

Rating Update: Mesa Consolidated Water District, CA

MOODY'S AFFIRMS A1 RATING ON MESA CONSOLIDATED WATER DISTRICT'S (CA) WATER REVENUE CERTIFICATES OF PARTICIPATION

A1 RATING AFFECTS \$14.3 MILLION IN DEBT OUTSTANDING

Water/Sewer
CA

Opinion

NEW YORK, May 13, 2009 -- Moody's Investors Service has affirmed the A1 rating on Mesa Consolidated Water District's (CA) Certificates of Participation. The bonds are secured by installment payments made by Mesa Consolidated Water District to Mesa Consolidated Water District Improvement Corporation. The installment payments are a special obligation of the system and are secured by the district's pledge of net revenues of the water system. The A1 rating incorporates the district's weak legal provisions, history of solid financial operations and debt service coverage levels, stable water supply, and well developed service area.

WELL DEVELOPED CUSTOMER BASE WITH MODEST GROWTH

Moody's expects the customer base will grow modestly though the service area is mature due to redevelopment projects in the City of Costa Mesa (G.O. rated Aa2). Mesa Consolidated Water District serves approximately 110,000 people and includes the City of Costa Mesa, parts of the City of Newport Beach (G.O. rate Aa3) and unincorporated parts of Orange County (G.O. rate Aa2). The customer base is primarily residential (62.3% of revenues) with some commercial presence (24.9% of revenues). The customer base grew by an average annual rate of 0.86% since 2003. The district expects additional growth through redevelopment for residential high rises due to its favorable location near South Coast Plaza. Currently one high rise residential development, delayed from an initial start date of 2009, is expected to be built in 2010. The top 10 customers represent 17.5% of the total water system revenues. The median family and per capita incomes for City of Costa Mesa are above average at 110.8% and 108.1% of national medians, respectively.

LOW DEBT BURDEN WITH LIMITED FUTURE DEBT PLANS

Moody's believes the district's debt burden will remain favorable given its low debt burden and limited future debt plans. While the district is not under any formal consent decrees or environmental mandates, the district plans to expand the colored water treatment plant and update its technology. The district expects to receive 50% of the project's cost in grant funding and plans to issue \$8 to \$14 million in 2010. The district's debt ratio is a low 16.3% and the district expects to retire almost 100% of its debt in 10 years. All of the district's debt is fixed rate and the district is not party to any derivative agreements.

SOUND FINANCIAL OPERATIONS

Moody's believes the district's historically sound financial operations will remain solid given its mature customer base and limited future debt plans. Since fiscal 2005 (ended June 30), the district's debt service coverage has averaged a solid 2.01x. In fiscal 2008 net revenues provided 2.51x coverage and are projected to provide 2.1x annual debt service coverage in fiscal 2009. Debt service coverage is expected to remain at the same level for the next three years. The operating ratio has improved since 2005 declining from 76.3% to 71.7% in fiscal 2008. The operating margin was 39.4% up from 25.5% in 2005 due to one time expenditures. The district benefits from having its own water source, with the majority (approximately 90%) of the district's water coming from local groundwater potentially limiting fiscal pressures to the increasingly costly state water project. The district's liquidity is strong with net working capital at 70.9% of operating expenditures. The district maintains a catastrophe fund of \$1 million and an operating fund of 10% of budget. Further, the district transfers annually any net revenues in excess of the 10% reserve to the rate stabilization fund.

Since 2005 the district has increased rates annually by an average of 9.08%. The district reviews rates annually and is currently developing a formal reserve policy for use in setting rates. In comparison to the area the district's rates are in the top third because the district does not levy a property tax and funds most asset replacement through operating revenues.

RELATIVELY WEAK LEGAL COVENANTS

The rate covenant and the additional bonds test at 1.1x annual debt service are narrow; however, Moody's believes the district will continue to maintain coverage in the range of 2.0x to 2.2x in line with medians for similarly A1 rated systems. The net revenue pledge includes gross revenues less operation and maintenance expenses. The district's bonds are additionally secured by a debt service reserve fund, which is required to be funded at 10% of original proceeds, maximum annual debt service, or 125% of average annual debt service. The debt service reserve fund is cash funded.

KEY STATISTICS

Service area population: 110,000

Billed water connections: 22,915

Average annual connection growth (2003-2008): 0.86%

Orange County Median Family Income (as % of state and US): \$64,611 (121.9% of CA and 129.1% of US)

Orange County Per Capita Income (as % of state and US): \$25,826 (113.7% of CA and 119.6% of US)

Operating ratio: 71.7%

Operating margin: 39.4%

Debt ratio: 16.3%

Maximum annual debt service coverage (2009): 2.81x

Annual debt service coverage: 2.50x

Analysts

Bridget Young
Analyst
Public Finance Group
Moody's Investors Service

Eric Hoffmann
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

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