

RatingsDirect®

Summary:

Metropolitan Water District of Southern California; Water/Sewer

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Credit Profile

US\$96.975 mil wtr rev rfdg bnnds ser 2021B due 10/01/2036

Long Term Rating

AAA/Stable

New

Rating Action

S&P Global Ratings assigned its 'AAA' rating to Metropolitan Water District of Southern California's anticipated \$97 million 2021 series B water revenue refunding bonds. The outlook is stable.

The 2021 series B bonds are being issued to refund all or a portion of the district's outstanding series 2011C, 2014C-3, and 2017B bonds for interest rate savings. The bonds will be on parity with \$2.6 billion of outstanding obligations and senior to \$1.4 billion of subordinate obligations.

We consider the bond provisions to be credit neutral. Key bond provisions include a rate covenant set at 1.2x for the parity lien bonds and 1.0x for the subordinate-lien bonds. There will not be a debt service reserve fund for the 2021 series B bonds.

Credit overview

The district serves an important role as the primary wholesale water provider to an extremely robust and diverse service territory in Southern California. Our ratings are supported by MWD's ability to draw water supplies from the Colorado River, the State Water Project (SWP), stored water, and supplemental water transfers to keep supplies and regional demands in balance, even under adverse water supply conditions. In particular, we consider MWD's comprehensive resource planning and its well-defined risk management practices and financial policies to be the cornerstone to its credit quality. Although the Feather River watershed (one of the district's primary sources of supply) is on track for its second-driest year on record, we do not expect current year hydrology to adversely influence the district's ability to meet its members' needs.

The district maintains an internal funding target of approximately 55% to 60% of capital expenditures from current revenues, which we also consider credit supportive. MWD's board policy is to maintain 2.0x annual senior-lien debt service coverage by net operating revenue, which we view to be credit supportive, and 1.2x fixed-charge coverage (across both the senior and subordinate liens), which we view as good, especially for a wholesaler.

Environmental, social, and governance factors

Given its location in Southern California, we believe MWD faces elevated environmental risk due to the region's inherent water supply scarcity and seismic exposure. In particular, its imported water supply--both the SWP and the Colorado River--remains susceptible to environmental scrutiny and risks related to climate change, rising

temperatures, and shifting precipitation patterns. Notably, the district currently maintains record dry-year and emergency storage balances (3.9 million acre-feet, or over two years of demand, as of Jan. 1, 2021) which we consider a stabilizing credit factor over the near term.

We expect MWD will continue to play a key role regarding Delta water conveyance and resource management in the Colorado River basin over the next decade. Moreover, management will face many other critical water supply decisions, which could require massive capital investments, such as whether to proceed with its Regional Recycled Water Project, which, while costly, would be favorable from a water supply management and environmental stewardship perspective, in our view.

The district's board recently announced the appointment of a new general manager. Given the complexities of the organization, having a leader with commensurate skill and experience in the water industry will be important to ongoing credit quality. While not currently a credit risk, persistent negative public sentiment or heightened discord among the 26 member agencies would adversely affect our view of its governance practices.

The district is sensitive to affordability pressure, given that retail water rates in its service area may not be affordable for all customers served (particularly those living in census tracts below 80% of median household income, which we estimate accounts for about 50% of the population). MWD oversees targeted programs for increasing water conservation in disadvantaged communities, such as by providing incentives for multifamily housing and grant funding support for the local agencies.

Stable Outlook

Downside scenario

The current stable outlook reflects our belief that the district has significant financial capability to withstand any revenue effects from either the pandemic or current drought. While unexpected, we could lower the ratings, revise the outlook to negative, or both, if MWD's water sales decline on a protracted basis from current levels--due to the development of significantly lower cost water supply alternatives or the loss of a major member--although we believe neither is likely to occur over the two-year outlook period.

For more information on the district, please see our report published May 12, 2021, on RatingsDirect.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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