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Upper Santa Clara Valley Joint Powers Authority, California
Santa Clarita Water Division; Joint Criteria; Water/Sewer

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Credit Profile		
US$27.02 mil rev bnds ser 2018A dtd 01/25/2018 due 08/01/2048		
Long Term Rating	AA/Stable	New
Castaic Lake Wtr Agy Wtr		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to the Upper Santa Clara Valley Joint Powers Authority, Calif.'s series 2018A subordinate-lien taxable revenue bonds, issued on behalf of the Santa Clarita Valley Water Agency (SCV Water, formerly known as the Castaic Lake Water Agency). At the same time, S&P Global Ratings affirmed its 'AA+' rating on the agency's outstanding senior-lien certificates of participation (COPs) and its 'AA' rating on the agency's parity subordinate-lien COPs. Finally, S&P Global Ratings affirmed its 'AAA/A-1+' rating on the agency's series 2008A subordinate-lien variable-rate refunding revenue COPs. The outlook, where applicable, is stable.

SCV Water does not sell water from its wholesale system directly to retail users but instead sells water to four separate retail water purveyors: the Santa Clarita Water Division (SCWD; 50% of the agency's 2017 water sales), Newhall Water Division (NWD; the former Newhall County Water District; 10%), the Valencia Water Company (VWC; 39%) and the Los Angeles County Waterworks District No. 36 (less than 1%.)

The agency's general creditworthiness (senior-lien rating) reflects a one-notch upward adjustment to our assessment of the credit quality of its second-largest retail purveyor, VWC, which effective Jan. 31, 2018, will become a wholly-owned division of the agency known as the Valencia Water Division, or VWD. We have also assigned a rating that is one-notch lower than the senior-lien rating to the subordinate-lien issues. The senior-lien is closed; however, no debt service will be paid on the outstanding senior-lien COPs until Aug. 1, 2021.

The long-term component of the series 2008A COP rating is based jointly (assuming low correlation) on the ratings on the obligor, SCV Water, and the letter of credit (LOC) provider, Wells Fargo Bank, N.A. The short-term component of the rating is based solely on the rating on the LOC provider. The LOC expires on May 6, 2019. SCV Water maintains roughly $22.8 million in variable-rate debt (series 2008A COPs), which will represent approximately 10% of its total debt, following this transaction.

Under our primary criteria, if a wholesale agency is made up of 10 or fewer participants, and there are no contractual provisions that require non-defaulting members or participants to increase their payments to account for such delinquency, we employ a weak-link approach to our analysis of the wholesale agency. This is because we believe the failure by a single purveyor to fulfill its payment obligations to a wholesaler would result in a project deficiency, thereby exposing bondholders to the credit quality of the wholesaler's weakest participant. However, certain additional factors allow a wholesaler's credit rating to move up or down (by a notch) from the weakest participants' credit quality. In this instance, we apply a one notch favorable adjustment to our assessment of VWD's credit quality, because of the additional credit strengths of the agency, which include a diverse revenue stream (wherein dedicated property taxes comprise 39% of pledged revenues, thus lowering the agency's overall exposure to any one of its retail purveyors) as well as its extremely strong cash reserves, which we forecast will be maintained at very strong levels over our two-year outlook period.

The ratings further reflect our view of the agency's:

- Broad and diversified service territory located in northwestern Los Angeles, as demonstrated through the service area's very strong income levels;
- Rate structure that recovers a significant portion of its imported water costs and operating expenses through fixed charges and dedicated property taxes, which enhances revenue stability; and
- Stable financial metrics, even with the dissolution of VWC and the merger with Newhall County Water District (NCWD), and plans for additional debt-financed capital expenditures.

Partly offsetting the above strengths, in our view, are:

- The risk that lower-than-anticipated development activity in the agency's service area could have an adverse impact on its overall net revenues.
- Despite the net revenue pledge for the series 2018A bonds, we believe the agency's board of directors would be reluctant to raise wholesale rates (for all of its purveyors) to cover a possible debt service shortfall, since the series 2018A bonds are being sold to fund a loan to one participant (VWD) rather than to support infrastructure on behalf of all the purveyors collectively.

We view the bond provisions as adequate. The series 2018A bonds are secured by the second lien on the SCV Water's net revenues, on parity with the agency's existing subordinate-lien COPs. We understand that the agency is not providing a debt service reserve fund for the series 2018A bonds. While the series 2018A installment payments are payable from net revenues of SCV Water's wholesale water system, the agency expects to apply certain payments received from VWD to pay the installment payments and the debt service is expected to be exclusively borne by the customers in the area served by VWD. The agency has authorized an interfund loan, pursuant to which VWD rate payers will be allocated the responsibility to pay the principal of and interest on the bonds. The interfund loan will become effective upon the Jan. 31, 2018, dissolution of the VWC.

