

FITCH AFFIRMS SAN ELIJO JOINT POWERS AUTHORITY, CA'S REVS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-09 October 2013: Fitch Ratings affirms its 'AA' rating on the following San Elijo Joint Powers Authority, California (the JPA) bonds:

--\$9.2 million refunding revenue bonds (San Elijo Water Reclamation Facility), series 2011.

The Rating Outlook is Stable.

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 secured by 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 loan agreements, roughly 52% of the debt is to be paid by Solana Beach and 48% is to be paid by Encinitas. The bonds are also secured by a debt service reserve fund, which is satisfied with a surety policy.

KEY RATING DRIVERS

SEJPA Rating Tied To Members: The rating on the authority's bonds is linked to the credit quality of the contributing members - the sanitation enterprise fund of the City of Solana Beach (Solana Beach) and the Cardiff Sanitation Division of the City of Encinitas (Encinitas). Given each member is only required to pay its proportional share of SEJPA debt service, a weak link approach is used to determine JPA's credit rating. Fitch views the credit quality of Solana Beach, which has weaker coverage levels and a higher debt burden than Encinitas, as the primary driver of JPA's rating.

Strong Financial Results of Members: Financial operations are solid and both members have demonstrated consistent fiscal performance in recent years, characterized by stable debt service coverage (DSC) and robust liquidity.

Essential Service: The authority provides an essential service, with all wastewater flows from member service areas diverted to the JPA's facilities.

Limited Capital Pressures: Capital needs for both the JPA as well as the participants is manageable and are expected to be cash-funded. This will alleviate any pressure to the member debt profiles, which is low in Encinitas' case but somewhat high for Solana Beach.

Reasonable Rates: Member user charges are moderate and should remain within Fitch's affordability benchmark.

Limited But Favorable Service Territory: The predominantly residential service area is relatively small but is stable and characterized by high wealth levels.

RATING SENSITIVITIES

Change in Financial Profiles: Changes in the credit quality of Solana Beach or Encinitas would affect the rating. The Stable Outlook reflects Fitch's belief that this is unlikely.

CREDIT PROFILE

The JPA, initially organized in 1963 and formally established in 1987, provides residential and

non-residential wastewater treatment services to a population of around 34,000 residents. The treatment facility is owned and operated by the JPA, which acts as a wholesale provider of wastewater treatment to the cities of Solana Beach and Encinitas (the members) while the members maintain responsibility for their respective wastewater collection infrastructure. Based on the loan agreements, 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.

AGREEMENT WITH MEMBER CITIES

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. Management is tenured and well-qualified.

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 1.3 times (x) 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.

No additional JPA bonds are permitted under the trust indenture. 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 historical test. Revenues under the test may be increased by increases to rates and charges in effect for part of the year or from increased revenues resulting from construction with bond proceeds. No senior debt is permitted.

Consistent with its role as a joint action agency, the JPA has limited financial cushion with typically minimal coverage of all debt service, although liquidity has been strong at over 200 days cash on hand. Consequently, the rating reflects the credit quality of the members and their financial performance as well as the essentiality of the service provided by the JPA.

AFFORDABLE RATES, STRONG COLLECTION PROVISIONS

Solana Beach and Encinitas both have raised rates in recent years, enhancing the financial performance of their respective utilities. Member wastewater charges are billed and collected by the county along with property taxes, minimizing the delinquency rates. Wastewater service rates are relatively reasonable, providing the members sufficient ongoing rate affordability if needed.

AMPLE TREATMENT CAPACITY

The JPA treatment facility's capacity totals 5.25 million gallons per day (mgd), well in excess of the 3.0 mgd average daily flows. This excess capacity is projected to exceed demand at build-out of the members, which is projected by 2030. No major capital needs are anticipated for the treatment facility and the capital improvement programs (CIP) for each member appear manageable. No additional debt currently is expected to be needed to fund the JPA's or the members' CIPs.

ROBUST LIQUIDITY, STABLE COVERAGE FROM SOLANA BEACH

Solana Beach produced solid ADS coverage of 1.8x on an all-in basis for fiscal 2012, while reporting senior lien coverage (Solana Beach's portion of the JPA's debt) of over 2.2x since fiscal 2006. Liquidity for Solana Beach was very strong at over 1,000 days cash on hand for fiscal 2012. Solana Beach's fiscal 2011 performance was weaker with debt service coverage registering at 1.3x. The city has increased rates by 2.5% for fiscal 2013 and 2014, which should keep coverage levels in line with historical norms. Solana Beach's debt ratios are high, but trending downward. Debt per capita is 2.5x the 'AA' median but should align more closely to 'AA' medians in 5 years based on

the city's above average rate of principal amortization.

ENCINITAS FINANCIAL METRICS EXCEPTIONAL

Encinitas financial results have remained excellent through the last five years. All in coverage has averaged 4.0x and liquidity is very robust at over 2,000 days of cash on hand. Fiscal 2012 saw a decline in coverage to a still very strong 3.1x. Encinitas has no other debt outstanding except that of the JPA, resulting in a low debt burden of \$309 per capita.

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

Applicable Criteria and Related Research:

- 'Revenue-Supported Rating Criteria' (June 2013);
- 'U.S. Water and Sewer Revenue Bond Rating Criteria' (July 2013);
- '2013 Water and Sewer Medians' (December 2012);
- '2013 Sector Outlook: Water and Sewer' (December 2012).

Applicable Criteria and Related Research:

Revenue-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=709499

U.S. Water and Sewer Revenue Bond Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715275

2013 Water and Sewer Medians

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695756

2013 Outlook: Water and Sewer Sector

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695755

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