

June 21, 2010

Summary:

Metropolitan Water District of Southern California; Water/Sewer

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Summary:

Metropolitan Water District of Southern California; Water/Sewer

Credit Profile

US\$132.765 mil special var rte wtr rev rfdg bn ds ser 2010A due 06/30/2040

<i>Long Term Rating</i>	AAA/A-1+/Stable	New
Southern California Metro Wtr Dist wtr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA/A-1+' rating to the Metropolitan Water District of Southern California's (MWD) \$132.765 million variable-rate water revenue refunding bonds series 2010A. At the same time, we affirmed our 'AAA' rating on the district's parity debt.

The ratings reflect our view of the district's:

- Scale of operations, as it supplies local and regional water utilities across Southern California and serves a combined population of 20 million;
- Critical service nature, with MWD-delivered water accounting for about half of the total water consumed in the region;
- Well-developed and one-of-a-kind infrastructure that connects MWD's arid service area to the California Aqueduct and conveys water from Northern California and from the Colorado River;
- Good storage supply as well as the ability to curtail water deliveries in drought situations, when less water is available from either major supply source;
- Consistently very strong financial position, including \$917.9 million in cash and investments as of April 30, 2010, with a three-year average balance of \$963.2 million and an Oct. 31, 2008, low point of \$679.1 million;
- Rate-raising flexibility, as demonstrated by regular historical increases and planned increases of 7.5% in January of 2011 and 2012;
- Good debt service coverage, at 1.54x, in 2010, supported by strong customer demand as well as a diverse mix of revenues, some of which are fixed and independent of water usage and are intended to cover MWD's fixed costs regardless of hydrology or customer demand.

The bonds are secured by net revenue of MWD's water enterprise. The bonds are on parity with \$4.6 billion in debt; we understand that the 2010A bonds will refund the series 2004C bonds.

The 2010A bonds are variable-rate, will be issued in a weekly interest rate mode, and are subject to tender provisions. To mitigate liquidity risk associated with tenders, MWD has designated these bonds "self-liquidity" bonds and has committed in the paying agent agreement to pay the purchase price of all series 2010A bonds that are tendered. As of April 30, 2010, MWD has identified \$917.8 million in fixed-income assets held in its core and managers portfolio. We understand that an additional \$250 million in variable-rate demand obligations (VRDOs) will be issued in July 2010, and that these assets, along with a dedicated line of credit with Wells Fargo in the

amount of \$400 million, are meant to guarantee the full and timely purchase price of the \$380 million weekly-mode VRDOs, in two separate series of \$130 million and \$250 million.

MWD is the primary wholesaler of water to 26 member agencies serving more than 19 million customers in Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura counties in Southern California; the district provides 40%-60% of the water within its service area, depending on weather conditions. MWD receives its water from two sources: the Colorado River and state water project water from Northern California. The assessed value of the service area subject to the district's ad valorem tax levy is \$2.08 trillion.

MWD recently implemented a 10% reduction in water available to customers due to drought. According to MWD, this is meant to preserve minimum water storage as well as encourage conservation and local resource development. In addition, the district implemented a 19.7% rate increase in September and has a 7.5% increase set for January 2011 and 2012. With the full effect of these rate increases, the district projects DSC to return to 2.2x in 2012 from a low of 1.5x during fiscal 2010.

MWD has made progress in the past decade in building storage capacity through projects such as Diamond Valley Lake. This has so far mitigated the impact of severe drought. Challenges to the district's main source of supply include drought and court decisions to protect fish in Northern California; these have reduced MWD's preliminary allocation of Northern California water to 35% of its maximum. In addition, rising demand in Nevada and Arizona and drought in the Colorado River Basin have curtailed the amount of water available to the district from the river.

According to the district, the practical consequence of these supply challenges in the near term will be a combination of rate increases and draws on water storage. We believe that rate increases should aid financial margins that are the lowest in a decade. In the long term, MWD is evaluating options to avoid harming fish, such as new infrastructure that would bypass the affected. A vote on a massive \$11 billion statewide bond measure is scheduled in 2010, and, according to the district, could enhance water conveyance infrastructure and might alleviate the district's capital spending.

MWD's vital position as a major supplier of Southern California's water gives it, in our view, very high rate-setting flexibility, despite costing more than the limited amount of local water. It has completed several major water storage projects in recent years, giving it 3.7 million acre-feet of total storage capacity, not counting 1.2 million acre-feet of state water project storage capacity.

MWD's board policy is to maintain strong 2x annual DSC by net revenues and 1.2x fixed-charge coverage. Annual DSC by net cash revenues was what we view as a strong 1.76x in fiscal 2008, 1.8x in 2009, and 1.5x in 2010, although down from 2.2x in 2007. The district projects senior bond DSC will return to 2x in fiscal 2012 due to rate increases. MWD purchases substantial water during wet years (when water sales typically decrease) to store for dry years, causing a slight decline in annual net revenues when conditions are wet. Conversely, net revenues improve when the district sells banked water to member agencies during drought.

MWD's cash reserve levels remained in our view exceptionally strong. At fiscal year-end 2008, MWD held a large \$286.1 million in reserves in its combined rate stabilization and working capital fund; in 2009, this was \$322 million.

Outlook

The stable outlook reflects our expectation of continued strong debt service coverage (DSC) and prudent management by MWD's staff and board. In our view, Southern California's dependence on MWD for water is likely to grow. The outlook also reflects our expectation that MWD will meet the challenges and large capital costs associated with finding additional water supply sources. We believe that MWD's ability to supply needed water is critical to the health of the Southern California economy, creating a large political incentive to meet future water demand. Dips in annual DSC to less than MWD's target coverage of 2x due to weather-related demand fluctuations should not affect the rating, especially because in our view MWD has prudently built up a large rate stabilization reserve. However, the rating reflects our opinion that MWD will be able to find new sources of affordable water to meet long-term rising demand while maintaining its very strong financial position.

Related Criteria And Research

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept.15, 2008
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007

Ratings Detail (As Of June 21, 2010)

Southern California Metro Wtr Dist var rate rev bnds ser 2000 B-1 dtd 09/20/2000 due 07/01/2035		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist var rate rev bnds ser 2000 B-3 dtd 09/20/2000 due 07/01/2035		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist var rate rev bnds ser 2000 B-4		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist var rate wtr 2001C-1 C2		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist wtr		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds (2008 Authorization) due 07/01/2024		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds 2003 authorization ser B-3 due 10/01/2005-2015 2017-2019 2021-2029 ser B-4 due 2031		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds 2005 authorization (weekly mode) ser B-1		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds 2005 authorization (weekly mode) ser B-2 dtd 07/28/2005 due 07/01/2028		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds ser 2004C dtd 11/16/2004 due 10/01/2029		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds ser 2008A-1 due 07/01/2037		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed

Ratings Detail (As Of June 21, 2010) (cont.)

Southern California Metro Wtr Dist wtr rev rfdg bnds 2004 dtd 02/19/2004 ser 2004 A-1&2 due 07/01/2023		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist wtr (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr (FGIC) (SEC MKT)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr (MBIA) (National)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist VRDB ser 2000 B-2		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist Wtr (AGM)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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