FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms San Elijo Joint Powers Authority, CA's Revs at 'AA'; Outlook Stable

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Fitch Ratings - Austin - 11 Jun 2020: Fitch Ratings has affirmed the 'AA' rating on the following San Elijo Joint Powers Authority, California (the JPA, or the authority) bonds:

--$235,000 refunding revenue bonds (San Elijo Water Reclamation Facility), series 2011.

In addition Fitch assigned an Issuer Default Rating (IDR) of 'AA' to the JPA.

The Rating Outlook is Stable

ANALYTICAL CONCLUSION

The 'AA' IDR and issue rating reflect the strong revenue defensibility and operating risks key rating driver assessments of 'aa' and 'a', respectively. The JPA has very strong revenue defensibility given its independent ability to adjust rates and charges and unconditional purchaser contracts, although it is not able to reallocate costs in the event of non-payment by one of its members (Solana Beach, CA and Encinitas, CA - Cardiff Sanitary Division). Revenue defensibility also includes an assessment of the purchaser credit quality (PCQ) of the two purchasers of '1'. Because of the JPA's inability to reallocate debt service costs, the financial profile assessment was considered less material in the analysis. Instead, the PCQ assessment, supplemented by the operating risks assessment, was considered more relevant in the final rating. Fitch notes that the credit quality of the two members is supportive of the rating.

Coronavirus Considerations

As a result on the outbreak of coronavirus and related government shut-downs, the JPA has temporarily halted progress of construction projects on its wastewater treatment plant and will be discussing with its contractor about moving forward with smaller segments of the project. One segment is expected to be built in the summer and another segment to be completed at a later time. The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for the Water and Sewer sector. While the JPA's performance data through most recently available data has not have indicated impairment, material changes in revenue and cost profile are occurring across the sector. Fitch's ratings are forward-looking in nature. Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks as appropriate.

CREDIT PROFILE

The JPA, established in 1963, provides residential and non-residential wastewater treatment services to a population of around 40,000 residents. The treatment facility is owned and operated by the JPA, which acts as a wholesale provider of wastewater treatment to the member cities of Solana Beach and Encinitas while the members maintain responsibility for their respective wastewater collection infrastructure. Based on the loan agreements related to the series 2011 bonds, 52% of the debt will be paid by Solana Beach and 48% will be paid by Encinitas.

Located in northwest San Diego County, the JPA's service area encompasses around 19 square miles. The members' primarily residential beach communities are characterized by their desirable location, high wealth levels with high-end housing and slow growth. The JPA is governed by a four-member board of directors, with two members representing Solana Beach and two representing Encinitas. A general manager oversees operations of the JPA and reports to the board of directors.

There is no step-up provision between the members on the JPA bonds, although there is a common debt service reserve pledged to the JPA bonds that may be used in the event one or both members fail to make their payments when due. Neither member has ever failed to make timely payments of their respective obligations to the JPA. Each member has agreed under their respective loan agreements to set rates and charges at no less than 1.3x annual debt service (ADS) on their portion of JPA's bonds, parity debt and any amount required to replenish the debt service reserve on the JPA's bonds, if needed. Under the loan agreements, the members may issue additional bonds on parity with the JPA loan, provided net revenues of the respective system equal at least 1.3x ADS based on a test that includes rates and charges in effect for part of the year or from expected increased revenues resulting from construction with bond proceeds. No senior debt is permitted, and no additional debt is planned by member cities at this time. The 1.3x ADS is more conservative than typically seen but this is offset by the inclusion of projected revenues.

Consistent with its role as a joint action agency with pass-through operations, the JPA has limited financial cushion with typically minimal coverage of all debt service, although liquidity has been strong at over 500 days cash on hand since fiscal 2015.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Purchaser Credit Quality

Rates are independently set by the board and charges are allocated to members based on their proportionate ownership interest in the JPA facility. Members demonstrate consistent fiscal performance, strong revenue defensibility and low operating cost burdens. The predominantly residential service area is relatively small, but is stable and includes high wealth levels.

