Fitch Rates Mesa Water District, CA's Revenue COPs 'AAA'; Outlook Stable

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Fitch Ratings-Austin-18 May 2017: Fitch Ratings has assigned a 'AAA' rating to the following Mesa Consolidated Water District Improvement Corporation, CA (the corporation) obligations issued on behalf of Mesa Water District, CA (formerly known as Mesa Consolidated Water District) (the district):

--Approximately $29.8 million revenue certificates of participation (COPs), series 2017.

The COPs will be sold via negotiation on May 31. A portion of the proceeds (about $13 million) will be used to fund 34% of the district's five-year capital program, with the remainder to refund outstanding series 2010 subordinate lien COPs for savings.

In addition, Fitch has affirmed the ratings on the following outstanding district obligations (pre-refunding):

--$1.9 million revenue COPs, series 2009 at 'AAA';
--$19.7 million revenue COPs, series 2010 at 'AAA'.

The Rating Outlook is Stable.

SECURITY

The COPs are secured by installment payments made by the district to the corporation. The corporation has assigned its right to receive installment payments to the trustee for the benefit of COP holders. Payments from the district are an absolute and unconditional obligation of the district and payable from a pledge of net water system (the system) revenues. The 2010 and 2017 COPs are subordinate in payment to the 2009 COPs.

KEY RATING DRIVERS

STRONG MANAGEMENT AND FINANCIAL PERFORMANCE: Management practices are
sound, as evidenced by the use of long-term financial and capital planning, rate structure, and implementation of a strong financial policy framework. Debt service coverage (DSC) has remained very strong despite the challenges faced by California water utilities during the severe recession and recent drought.

MANAGEABLE DEBT LEVELS: Debt levels are slightly above the ‘AAA’ median and will rise somewhat with the current bond sale. But rapid amortization should reduce debt metrics to below peer credits over the next five years.

AMPLE WATER SUPPLY: The district recently completed a water treatment facility investment that eliminates its reliance on imported water supplies while maintaining a reliable back-up water source. The new facility allows the district to treat a relatively abundant supply of groundwater that is more reliable than imported water and can be produced at more predictable prices.

SOLID SERVICE AREA: The service area is economically strong, stable and diverse.

RATING SENSITIVITIES

LOW RATING TRANSITION RISK: The rating is sensitive to shifts in the Mesa Water District's fundamental credit factors, including specifically erosion of the district's historically strong financial metrics. Fitch believes such shifts are unlikely.

CREDIT PROFILE

With approximately 24,500 connections, Mesa Water District is an independent water district within an 18 square mile area that serves most of the city of Costa Mesa, parts of Newport Beach and unincorporated areas in Orange County, California. As a built-out community in Orange County, the district's 110,000 population and largely residential customer base has been very stable.

SOLID DEBT SERVICE COVERAGE AND RESERVE BUILD-UP

Financial performance is strong, reflecting conservative board-approved financial policies. All-in DSC has been solid and in excess of 3.0x in each of the last five audited fiscal years (2012 to 2016). The five year forecast for fiscal 2018 to 2021 points to similar performance with all-in DSC projected to range from 2.9x to 3.1x. The forecast conservatively assumes continuation of lower per capita usage experienced during the recession and recent drought restrictions.

Unrestricted cash and investments nearly doubled from $22 million, or 391 days cash on hand (DCOH) in fiscal 2012 to $41.7 million, or 707 DCOH at the end of fiscal 2016, well over the board's 600 day target. A key driver for the large reserve target was to provide for future system maintenance, although the district has determined to use a portion to cash fund a significant amount of its net pension liability. Currently, the district plans to deposit $13 million for credit in its CalPERS-administered defined benefit pension plan to increase its funded ratio to approximately 85%. The cash reduction is projected to result DCOH falling to 370 days at the end of fiscal 2017 but gradually rise to 447 DCOH over the five-year forecast even after the
district cash funds 66% of its capital improvement program (CIP).

MANAGEABLE DEBT AND CIP WITH RAPID AMORTIZATION

Debt levels are favorable at $1,010 per customer, although marginally above the 'AAA' median of $863. Debt per customer will rise to around $1,380 following this issuance. However, amortization is very rapid and debt levels are projected to roll back to less than $1,000 debt per customer by year five of the CIP and be below the 'AAA' median. The senior lien 2009 COPs are due to mature on March 15, 2018 at which point the 2017 COPs will become senior lien obligations. All of the district's debt is scheduled to mature in 2027.

The fiscal 2018 to 2022 CIP totals $38.2 million of which $13 million will be funded with the 2017 COP proceeds and the remainder with reserves and pay-go. Notable CIP items include well automation and rehabilitation, pipeline replacements, acquisition of well sites for two new wells, well construction and corresponding pipeline, as well as purchase and installation of new HVAC at the district headquarters.

STRONG SUPPLY POSITION, IMPORT INDEPENDENCE

The district benefits from access to an ample supply of ground water, and it recently completed construction of an advanced treatment facility in fiscal 2013 that essentially eliminates dependence on imported supplies by treating a deeper, abundant amber colored water supply. While the cost of treating amber water is relatively high compared with the district's traditional clear water treatment, the amber water is plentiful and is not subject to the basin equity assessment. Treatment costs are also expected to be lower than imported water costs over time.

SOLID SERVICE AREA

The district benefits from its location in the large and diverse Orange County employment market. Income levels are solid, with the city of Costa Mesa median household income at 125% of the national median. Its unemployment rate at 3.7% in March 2017 was well below the state (5.1%) and national average (4.6%).

The customer base is reasonably diverse, with residential customers accounting for 82% of total connections. The top 10 customers accounted for a moderate 14% of water by volume in 2016. However, concentration concerns are limited as six of the top 10 customers are governmental entities.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

**Applicable Criteria**
- Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
- U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)

**Additional Disclosures**
- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

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