Santa Clarita Valley Water Agency

SCV Water was formed through a statutory merger of the former Castaic Lake Water Agency and the Newhall County Water District (NCWD) effective Jan. 1, 2018, as authorized by Senate Bill 634. NCWD is now operated as a wholly-owned retail division (NWD, or the Newhall Water Division) of the agency.

The agency's retail purveyors serve the northwestern portion of Los Angeles County, about 35 miles from downtown Los Angeles. The wholesale service area has a population of approximately 273,000, and covers an area of approximately 195 square miles. The majority of the population served is located in the city of Santa Clarita and other nearby communities. We believe that the local economy is well connected within the deep and diverse Los Angeles metropolitan regional economy. Furthermore, we consider the service area's income levels to be very strong, based on Santa Clarita's median household effective buying income (MHHEBI), which was 150% of the national median in 2016.

The agency's primary source of water supply is the State Water Project (SWP), but the agency is able to draw from other water sources when SWP allocations are low. The agency has contracted with the California Department of Water Resources (DWR) for 95,200 acre-feet annually from the SWP. However, each year DWR sets an allocation percentage based on water supply availability, and this percentage is applied to each SWP contract to determine the amount of water that will be made available to each contractor. During the past decade, the SWP allocation has ranged from 5% to 100%. Based on a Nov. 29, 2017 announcement by DWR, the agency's SWP contractors' Table A allocations for 2018 is 15% or approximately 14,280 acre-feet. The allocation for 2018 is subject to revision by DWR.

In addition to SWP water, the agency has an agreement with Buena Vista Water Storage District and Rosedale-Rio Bravo Water Storage District (BVWSD-RRBWD) to purchase up to 11,000 acre-feet annually in total, as well as water that has been banked or exchanged with other water districts. During drought conditions, management anticipates using a combination of these and other minor sources of supply to meet estimated annual demand of about 29,500 acre-feet. Management reports that the agency's current water supply will likely be sufficient to meet demand through approximately 2050.

The agency projects that it will be able to meet existing demand for imported water through fiscal 2020, even if dry conditions return. In addition to water purchased pursuant to the BVWSD-RRBWSD Acquisition Agreement, the agency indicates it will meet its imported water demands from previously unused SWP water and other supplies stored in SWP surface reservoirs, as well as the agency's groundwater banking and exchange programs.

In addition to the wholesale water provided by the agency, the retail purveyors each own and manage various local supplies. In fiscal 2017, SCWD purchased about 83% of its water from the agency, while VWC and NCWD only purchased 67% and 43%, respectively, of their water from the agency.

In March 2016, the board of directors of the former Castaic Lake Water Agency adopted a new wholesale water rate structure effective April 1, 2016, and therein adopted rates for calendar years 2017 and 2018. In November 2017, following completion of a wholesale water rate study, the agency adopted fixed and variable wholesale water rates for calendar 2019; and is set to increase rates each fiscal year by the Los Angeles County consumer price index. The 2019 rate study follows the same methodology and rate structure currently being used. It also includes a financial forecast for fiscals 2020 and 2021. The revised wholesale rate structure should provide greater stability in SCV Water's financial performance going forward. Moreover, each of the three wholly-owned retail divisions (SCWD, VWD and NCWD) have retail rate structures that allow for the automatic pass-through of increases in SCV Water's wholesale rates.

We view the agency's diverse revenue stream to be a key credit strength. The largest component of its fiscal 2017 revenues was from its share of the county's 1% property taxes (39%), followed by wholesale water sales (37%), one time-facility development fees (16%), and other revenues (9%).

In fiscal 2017, pledged revenues totaled $61.5 million, compared to $52.6 million the prior year. The increase was primarily driven by growth in wholesale water sales and one-time facility development fee receipts. The agency's coverage of total (senior and subordinate) debt service was 1.6x in fiscals 2015 and 2016, as calculated by S&P Global Ratings, and improved to a very strong 1.9x in fiscal 2017 as a result of the rise in pledged revenues that year.

Although VWC and NCWD's operations will both be brought onto the agency's overall balance sheet by the end of January 2018, the reorganization is not expected to have a material impact on the agency's financial metrics. This is largely because each division's retail system obligations will remain the obligation of their specific customer base and will not become direct obligations of the agency.

