down the reserves in fiscal 2014 to redeem the series

2005 bonds. The city has a policy of maintaining operating reserve equivalent to 50% of the Hyperion Treatment expenses (three-year running average), with a minimum level of \$3 million, capital reserve of 50% of annual capital program expenditures except Hyperion capital payment, with a minimum of \$3 million and a rate stabilization of \$1 million. The unaudited results for fiscal 2015 project the unrestricted cash and investments to be \$34.5 million, equivalent to approximately 1,050 days' of operating expenses, a level we consider strong.

Future system capital needs are manageable with the majority of the city's capital improvement program (CIP) focusing on main replacements. Also included in the CIP are projected \$3.5 million annual capital payments to the Hyperion Plant. This has increased from recent years due to an increase in capital expenditures by the plant. We understand that the CIP from fiscal 2016 to fiscal 2019 totals \$30.2 million when including the Hyperion capital charges and that management intends to pay for the CIP on a pay-as-you-go basis. There are no plans to issue additional debt at this time.

The wastewater system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the entity's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

Outlook

The stable outlook reflects our view of the wastewater system's strong service area economy, affordable rates, and very limited capital needs. We anticipate that during the two-year outlook period, management will continue to operate the system in a manner that will produce results consistent with the system's historically strong financial profile.

Downside Scenario

Although not anticipated, if financial metrics were to materially deteriorate, we could lower the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Water And Sewer Ratings, June 25, 2007
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- 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
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 22, 2015
- U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014

- 2014 Review Of U.S. Municipal Water And Sewer Ratings: How They Correlate With Key Economic And Financial Ratios, May 12, 2014

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.

Copyright © 2015 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.