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## Summary:

# San Elijo Joint Powers Authority, California; Water/Sewer

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## Summary:

# San Elijo Joint Powers Authority, California; Water/Sewer

### Credit Profile

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

## Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on San Elijo Joint Powers Authority, (SEJPA or the authority) Calif.'s series 2011 wastewater treatment facilities revenue refunding bonds to 'AA' from 'AA-'. The outlook is stable.

The raised ratings reflect our view of the SEJPA's consistent financial performance and the strong credit quality of the participants, the city of Solana Beach (AA/Stable) and the Cardiff Sanitary Division (Encinitas, Calif.; AAA/Stable issuer credit rating), which each own half of the San Elijo wastewater treatment facility.

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

- Good financial management, as demonstrated by the maintenance of unrestricted cash equal to 120% of one year of SEJPA's operating expenses in each of the last three years;
- Ample wastewater treatment capacity;
- Improved economies of scale due to expansion of wastewater treatment services and reclaimed water sales to neighboring beach communities; and
- Both members' historical maintenance of strong financial metrics, characterized by strong debt service coverage (DSC) and robust liquidity, which we anticipate will remain strong during the five-year forecast period.

Partly offsetting these credit strengths, in our view, are the authority's additional borrowing plans to fund \$22.4 million of wastewater treatment facility capital improvements over the next five years. Management, we believe, has a measured approach for the funding of the capital improvement plan (CIP), which, during the near term, will be funded through 1.3% increases in member sewer rates.

Solana Beach and Encinitas have each entered into separate loan agreement to finance their respective share of SEJPA's outstanding debt. Each city has pledged net revenues (defined as gross revenues less operation and maintenance expenses) from their respective wastewater collection system. We view the loan provisions as adequate, with a rate covenant equal to 1.3x annual loan installment payments and annual debt service on all parity bonds (of which only Solana Beach has parity debt currently outstanding). Also present is a standard debt service reserve, and

the reserve requirement is satisfied through a surety policy. However, neither city is responsible for the other agency's installment or is obligated to make up any deficiencies for the other. A default by one local agency will not result in a default of the other. The credit quality of Solana Beach, which has weaker coverage levels and a higher debt burden than Encinitas, in our view, is the primary driver of the ratings.

The members are primarily residential beach communities located 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 Encinitas is about 19,000 and in Solana Beach is about 13,000. We understand that residents are able to commute throughout San Diego County for employment opportunities. We view the customer base's income levels as very strong, based on the median household effective buying incomes of about 148% of the national median in 2014 in Solana Beach, and 140% of the national median in Encinitas. The unemployment rate in Solana Beach was 4.0% in April 2015, and in Encinitas was 3.9%, lower than the state's rate of 6.1% and the nation's rate of 5.1%.

The Cardiff sanitation division of the city of Encinitas posted very strong DSC of its loan payments to SEJPA of 4.2x in fiscal 2014, which equated to 2.82x fixed-charge coverage, which includes the city's capital expenditures and share of SEJPA's capital requirements. The sanitation division maintains unrestricted cash balances of \$12.4 million, exceeding five years of its operating expenses at fiscal year-end 2014. Inclusive of Solana Beach's direct sanitation system debt and loan payments to SEJPA, Solana Beach posted DSC of 1.9x in fiscal 2014. Including capital contributions to SEJPA, the Solana Beach's fixed-charge coverage was 1.5x in fiscal 2014. The city has also historically maintained a strong liquidity position, in our view, with unrestricted cash of \$9.3 million as of June 30, 2014, or about 3.5 years of its operating expenses.

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 the ongoing drought. The wastewater treatment facility's design capacity is 5.25 million gallons per day (mgd), with a five-year average daily flow of about 3.0 mgd. With no substantial development expected in the combined service area, the plant's capacity is sufficient to meet demand, though 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 early 2016. We understand that the net benefit to the members will be about \$100,000 a year. Operations and maintenance expenses at the facility are allocated on the basis of percentage of use, as indicated by measured flows.

SEJPA provides recycled water to the Santa Fe Irrigation District, the San Dieguito Water District, the city of 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 SEJPA separately from sanitation revenues, management indicates that recycled water sales from the wastewater treatment facility are expected to grow from 1,520 acre feet (AF) in fiscal 2016 to 1,800 AF in fiscal 2020.

The SEJPA maintains separate capital plans for the wastewater treatment program and the recycled water program. The wastewater CIP totals \$22.4 million through fiscal 2020, with most of the expenditures planned in fiscal 2017 and 2018, and focuses on building improvements and land outfall projects. Our assessment of SEJPA's financial projections is that the CIP will have a modest impact on the members, due to management's expectation that future debt issuance

will be structured around the amortization of the 2011 refunding bonds, which will largely be retired by fiscal 2020.

## Outlook

The stable outlook reflects our view of the SEJPA's operations and very strong liquidity position. During the two-year outlook period, we anticipate that SEJPA and its members will continue to raise rates to fund the wastewater CIP in step with management's current forecasts. We could take a positive rating action if coverage metrics strengthen, particularly fixed-charge coverage for each of the members, and we believe the stronger performance level is sustainable. Conversely, we could take a negative rating action if these coverage metrics materially weaken.

## 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: Wholesale Utilities, May 24, 2005
- 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

### Ratings Detail (As Of September 1, 2015)

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*

NR(SPUR)

Current

Many issues are enhanced by bond insurance.

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