Based on management's forecast (which assumes wholesale water sales will average about 34% of pledged revenues through fiscal 2021, property taxes about 38%, and facility development fees about 11%), total debt service by pledged revenues are forecast to remain at between 1.8x and 1.5x through 2021, which we also consider very strong. If development fees decline from current projections (or if the agency sells additional debt sooner than currently forecasted) we believe coverage could decline from current projections; we believe the agency's revised wholesale rate structure largely insulates the agency from potentially adverse shifts in hydrology or water demand. The agency's liquidity levels, in our view, are also forecasted to remain strong. The agency held unrestricted cash and investments of about $86 million, equivalent to about two years' of operating expenses at the end of fiscal year 2017. Based on management's forecast, we anticipate that the agency's unrestricted liquidity position will either be maintained or grow during the forecast period.

In general, we believe the agency's financial practices are strong, comprehensive, and supportive of high credit quality. Revenue and expenses assumptions are reasonable, and interim financial reporting is provided to the board on a regular basis throughout the fiscal year. The long-term planning process is rigorous, and the detailed financial and capital improvement forecasts are annually updated. Financial planning and operational information is somewhat abbreviated, however, with pledged revenues reported as a "government-type activity" in the agency's financial statements.

The agency's upcoming capital improvement plan (CIP) is relatively sizable. SCV Water has identified projects with total estimated costs (in fiscal 2018 dollars) of approximately $220.0 million through fiscal 2024, of which all but $11.8 million is expected to be debt financed, and likely recovered in the agency's future wholesale rates. However, a more moderate $57.4 million of new debt is anticipated to be issued by the agency through fiscal 2021. Key projects in the CIP will extend the agency's water transmission system, expand its recycled water system and water treatment capacity, provide improved reliability to its SWP supply, develop groundwater supplies, and continue to replace the groundwater extraction capacity lost due to perchlorate contamination. In addition to SCV Water's upcoming CIP, each of the three wholly-owned retail divisions (SCWD, VWD and NWD) have their own identified capital needs, which we believe could also require specific adjustments to each entity's retail water rates over the next five years.

Outlook

The stable outlook reflects our view of the agency's adequate water supply and very strong liquidity position, as well as our assessment that each of the three retail division's credit quality will remain consistent with current projections.

During the two-year outlook period, we anticipate that the agency will draw on its other water supply resources to adequately meet demand, should drought conditions return and SWP allocations remain low.

Upside scenario

While unexpected, we could take a positive rating action if the financial metrics of both the agency and VWD materially strengthen, and if we believe the stronger performance level is sustainable.

Downside scenario

We could take a negative rating action if the underlying credit quality of any of three retail purveyors were to weaken or if the agency's cash balances materially decline from current levels.

Retail Purveyors

In September 1999, the agency acquired the stock of the Santa Clarita Water Company (SCWC) through the settlement of an eminent domain action. The assets of SCWC were subsequently transferred to the agency and thereafter have been operated by the agency as a wholly-owned retail system renamed the Santa Clarita Water Division (SCWD). SCWD served 31,478 service connections in fiscal 2017, of which 95% of its customer accounts were residential. We understand SCWD recently completed a new rate study and the former Castaic Lake Water Agency's board of directors preapproved retail rates for SCWD's customers (including a pass-through of the agency's wholesale costs) through fiscal 2021.

SCWD's recent financial performance has been very strong. All-in coverage, which includes a portion of the agency's debt service and fixed charges (excluding those associated with the SWP, which are covered under a separate property tax) exceeded 2.0x over the past three years (but averaged 1.6x excluding one-time connection fees). Our calculation does not take into consideration a partial defeasance of about $2.3 million in annual debt service in both fiscals 2016 and 2017, wherein management utilized net revenues from the prior year to prepay the full principal and interest due in each of those years. Even with the cash defeasances, the division has maintained robust unrestricted cash reserves, and we view the division's liquidity as a credit strength. Unrestricted cash most recently stood at $32.5 million as of June 30, 2017, equivalent to over 400 days' cash on hand. The agency's forecast assumes that SCWD will make up an average of 46% of its wholesale water sales through 2021; and based on the division's upcoming CIP (which assumes $23.9 million of pay-go funded capital needs through fiscal 2021) we assume that SCWD's financial metrics will remain consistent over this period. For more information on SCWD, please see our report published Sept. 1, 2017, on RatingsDirect.

