

RatingsDirect®

Summary:

California Statewide Communities Development Authority St Helena; Water/Sewer

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Credit Profile

California Statewide Communities Dev Auth, California

St Helena, California

California Statewide Comntys Dev Auth (St Helena) wtr & wastewtr (AGM)

Unenhanced Rating

A-(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services affirmed its 'A-' rating on the California Statewide Communities Development Authority's (CSCDA) water and wastewater revenue bonds, issued on behalf of the city of St. Helena. The outlook is stable.

The ratings reflect our assessment of the following factors:

- Robust service area economy in the Napa Valley that is tied to wine production and tourism;
- Primarily residential customer base with very strong income indicators;
- Sound financial performance between fiscals 2012 and 2014, and healthy liquidity position as of June 30, 2014, with over a year's of cash on hand held in the water and sewer funds, respectively.

The above credit strengths are partially offset, by our view of:

- Uncertainty regarding the near-term financial impact of reduced water consumption as a result of the statewide drought and conservation;+
- Management's lack of long-term financial planning and limited disclosure, although we understand that a rate study is expected to be completed in late 2016;
- Additional capital needs, and implementation of proposed wastewater effluent discharge requirements.

The bonds are backed by installment payments made by the city to CSCDA under two separate installment purchase agreements. A pledge of the city's water system net revenues secures installment payments under one agreement, and a pledge of the city's wastewater system net revenues secures the installment payments under the other. The rating on the bonds is based on the weaker of the two systems. While the water system has relatively higher leverage and lower debt service coverage (DSC) than the sewer system, we view the potential costs associated with the proposed National Pollutant Discharge Elimination System (NPDES) wastewater permit as a risk, and on balance believe the credit quality of the two systems is the same.

St. Helena (population: 5,906) is located in Napa Valley, 45 miles north of San Francisco and home to more than 250

wineries and restaurants. While the economy is concentrated in wine- and tourism-related industries, income levels are very strong, in our view, with median household and per capita effective buying incomes at 131% and 157% of the national levels, respectively in 2014. Historically Napa County's unemployment rate has been below the state and national average; as of July 2015, the county's unemployment rate was 4.4%, lower than both the state's 6.5% rate and nation's 5.6% rate.

Both systems' customer base is small, but primarily residential, and very diverse. The water system provides service to about 8,100 residents in a roughly 9-square-mile area--approximately 5 square miles within the city and 4 square miles of unincorporated county areas. The wastewater system's service area is smaller than the water system's, and covers just 3.3 square miles within the city. Management indicates that the service area is largely built out, and the number of water accounts increased modestly from 2,518 in 2012 to 2,561 in 2014.

Growth in wastewater accounts during the period was comparable, increasing from 1,698 to 1,728, respectively. Residential users make up most of the system accounts (85% for water, 84% for wastewater) and contribute the majority of revenues (57% for water, 62% for wastewater) in fiscal 2014. In fiscal 2014, the top five water customers account for 2.58% of the total water system revenues and the top five sewer customers account for 1.73% of the total sewer system revenues.

Water supply in our view is adequate to meet system demand. The water system's primary source of supply is the 2,400 acre-foot reservoir at Bell Canyon, which is owned by the city. In an average year, approximately 1,000 acre-feet of water is treated and distributed from this source. In addition, the city is able to pump groundwater from two wells; however, management limits the amount of groundwater that is pumped to preserve groundwater for the deep-root systems of the area vineyards. The city has also entered into an agreement with the city of Napa, under which the city is required to purchase 600 acre-feet of water annually during the term of the agreement that expires in 2035.

Average daily water consumption increased from 1.369 million gallons per day (mgd) in fiscal 2013 to 1.577 mgd in fiscal 2014. We understand that the city is not subject to the state's mandatory conservation mandates due its size, however, the city has asked its customers to voluntary target a 25% reduction in consumption, which could have an impact on fiscal 2016 finances. Moreover, based on preliminary cash flows provided by management, customer receipts in fiscal 2015 (unaudited) were 16% lower than in fiscal 2014.

