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Ratings

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San Elijo Joint Powers Authority, California; Water/Sewer

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Credit Profile		
US$22.645 mil 2017 rev bnds (Clean Wtr Proj) ser 2017 due 03/01/2047		
Long Term Rating	AA+/Stable	New
San Elijo Jt Pwr Auth		
Long Term Rating	AA+/Stable	Upgraded
San Elijo Jt Pwr Auth 2003 rfdg rev bnds (San Elijo Wastewtr Treatment Facs) dtd 04/29/2003 due 03/01/2004-2020		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) on the San Elijo Joint Powers Authority (SEJPA), Calif.'s series 2011 refunding revenue bonds to 'AA+' from 'AA'. At the same time, we assigned our 'AA+' long-term rating to the authority's series 2017 revenue bonds. The outlook is stable.

We raised the ratings based our view of the SEJPA's consistent financial performance and an improvement in the credit quality of Solana Beach, one of the member participants. (For more information, please see the summary analysis on the Solana Beach Public Finance Authority, published May 25, 2017, on RatingsDirect.)

Solana Beach and the Cardiff Sanitary Division (Encinitas), which each own half of the San Elijo wastewater treatment facility, have extremely strong enterprise risk profiles and very strong financial risk profiles, in our view. The rating is based on a weak-link structure; however, we view the credit characteristics of both member participants as comparable.

Additional factors in support of the raised ratings include our view of:

- An economic base with strong underlying fundamentals, including very strong income indicators;
- Ample wastewater treatment capacity;
- Improved economies of scale due to expansion of wastewater treatment services and reclaimed water sales to neighboring beach communities;
- Both members' historical maintenance of very strong financial metrics, characterized by very strong all-in debt service coverage (DSC) and liquidity, which we anticipate will remain very strong during the five-year forecast period; and
- Good financial management, as demonstrated by the maintenance of unrestricted cash equal to 133% of one year of the SEJPA's operating expenses.

The 2017 revenue bonds are issued for funding facilities and improvements as part of the authority's capital improvement plan (CIP). Solana Beach and Encinitas have each entered into separate loan agreements to finance their respective shares of the SEJPA's outstanding debt. Each city has pledged net system revenues (defined as gross revenues less operation and maintenance [O&M] expenses) from their respective wastewater collection systems. We view the loan provisions as credit neutral, with a rate covenant equal to 1.3x annual loan installment payments and annual debt service on all parity bonds. However, neither city is responsible for the other agency's installment nor is obligated to make up any deficiencies for the other. While the authority has chosen not to establish a debt service reserve fund for the series 2017 bonds, its strong liquidity mitigates any credit concern.

The members are primarily residential beach communities about 20 miles north of San Diego and are characterized by their desirable location and high wealth levels. Both communities are largely built out. The service area population in Solana Beach is about 13,000 and in Cardiff Sanitary Division it is about 26,000. We understand that residents can commute throughout the San Diego metropolitan statistical area (MSA) for employment opportunities. We view the customer base's income levels as very strong, based on the median household effective buying incomes (MHHEBIs) of about 158% of the national median in Solana Beach, and 160% of the national median in Encinitas. The unemployment rate in Solana Beach was 3.5% in April 2017, and in Encinitas it was 3%, lower than the state's and the nation's rates.

Based on our calculations, the Cardiff Sanitation Division of the city of Encinitas posted extremely strong all-in DSC of its loan payments to SEJPA of 3.3x in fiscal 2016. The division maintained all-in DSC of no less than 2x in the past five fiscal years. It also maintains unrestricted cash balances of $13.5 million, exceeding five years of its operating expenses at fiscal year-end 2016. Including Solana Beach's direct sanitation system debt and loan payments to the SEJPA, Solana Beach posted an all-in DSC of 2.1x in fiscal 2016, and no less than 1.8x in the past four years. The city has also historically maintained a very strong liquidity position, in our view, with unrestricted cash of $11.8 million as of June 30, 2016, or about 4.9 years of its operating expenses. The authority has generally maintained coverage at near sufficiency levels when including member capital contributions.

The SEJPA wastewater treatment facility treats sewage from Solana Beach and the Cardiff Sanitation Division, which is either processed and discharged into the ocean or recycled and sold as recycled water for landscape irrigation, which is of increasing importance in San Diego due to preceding drought conditions. The wastewater treatment facility's design capacity is 5.25 million gallons per day (mgd), with a three-year average daily flow of about 2.5 mgd. With no substantial development expected in the combined service area, the plant's capacity is sufficient to meet demand, though the SEJPA recently reached an agreement to expand wastewater treatment services to the city of Del Mar, through the use of idle treatment capacity, which is expected to begin in July 2017. We understand that the annual net benefit will be about $600,000. O&M expenses at the facility are allocated on the basis of percentage of use, as indicated by measured flows.