In December 2012, the Castaic Lake Water Agency acquired 100% of the stock of the VWC in accordance with a settlement of an eminent domain action. After the acquisition, VWC continued to operate as a separate company. Upon the anticipated dissolution of VWC on Jan. 31, 2018, VWD will be operated as a wholly-owned retail system (similar to SCWD) wherein the agency will account for the revenues, expenses, and debt allocable to VWC through the newly formed Valencia Water Division (VWD). VWC served 31,580 connections in fiscal 2017 and no changes to the number of connections served are anticipated following its dissolution. Based on VWC's historical revenues, we understand 54% were derived from residential accounts; 11% from commercial users; and 35% from other accounts (including multi-family residences). VWC completed a cost of service study in 2017 and approved retail rate increases of about 6.2% annually through Dec. 31, 2020.

VWCs recent financial performance has been very strong but is expected to weaken somewhat as its rate payers take on the series 2018 debt service and a $58 million loan associated with the agency's acquisition of VWC begins amortizing. All-in coverage, which includes a portion of the agency's debt service and fixed charges (excluding those associated with the SWP, which are covered under a separate property tax), averaged 1.8x over the past three years (we did not calculate an adjusted calculation without one-time connection fees because VWC did not historically receive connection revenues).

The agency's forecast assumes VWD will comprise an average of 44% of its wholesale water sales through 2021. We calculate VWD's coverage will decline to 1.3x and 1.4x in fiscals 2019 and 2020. We also consider VWD to be highly leveraged, as characterized by a 75.7% debt-to-capitalization ratio, which is inclusive of the acquisition loan. Unrestricted cash most recently stood at $16 million (unaudited) as of Dec. 31, 2017, equivalent to about 278 days' cash on hand; we anticipate VWD's cash will decline to about $10 million over the next year, before growing to about $12 million (or 200 days' cash on hand) by fiscal 2020. VWD has no additional retail system debt needs anticipated at this time.

In 2014, the Newhall County Water District filed an action in the Los Angeles County Superior Court challenging the agency's acquisition of VWC. The NCWD's action was one of a number of actions filed by various parties challenging the agency's acquisition of VWC. During the course of the settlement discussions, the negotiation of a potential merger of the Castaic Lake Water Agency and NCWD arose. In December 2016, Castaic Lake Water Agency approved a settlement agreement that dismissed the NCWD action and the agency and NCWD agreed to jointly pursue legislation to combine the two entities into a new water agency as the successor to both, wherein retail customers of NCWD will be served by a new wholly-owned retail system called the Newhall Water Division (NWD). NCWD served about 9,772 connections in fiscal 2017; of which 92% of its customer accounts were residential; no changes to the number of connections served are anticipated following the merger.

NWD has no additional retail rate increases planned, although its current projections include a pass-through of the agency's wholesale costs. All-in coverage, which includes a portion of the agency's debt service and fixed charges (excluding those associated with the SWP, which are covered under a separate property tax) averaged 2.0x during the past three years (we did not calculate an adjusted calculation without one-time connection fees because NCWD did not historically receive significant connection revenues). NCWD held about $7.6 million in unrestricted cash as of June 30, 2017, equivalent to about 300 days' cash on hand, and we understand that management intends to grow NWD's cash balances by about $500,000 per annum during the upcoming five-year period.

The agency's forecast assumes that NWD will comprise an average of 10% of its wholesale water sales through 2021; and based on the division's upcoming CIP (which assumes about $2.7 million of annual pay-go funded capital needs) we assume that NWD's financial metrics will improve to levels that we consider extremely strong over this period, with all-in coverage forecasted to exceed 3.0x after fiscal 2019 as NWD's direct debt service is scheduled to decline from about $1.9 million per annum to $602,000. We consider NWD to have extremely low leverage, as characterized by a 5.6% debt-to-capitalization ratio as of June 30, 2017; NWD has no additional retail system debt needs at this time.

Ratings Detail (As Of January 11, 2018)		
Santa Clarita Vy Wtr Agy COPs		
Long Term Rating	AA+/Stable	Affirmed
Santa Clarita Vy Wtr Agy COPs (2001 Rfdg Proj)		
Long Term Rating	AA/Stable	Affirmed
Santa Clarita Vy Wtr Agy COPs (2001 Rfdg Proj) (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Santa Clarita Vy Wtr Agy JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Upper Santa Clara Vy Jt Pwrs Auth, California		
Santa Clarita Vy Wtr Agy, California		
Upper Santa Clara Vy Jt Pwrs Auth (Santa Clarita Vy Wtr Agy)		
Long Term Rating	AA/Stable	Affirmed
Upper Santa Clara Vy Jt Pwrs Auth, California		
Santa Clarita Water Division, California		
Upper Santa Clara Vy Jt Pwrs Auth (Santa Clarita Water Division) wtr rev rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.