

Summary:

Mesa Consolidated Water District, California; Water/Sewer

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Credit Profile		
US\$23.175 mil 2010 subord In rev certs of part due 03/15/2025		
<i>Long Term Rating</i>	AA+/Stable	New
Mesa Cons Wtr Dist rfdg certs of part		
<i>Long Term Rating</i>	AAA/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating to 'AAA' from 'AA' on Mesa Consolidated Water District (MCWD), Calif.'s series 2009 refunding certificates of participation (COPs). The raised rating reflects our view of the closed lien of the senior COPs, the very strong debt service coverage of the senior-lien debt at 3.8x in fiscal 2010, and the district's projected strong coverage of 4.5x-8.1x in 2011-2015. The raised rating also reflects our view of its continued strong operating performance, liquidity, and adopted rate increases over the next five years. In addition, Standard & Poor's assigned its 'AA+' long-term rating to the district's subordinate 2010 revenue COPs. The outlook on all ratings is stable.

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

- Consistently strong financial operations and reserves, along with a reduced reliance on imported water to meet demand;
- Strong local economic base (Costa Mesa's appropriation bonds are rated 'AA');
- Consistently strong financial operations and liquidity;
- Diversified water resource mix; and
- Manageable capital plan.

Partially offsetting the foregoing strengths is our view of the district's rates, which are higher than those of its peers, and partial reliance on imported water from Municipal Water District of Orange County (MWDOC) to meet demand.

The COPs represent an interest in installment payments payable by the district to the trustee pursuant to an installment purchase agreement. The district has a special obligation to make the series 2010 installment payments solely from net revenues of the water system, but the series 2010 COPs are subordinate to the district's 2009 COPs, with roughly \$13 million in aggregate principal outstanding. The lien on the 2009 senior COPs is closed and the district has covenanted not to incur additional obligations payable from net revenues senior to these 2010 COPs.

Mesa Consolidated Water District serves a predominantly residential base, which provides 81% of water revenues. The district serves about 24,000 customer accounts in an 18-square-mile area that includes Costa Mesa, John Wayne International Airport, portions of Newport Beach, and neighboring areas in Orange County. Costa Mesa, with a population of approximately 113,955, is located in the southern coastal area of Orange County, adjacent to

the cities of Santa Ana and Newport Beach, about 35 miles southeast of Los Angeles. The City of Costa Mesa's effective buying income is in our view strong at 120% and 106% of the national average on a median household and per capita basis, respectively.

The district's facilities consist of nine local wells, including two that treat colored groundwater, a colored-water treatment facility, two water reservoirs, and 350 miles of pipeline.

The district's water supply mix consists of:

- Groundwater, including clear water and colored water, that provides a combined 82% of the district's supply at \$249 per acre-foot up to the basin production percentage limit and an additional \$474 per acre-foot pumped in excess of the limit;
- Imported water from MWDOC (12% of supply at a surcharge of \$6.75 per acre-foot plus a readiness-to-serve charge of \$80,400 per year); and
- Recycled water from Orange County Water District, or OCWD (5.7% of supply at a cost not to exceed 80% of area groundwater cost).

The district sometimes supplements the supply with in-lieu water from OCWD, but has not since 2007 and does not project doing so. Total maximum daily production from the district's wells is about 22.8 million gallons, which, according to the district, is sufficient to supply 100% of water demand. The COP proceeds will fund the expansion of the district's colored-water treatment plant. Colored water is found in Orange County's lower aquifer at depths of 600 to 1,200 feet. Its color comes from primarily redwood forests. The district has been pumping water from the lower aquifer since 1985, with a colored-water treatment plant capacity of 6,450 acre-feet annually. Following the expansion of the plant, it will be able to treat 9,670 acre-feet of water per year, roughly half of the district's projected annual water delivery of 18,816 acre-feet. The district projects achieving its goal of water supply reliability and independence in fiscal 2013, when it expects the treatment plant to become fully operational and relieve the district of the need to import water from MWDOC. The district's top 10 customers represent about 7% of total revenues, and are mostly government agencies.

The district's rates are what we consider relatively high among MWDOC's member agencies. The typical monthly bill for a single-family residential user is \$57.50. The bimonthly base rate for a five-eighths-inch residential meter is \$16; the rate per 100 cubic feet for potable water is \$2.70 and for recycled water \$2.43. In December 2009, the district's board adopted a five-year comprehensive rate plan that became effective Jan. 1, 2010. The plan includes adopted rate increases of 5.25% annually for 2010 and 2011 and additional increases of 6% annually in 2012-2014.

In our view, MCWD's financial performance is strong, with debt service coverage of 2.6x based on unaudited fiscal 2010 results. The only senior obligation outstanding is the district's 2009 COPs, with roughly \$13 million outstanding that matures in 2018. Parity obligations include three well loans with OCWD with \$940,610 outstanding. The district has a pension loan with \$658,702 remaining that it plans to repay at the end of this month. Management has kept coverage levels above what we consider to be a strong 1.4x since at least 1997. Pro forma combined senior and subordinate coverage of maximum annual debt service, based on fiscal 2011 projections, is in our view a strong 2.5x. For 2012-2015, management projects combined coverage remaining strong at 2.7x-4.5x, factoring in projected rate increases of 6% annually and lower imported water costs as a result of the expanded colored-water treatment plant.

The district has also maintained what we consider to be very strong liquidity and reserves. Unaudited fiscal 2010 days' cash on hand was in our view strong at roughly 264. Since 2006, the district has maintained at least 164 days' cash. Management projects its cash levels to increase to roughly 703 days by 2015. Supporting the projections are management's adopted strong reserve policies, which include the maintenance of a minimum of \$10 million in capital reserves, 15% of annual general and administrative expenses, 2% of plant and equipment in a catastrophe fund, a minimum of 45 days of budgeted operating expenses in a liquidity and rate stabilization fund, and a minimum of 60 days of budgeted operating expenses in an operating fund.

We understand that the district expects to undertake about \$16.8 million in capital improvements over the next five years using cash on hand. We also understand that the district has no plans for additional debt.

Bond provisions include a rate covenant of 1.15x annual debt service and an additional bonds test of 1.15x the debt service for any 12-month period within the 18 months preceding the board of directors' authorization of the issuance of such bonds, including adjustments to increases or decreases in income, fees, rates, or charges for the water system approved and in effect at the date of the calculation. We understand that there is no reserve requirement.

Outlook

The stable outlook reflects our view of the strength and diversity of the area's local economic base, as well as management's continued efforts to reduce its dependence on expensive imported water. If the district maintains its strong finances and is able to reduce its reliance on imported water, as planned, then we may raise the rating on the subordinate-lien COPs. Although highly unlikely over the near term, if operating performance deteriorates substantially then we may lower the ratings on the bonds.

Related Criteria And Research

- 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

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