Operating Risks 'a'

Low Operating Cost Burden; Continued Capital Investment

The operational cost burden, measuring total costs relative to wastewater flows, of the facility is low. Capital investment the last several years has led to a reduction in the lifecycle ratio.

Financial Profile 'aa'

Increasing Leverage Due to Capital Investment

System debt levels have increased as the JPA partially debt financed its master plan to rehabilitate its wastewater treatment plant. Liquidity cushion is neutral reflecting strong cash balances.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--An upgrade in the purchaser credit quality of one or more of the JPA's customers.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade in the purchaser credit quality of one or more the of the JPA's customers.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The bonds are payable from loan installments made by the JPA's members (i.e. the cities of Solana Beach and Encinitas) to the trustee. Each member's obligation to pay installment payments is a first and prior lien on and pledge of net revenues of the members' respective wastewater enterprises; Encinitas' installment payments are derived solely from the city's Cardiff Sanitary Division. Based on the 2011 loan agreements, roughly 52% of the debt is to be paid by Solana Beach and 48% is to be paid by Encinitas. The 2017 loan agreement was updated and that debt is repaid 50% Solana Beach and 50% Encinitas Cardiff Sanitary Division.

REVENUE DEFENSIBILITY

The revenue defensibility is assessed at 'aa' due to the underlying purchaser credit quality (PCQ) and the support of the contracts between the JPA and its member cities, who are obligated to make specified payments to the JPA. The JPA has the independent legal ability to increase rates without outside approval. It is governed by a three member board appointed by each of the member agencies to serve a fouryear term. The PCQ is driven by strong credit quality of Solana Beach, CA and Encinitas, CA - Cardiff Sanitary Division.

OPERATING RISKS

The JPA's 'a' operating risk assessment takes into consideration a midrange operating cost burden with low life-cycle investment needs. The system's operating burden has become more elevated in the last two years, pushing the assessment from very low cost burden to low cost burden. JPA expenses are growing due to new regulations, safety and odor control measures. Also influencing the increased operating cost burden are increased pension expenses related to the JPA's participation in CalPERS. CalPERS is phasing in a 7% discount rates, which results in growing net pension liability and higher pension costs and the discount rate decreases.

Overall the JPA's system has moderate life cycle investment needs as evidenced by the 40% life-cycle ratio and strong annual capital investment well above depreciation. The system's life cycle ratio has trended down as it continues to progress through its master plan to rehabilitate the wastewater treatment plant.

FINANCIAL PROFILE

The financial profile holds less relevance as the PCQ drives the credit rating, as supplemented by the operating risks assessment. The JPA's net adjusted debt to adjusted funds available for debt service ratio (net leverage) has seen a steady rise since 2016. Coverage of full obligations (COFO) registered less than 1x in fiscal 2019, but this weaker COFO is offset by the JPA's very strong cash position of over 1,700 days cash on hand. The low COFO reflects the decrease in funds available for debt service (FADS) due to reduced contributions from members. The prior year's FADS were significantly higher than typical years due to higher charges to member as the series 2017 bonds rolled on the JPA's financial statements and higher contributions to support the JPA's capital improvements.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

SOURCES OF INFORMATION

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
San Elijo Joint Powers Authority (CA) [Water, Sewer]	LT IDR	AA Rating Outlook Stable	New Rating
• San Elijo Joint Powers Authority (CA) /Sewer Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Teri Wenck, CPA
Director
Primary Rating Analyst
+1 512 215 3742
Fitch Ratings, Inc. 111 Congress Avenue Suite 2010 Austin 78701

Victor Valdez
Analyst
Secondary Rating Analyst
+1 512 813 5650

Douglas Scott
Managing Director
Committee Chairperson
+1 512 215 3725

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub. 03 Apr 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

San Elijo Joint Powers Authority (CA)	EU Endorsed

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