Wastewater treatment capacity is sufficient for current flows. The wastewater system's designed average dry weather flow (ADWF) capacity is 0.5 mgd and the plant can treat up to 2.8 mgd during wet weather, the ADWF in fiscal year 2014 was 0.403 mgd or 81%, of capacity. However, the plant's NPDES permit expired in October 2015, and the replacement permit is expected to be granted early next year. In re-issuing the 2016 NPDES Permit, the Regional Water Board found that requiring the discharger to build an outfall to non-tidal waters (more than 40 miles away) or to not discharge under any circumstances, including wet weather, would impose an undue burden. In granting the exception, we understand that the discharger must provide equivalent protection when discharging to the Napa River by providing advanced secondary treatment by 2021, which could include more stringent biochemical oxygen demand and total suspended solids effluent limitations. While management indicates that they may be able to meet the permit terms through additional inflow and infiltration mitigation and operational changes, the capital costs, in our view, will not be known until a feasibility report is completed later this year.

Financial performance of each system has generally been strong, with significant improvement since fiscal 2010, when the water system's DSC was an extremely thin negative 0.23x. The water system posted healthy 2.15x DSC in fiscal 2012, and adequate 1.79x DSC in 2014. The sewer system's DSC has also been strong, but declined from a very strong 5.57x to a good 3.20x in 2014. Nonetheless, we consider the city's financial disclosure to be a weakness, as the city was unable to provide unaudited financial statements for fiscal 2015, almost six months after the close of the fiscal year. We also note that the city does not produce multi-year financial projections for either system. As is characteristic of smaller utilities with a somewhat narrow customer base over which to spread its fixed costs, we believe that a minor escalation in expenses could have a disproportionate impact on either system's future DSC.

Meanwhile, we view each system's liquidity to be a key credit strength. At the end of fiscal 2014, the water system had unrestricted cash of \$6.4 million or 745 days' operating expenses, which we consider strong. At the end of fiscal 2014, the sewer system had \$1.7 million or 461 days' operating expenses. While we believe the nominal amount of cash available to each system could decline slightly during the two-year outlook period, due to the effects of the drought, a material decline in cash reserves to fund operations or capital expenditures would pressure the rating.

The city's combined water and sewer rates, at \$151.10 per month, we consider high, at 3.2% of median household income. Following the completion of a rate study in 2011, a multi-year rate increase was approved by council, and both water and wastewater rates were increased 2.8% in January 2013, and 2.5% in January 2014 and 2.6% in January 2015. Additional rate increases, in our view, will be necessary to fund both system's capital expenditures and in the case of the water system, to potentially offset the impact of conservation. The water system's capital improvement plan (CIP) is moderately large in our opinion, and totals about \$9.4 million through fiscal 2020. The largest project is the \$6.2 million York Creek Upper Dam removal project, with \$2.9 million of the project's cost being funded with the remaining series 2012 bond proceeds, \$1.7 million through a grant, but the remainder has not been identified. While the wastewater system CIP is currently projected to total a relatively moderate \$2 million through 2020, we believe that this amount is subject to change upon board approval of the NPDES permit and completion of the associated feasibility study.

Although the city was unable to provide financial forecasts for the outlook period, we understand that the city has a rate study planned to begin in early 2016, which, when implemented, could result in an improvement in DSC and system revenues. We expect rate increases would go into effect on July 16, 2016 for the five-year study period (fiscals 2017-2022).

Outlook

The stable outlook reflects our expectation that city council will adopt sufficient rate increases to follow fluctuations in demand and rising capital expenditures, such that each utility maintains DSC metrics in line with historic trends.

Upside scenario

Should each system's overall liquidity position improve considerably, while maintaining good-to-strong DSC, we could raise the rating.

Downside scenario

If the city fails to continue raising rates and does not take other measures to maintain comparable metrics to historical financial performance while supporting its CIP needs, resulting in a material decline in DSC or liquidity for either system, we could lower the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Water And Sewer Ratings, June 25, 2007
- 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
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

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