The SEJPA provides recycled water to the Santa Fe Irrigation District, the San Dieguito Water District, Del Mar, and Olivenhain Municipal Water District, none of which have financial participation with respect to the wastewater treatment facility bonds or loan agreements of the authority. Although recycled water sales are booked at the SEJPA separately from sanitation revenues, management indicates that recycled water sales from the wastewater treatment facility are expected to grow from 1,500 acre feet (AF) in fiscal 2016 to 1,700 AF over the next four years. In addition, management notes that recycled water pricing is expected to increase at approximately 4% annually, which provides for additional sources of operating income, in our view.

The SEJPA maintains separate capital plans for the wastewater treatment program and the recycled water program. The authority's current CIP is an extension of its 2015 facility plan, which indicated an aggregate project cost of approximately $36.9 million and is expected to be mostly funded from the 2017 bond proceeds, while the balance will be funded from proceeds of grants and member capital contributions. The CIP focuses on preliminary treatment upgrades, building improvements, land outfall replacement projects, and other system improvements. Our assessment of the SEJPA's financial projections is that the CIP will have a modest effect on the members, as this 2017 debt issuance has been structured around the amortization of the 2011 refunding bonds, which will largely be retired by fiscal 2020. The member systems have each pre-approved rate adjustments to their own costs of service to align with the agency's rate plans.

The authority's liquidity position is very strong, in our view. As of June 30, 2016, overall unrestricted cash and investments totaled about $6.9 million, representing about 486 days of operating expenses on hand. Excluding the reclamation portion that is not pledged, liquidity levels have been no less than one year of operating expenses in the past four fiscal years. Based on the authority's expectations for cash-funded capital projects, we anticipate the very strong cash levels will be sustained in the near term.

Outlook

The stable outlook reflects our view of the SEJPA's stable operations and very strong liquidity position. During the two-year outlook period, we anticipate that the authority and its members will continue to raise rates to fund the wastewater CIP in line with management's current forecasts. The outlook also reflects our anticipation that each of the member systems will produce very strong financial metrics due to their pre-approved rate plans, while the economic stability of the customer base will further reinforce the SEJPA's credit quality.

Upside scenario

We do not anticipate taking a positive rating action during the two-year outlook period. In the longer term, we could consider raising the rating on the SEJPA to the extent that we raise the ratings on its members.

Downside scenario

If any member's credit profile were to significantly decline such that we believe that it would have a substantial effect on the credit profile of the authority, or if the authority's cash positon were to erode materially, we may lower the ratings.

Strong Member Credit Quality

Cardiff Sanitation Division of the city of Encinitas

The service area of the Cardiff Sanitary Division encompasses approximately 12 square miles or around 57% of city of Encinitas and provides sewer service to approximately 6,416 connections. The service area is affluent and predominantly residential, with good access to the greater San Diego MSA economy. The customer base has been relatively stable during the past four years and management does not expect any major changes as the service area is largely built out. For fiscal year 2016, the leading 10 customers represented a very diverse 9.1% of operating revenues.

The sanitation division has full rate-setting ability, with residential user charges collected on the county property tax bill. The most recent sewer rate study was adopted in 2015; the city council approved annual increases of 3% to 4% during fiscal years 2016 through 2019. The annual sewer rate is $634 in fiscal 2016, or $52.8 per month, which is equal to about 0.8% of MHHEBI. Rates are, in our view, affordable given the very strong income indicators and moderate county poverty rate.

For the Cardiff Sanitary Division, all-in coverage of the sewer system's share of SEJPA debt service has been extremely strong, in our view; all-in coverage exceeded 2.5x in the past five fiscal years. Management's forecast, which reflects the approved rate plan, indicates all-in DSC will exceed 1.8x over a five-year period, including the SEJPA 2017 loan payments in the forecast period. Unrestricted cash and investment balances for the division as of fiscal year 2016 improved to about $13.5 million, equivalent to about 1,921 days or above five years of operating expenses, a level we consider extremely strong. Liquidity levels have been no less than four years of operating expenses in the past three fiscal years. The CIP through fiscal year 2021 is manageable, in our view, at about $4.6 million, with no additional bond issuance planned in the next five years.