S&P Global
Ratings

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Summary:

Oxnard Financing Authority, California
Oxnard; Water/Sewer

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Table Of Contents

Summary:

Oxnard Financing Authority, California Oxnard; Water/Sewer

Credit Profile		
Oxnard Fincg Auth, California		
Oxnard, California		
Oxnard Fincg Auth (Oxnard) wastewtr (AGM)		
Unenhanced Rating	BBB(SPUR)/Positive	Outlook Revised
Oxnard Fincg Auth wastewtr (Headworks)		
Unenhanced Rating	BBB(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised its outlook to positive from negative, and affirmed its 'BBB' long-term rating and underlying rating (SPUR) on the City of Oxnard Financing Authority, Calif.'s wastewater revenue bonds, issued for the City of Oxnard. The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and an adequate financial risk profile.

We revised the outlook based on greater clarity regarding the potential outcome and impact of the Measure M litigation, and the city completing a rate-setting process in 2017 and implementing the first two of five approved rate increases that we anticipate will drive stronger near-term performance.

We understand that the court has come to a tentative ruling against the city in the Measure M litigation, and that the potential impact has been updated to $5.2 million under a worst-case scenario as estimated by the city. It is unclear at this point whether the city will be required to make refund payments to affected customers, or if the refunds can take the form of credits against future billings. However, based on recent audited and unaudited cash and investment balances, we believe that the system has the capacity to make these refunds without adversely affecting credit quality at the current rating level. Management reports that the city is assessing the merits of an appeal.

In May 2017, the city completed a rate-setting process that set new service rates in response to the Measure M litigation. In lieu of the 35% rate increase that was the subject of the litigation, the city approved a new, five-year rate schedule with annual 5.25% rate increases effective July 1, 2017, and Jan. 1 of each year from 2018 through 2021. We understand that the city has implemented the first two of the five approved rate increases and that the rates have not been challenged by the existing plaintiff in the Measure M litigation nor any other party. Our expectation is that the city will continue to implement the rate increases as approved, and begin another rate-setting process in fiscal year 2021 to set rates thereafter--in particular to address the system's deferred capital needs.

The wastewater system's financial performance improved significantly in fiscal year 2017 following a long track record of insufficient to adequate performance. Based on the city's audited financial statements, we calculate all-in coverage of 0.9x, 0.9x, and 2.0x for fiscal years 2015 through 2017, sequentially. If we exclude the $5.2 million of rate revenues collected in fiscal year 2017--but may be subject to rebate based on the final outcome of the Measure M litigation--then all-in coverage would remain good at about 1.4x. Insufficient financial performance in fiscal years 2015 and 2016 was driven by flat revenues as the city faced significant headwinds to routine rate setting while the system incurred higher-than-usual repair and maintenance expenses resulting from long-term inadequate investment in capital renewal. Improved financial performance in fiscal year 2017 was driven by a substantial rate increase as well as increased billable volumes as water conservation requirements were rescinded.

We anticipate that financial performance going forward will likely remain strong during the near term, but will likely be pressured beginning in the medium term. Based on management's forecast, we calculate all-in coverage during the next five years of at least 1.5x. Key assumptions in the forecast include the implementation of approved 5.25% annual rate increases through fiscal year 2021 with 2% inflationary adjustments thereafter, annual operating expense increases of about 3% annually, and additional debt service associated with a potential borrowing in fiscal year 2020 to finance about $53 million of capital improvements. We believe these assumptions are generally reasonable; however, the approved rate increases do not finance the significant capital needs just outside of the five-year window, and increased leverage is likely to pressure financial performance as the city addresses regulatory requirements and deferred capital needs at the treatment plant. Although the scope may change from the proposals included in the 2015 Public Works Integrated Master Plan, the range of costs for the three possible projects identified at that time ranged from $405 million to $489 million. According to the city and based on a recent condition assessment of the treatment plant, "30 percent of the system's assets are in poor or very poor condition, with 72 percent at a moderate, high, or very high risk of experiencing failure."

The wastewater system's liquidity position improved during fiscal year 2017, but a significant portion of the improvement may be rebated to customers if the plaintiff in the Measure M litigation prevails. Based on the city's audited financial statements, the wastewater fund held about $12.2 million, equivalent to 217 days of operating expenses, at the end of fiscal year 2017. When excluding the $5.2 million that is subject to litigation, unrestricted cash and investments is weaker, but still strong, at about $7.0 million, or 125 days. Based on management's forecast, we anticipate that cash reserves will generally increase over time as rates are increased and debt is used to fund the majority of capital improvements, but could be deployed to finance additional capital improvements or buy-down future rate increases.

We understand that the city is also engaged in litigation regarding an infrastructure use fee that the city's utilities--including the wastewater system--annually pay to the city's general fund. If the plaintiff prevails in the litigation, the city's general fund could potentially be required to refund about $21 million to the wastewater system, which could possibly be retained by the wastewater system and used for other eligible purposes or could possibly be rebated to rate payers if required by the court. Although the outcome of this litigation is uncertain, we view it as likely either credit neutral to credit positive.

The wastewater system's debt portfolio complexity has historically weighed on its credit profile as the city faced challenges with credit facility renewals and an out-of-the-money swap termination exposure. We understand that the city is exploring de-risking the debt portfolio by refunding the variable-rate bonds with fixed-rate bonds and terminating the swap, and we would view this de-risking as a credit-positive development if it comes to fruition. The current credit facility supporting the series 2004B variable-rate bonds is provided by JPMorgan Chase Bank N.A. and has a stated expiration date of Jan. 25, 2021.

Outlook

The positive outlook reflects our expectation that the wastewater system will likely post at least sufficient financial performance going forward, and that further rate increases will not be deferred or delayed. We could take a positive rating action--possibly multiple notches--if the city pursues its strategy to de-risk the wastewater system's debt portfolio, or if the wastewater system is able to develop a track record of strong financial performance that we believe is sustainable with no further interruptions to the normal rate-setting process. We could revise the outlook to stable if the wastewater system's rates continue to be challenged, or if financial performance returns to insufficient levels.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.