

**Fitch Upgrades Mesa Consolidated Water District Revenue Bonds to 'AAA'; Outlook Stable**

Fitch Ratings—San Francisco—Nov. 3, 2010: Fitch Ratings upgrades Mesa Consolidated Water District, California's senior lien water revenue certificates of participation to 'AAA' from 'AA+'. Fitch assigns its 'AAA' rating to the following certificates of participation (COPs):

--Approximately \$25 million series 2010 subordinate lien water revenue certificates of participation (tax-exempt) at 'AAA'.

Proceeds from the Series 2010 COPs will fund construction of the Colored Water Treatment Facility and pay costs of issuance. No debt service reserve fund will be funded. The COPs are expected to price via negotiation during the week of December 8, 2010, depending on market conditions.

Fitch upgrades the outstanding COPs of the district to the following:

--\$12.985 in water revenue COPs are upgraded to 'AAA' from 'AA+'.

The Rating Outlook is Stable.

While the series 2010 COPs have a subordinate lien on net revenues, the bonds are rated 'AAA'. Fitch rates the bonds on par with the closed senior lien bonds because of the closed nature of the senior lien and its rapid amortization and the fundamental credit strength of the cashflow supporting the overall debt of the district, including the subordinate lien.

**RATING RATIONALE:**

--The upgrade reflects Mesa Consolidated Water District's very strong financial performance through the recession and the Western regional drought, Board approval of a five-year rate package designed to increase its healthy liquidity levels to very robust levels, and greater certainty regarding the scope and costs of the capital improvement plan.

--The district approved a five-year rate package in 2009 that is designed to provide very strong debt service coverage for both senior and subordinate debt as well as improve cash reserves to a very strong level.

--Debt levels are low, and the district has no further issuance plans after the current sale.

--The current project will reduce the district's reliance on imported water entirely in exchange for increased production of an ample source of local groundwater.

--Management practices are sound including long-term forecasting and willingness to raise rates when necessary.

--The service area is economically strong, stable and diverse.

KEY RATING DRIVERS:

--Continued strong financial performance and implementation of approved rate increases.

--Successful construction and operation of the Colored Water Treatment Facility.

SECURITY:

The certificates are being issued by the Mesa Consolidated Water District Improvement Corporation and will be secured by purchase payments made by the district in accordance with the installment purchase agreement, which is a common structure in California. Payments from the district are an absolute and unconditional obligation of the district and backed by a pledge of net revenues. The series 2010 COPs are subordinate to \$12.985 million of outstanding senior-lien obligations.

CREDIT SUMMARY:

Mesa Consolidated is an independent, financially sound water district that serves the city of Costa Mesa and adjacent areas in Orange County, California. The district has performed very well financially in recent years, despite a drought and severe recession. As a built-out Orange County community, the district's population and largely residential customer base have been stable.

The upgrade is the result of the action to raise rates to provide strong coverage of all outstanding debt (projected to remain over 4.0), increase reserve levels to a target of 600 days operating cash, and greater certainty regarding the capital improvement plan (CIP), including known costs related to the Colored Water Treatment Facility and the lack of additional debt plans for at least the next five years.

The district's board has independent rate-setting authority. It approved a five-year rate package on December 22, 2009 that included average rate increases of 5.8% over the next four years. While the district's rates are somewhat elevated as a percent of median household income, they are low relative to other Southern California communities that rely on imported water, and the district is viewed as having rate flexibility. The rate increases are designed to improve liquidity levels, including the funding of a large capital facilities fund to fund ongoing repair and replacement and support the additional debt service of the series 2010 bonds.

The district benefits from access to an ample supply of ground water, and the current project will further increase the reliability of its water supply by eliminating its reliance on imported water. Mesa Consolidated produces about 60% of its water from clear water wells that require minimal treatment and 23% from deep wells that pump brownish, "colored" water that requires well-head treatment to remove color and odor. The balance comes from water recycling (6%) and imported water (12%). COP proceeds will finance the upgrade and expansion of Mesa Consolidated's

Colored Water Treatment Facility. The expansion will allow the district to use its two existing wells to their full capacity and will move to a treatment process that involves lower energy and labor costs. The colored water is plentiful, and pumping is not limited by local groundwater management agreements. Colored water is expected to provide more than a third of water supply once the project is complete, up from less than a quarter. While the cost of treating colored water is close to the cost of imported water, the project increases the reliability of the district's water supply, which Fitch views as a significant credit strength.

Financial performance is strong. Net revenues available for debt service averaged 3.3-times(x) senior debt service over the past three fiscal years. All-in debt service coverage, which includes subordinate debt service, averaged 2.0x for the last 3 years. Both coverage ratios are expected to rise significantly over the next four years due to already approved water rate increases, with all-in coverage projected to remain above 4.0x and senior lien coverage rising to 8.1x. Liquidity levels are projected to grow from 259 days cash at the end of fiscal 2010 to greater than 600 days by 2014.

Debt levels are low at \$612 per customer debt will remain quite manageable after the current offering, with per capita debt of \$1,224 per. Amortization is very rapid with 100% of debt paid down in less than 20 years. The district has no further issuance plans after the current sale.

Mesa Consolidated's service area weathered the recession well. Its unemployment rate was below the state and national averages in August at 8.6%. The Orange County labor market, which was hard hit early in the recession due to its significant concentration of subprime mortgage lenders, has begun to recover. Wealth levels are high with median household incomes at 123% of the national median.

Contact:

Primary Analyst  
Andrew Ward  
Associate Director  
+1-415-732-5617  
650 California St., Fourth Floor  
San Francisco, CA 94108

Secondary Analysts  
Julie Seebach  
Associate Director  
+1-512-215-3740

Kathryn Masterson  
Senior Director  
+1-415-732-5622

Committee Chairperson  
Jessalynn Moro

Managing Director  
+1-212-908-0608

Media Relations: Cindy Stoller, New York, Tel: +1 212-908-0526, Email:  
cindy.stoller@fitchratings.com.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'

In addition to the sources of information identified in the *Water and Sewer Revenue Bond Rating Guidelines*, this action was additionally informed by information from Creditscope, University Financial Associates, LoanPerformance, Inc., IHS Global Insight, Underwriter, Bond Counsel, and the Financial Advisor.

Related Research:

'Revenue-Supported Rating Criteria', dated Aug. 16, 2010.

'Water and Sewer Revenue Bond Rating Guidelines', dated Aug. 6, 2008.

'2009 Median Ratios for Water and Sewer Revenue Bonds-Retail Systems', dated Jan. 28, 2009.

'2010 Water and Sewer Sector Outlook', dated Feb. 10, 2010.

**Comment [KM1]:** Is this the one that changed to Oct. 8?

For information on Build America Bonds, visit [www.fitchratings.com/BABs](http://www.fitchratings.com/BABs).