S&P Global
Ratings

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Summary:

Oxnard Financing Authority Oxnard; Water/Sewer

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Summary:

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Credit Profile		
US$24.695 mil wastewtr rev rfdg bnds ser 2018 due 06/01/2036		
Long Term Rating	A-/Stable	New
Oxnard Fincg Auth, California		
Oxnard, California		
Oxnard Fincg Auth (Oxnard) wastewtr (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Oxnard Fincg Auth wastewtr (Headworks)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) by two notches to 'A-' from 'BBB' on the city of Oxnard Financing Authority, Calif.'s existing wastewater revenue bonds, issued for the city of Oxnard. At the same time, we assigned our 'A-' long-term rating to the city's series 2018 wastewater revenue refunding bonds. The outlook is stable.

The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and an adequate financial risk profile.

The raised rating reflects our view of the steps taken by the city to de-risk its debt portfolio by refunding its existing variable-rate bonds with this series 2018 fixed-rate bonds and terminating a swap agreement to which it is a party. We view this de-risking as credit positive because it eliminates contingent liquidity risk for the city. In addition, the city completed a rate-setting process in 2017 and implemented the first two of five approved rate increases that led to a significant improvement in the city's fiscal 2017 financial performance, and we anticipate that the approved rate plan will drive stronger performance in the near future.

The enterprise risk profile reflects our view of the sewer system's:

- Service area participation in the broad and diverse Oxnard-Thousand Oaks-Ventura metropolitan area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable service rates, in the context of the service area's strong income levels and average county poverty rates; and
- Standard operational management practices and policies.

The financial risk profile reflects our view of the sewer system's:

- Historical insufficient all-in debt service coverage (DSC) that is projected to improve to stronger levels due to the approved rate plan;
- Good liquidity position which we believe is sustainable in the near future;
- Significant long-term capital needs, with additional planned borrowing in fiscal 2020; and
- Standard financial management practices and policies.

The district is issuing the series 2018 bonds to refund existing obligations for annual debt service savings, and de-risking its debt portfolio from existing variable-rate bonds. Existing obligations include the series 2004B variable-rate debt, and 2006, 2013, and 2014 bonds. Following the issuance of the series 2018 bonds, the series 2013, 2014, and 2018 bonds will be the only remaining debt outstanding. Post issuance, the city will have approximately $103 million in wastewater debt outstanding.

We view the bond provisions as permissive. The bonds are secured by the net revenues of the city's wastewater system. Key bond provisions include a rate covenant of 1x as long as there is cash available equivalent to at least 25% of maximum annual debt service (MADS). The additional bonds test allows for the same restrictions as the rate covenant. We understand that the city intends to provide a standard debt service reserve fund for the series 2018 bonds, which, in our view, will provide additional liquidity.

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.

We now have greater clarity regarding the potential outcome and impact of the Measure M litigation. 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 $5.9 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.

Enterprise and Financial risk profile details

Oxnard, with a population of about 208,000, is situated approximately 65 miles west of Los Angeles in Ventura County. Historically, the city served as a processing and service center for a surrounding agricultural region, but the city's economic base now includes a diverse mix of industrial and commercial activity, along with a base of regional commuter neighborhoods. We view the service area's income levels to be strong based on the city's median household effective buying income (MHHEBI), which was 115% of the national median. The customer base is stable and primarily residential, having grown less than 1% annually in terms of wastewater service accounts during the past five years. At the end of fiscal 2017, there were 39,580 accounts, of which about 94% were residential.

We view the sewer system's market position to be very strong. The rate structure for single-family residential customers consists of a flat monthly service charge and three usage-based rate tiers. We understand that a typical residential customer within the service area uses an average of 900 cubic feet of water per month and this level of usage would produce a monthly wastewater bill of $46.36. We consider this affordable at 1% of MHHEBI when annualized. The county poverty rate as reported by the U.S. Department of Agriculture is 11.5%, which we view as moderately low and not a material source of resistance to revenue raising.

Consistent with "Methodology: Industry Risk" (published Nov. 19, 2013 on RatingsDirect), we consider industry risk for the system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the strongest.

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 in fiscals 2015 and 2016, and at 2x in 2017. If we exclude the $5.9 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.

We anticipate that financial performance going forward will likely remain strong during the near term, but could 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 updated 2017 Public Works Integrated Master Plan, the costs for these projects identified will be over $300 million in the long-term. 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 near-term (five-year) capital projects recommended by the master plan totals approximately $79 million.

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 $5.9 million that is subject to litigation, unrestricted cash and investments is weaker, but still good, at about $6.3 million, or 112 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 city's utilities, a portion of which could possibly be used by the wastewater system 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.

Outlook

The stable outlook reflects our expectation that the wastewater system will likely post at least good financial performance going forward, with no further interruptions to the normal rate-setting process. The outlook also reflects our anticipation that the system will continue to refine its long-term capital plans with no significant erosion in financial performance.

Upside scenario

Although unlikely in the two-year outlook period, we could take a positive rating action if the wastewater system is able to establish a track record of strong financial performance that we believe is sustainable, while management develops a credible plan to meet the system's long-term capital needs.

Downside scenario

We could take a negative rating action if the wastewater system's rates continue to be challenged, or if financial performance returns to insufficient levels. The rating would likely also be pressured downwards if the system draws down cash reserves to fund a greater portion of future capital improvements on a pay-as-you-go basis (absent commensurate rate increases), or the total dollar amount of the capital funding plans materially exceeds current expectations.