

RatingsDirect®

Summary:

Oxnard Financing Authority, California; Water/Sewer

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Credit Profile

US\$24.53 mil wtr rev and rev rfdg bnds (Oxnard) ser 2020A due 06/01/2055		
<i>Long Term Rating</i>	A/Stable	New
US\$5.39 mil rev rfdg bnds (Oxnard) ser 2020B due 06/01/2030		
<i>Long Term Rating</i>	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' long-term rating to Oxnard Financing Authority, Calif.'s anticipated \$30 million series 2020A and 2020B water revenue bonds (2020 bonds), on behalf of Oxnard city. At the same time, we affirmed our 'A' long-term rating and underlying rating (SPUR) on the existing water revenue and revenue refunding bonds issued by the authority on behalf of the city. The outlook is stable.

The 2020 bonds are being issued to finance approximately \$25 million in construction of certain water capital improvement projects, and to refund certain outstanding water revenue bonds (including a refunding of the existing 2010A and 2012A bonds) for debt service savings. The bonds are payable from installment payments that are secured by the net revenues of the city's water system. We view the bond provisions as adequate and permissive. 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 2020 bonds, which, in our view, will provide additional liquidity.

Credit overview

The ratings reflect our opinion of the city water system's general creditworthiness and a combination of its very strong enterprise risk profile and strong financial risk profile. The water system is in the middle of a large capital cycle to address potential capital projects including recycled water facility improvements and recharge and recovery expansion related to its Groundwater Recovery Enhancement and Treatment Program (GREAT Program), a regional water resources plan that enhances its water supply reliability through local sources in the near future. We recognize these capital projects are also critical to mitigate future anticipated groundwater cutbacks and pumping allocation reductions that reduces groundwater pumping over the next 20 years. The city is initiating a comprehensive cost-of-service rate study in early 2021 to develop a rate structure around funding its capital needs. Based on our assessment, the system will need additional debt to fund the large capital plan. In addition, the city's credit profile will center on greater clarity regarding the system's upcoming financial plan and rate study to offset future anticipated debt service costs, or any potential declines to operating margins from unexpected reduction in consumption stemming from conservation, weather, or economic contraction.

In addition, we believe Oxnard is experiencing the tail end of a period of institutional stress and political conflict, with ineffective wastewater utility management earlier in the decade. The topic of wastewater rates and fees may be fading in its political potency, given the recent favorable court of appeal ruling (on Oct. 13, 2020) to overturn the Measure M initiative (a ballot initiative to repeal the city's wastewater rate increase ordinance in 2016). A diminishing credit weakness, in our view, is the city's legacy of management deficiencies. Management has been addressing the weaknesses in internal controls and management practices, which is reflected in the city's audits that have been unqualified since the fiscal 2017 report. Moreover, the auditor views the city as having addressed over 90% of its previous findings and recommendations list. We view the city's implementation of a new enterprise resource planning system as essential to institutionalizing gains in this area.

S&P Global Ratings acknowledges a high degree of uncertainty related to the effects of COVID-19, including the rate of spread and peak of the outbreak. Although we consider the water system's financial flexibility could likely be affected by reduced economic activity in the region depending on the probability of additional shelter-in-place restrictions, in our view, this risk is somewhat mitigated by the system's strong liquidity position, which we believe provides sufficient cushion for short-term disruptions. While we continue to monitor events related to COVID-19, we do not currently anticipate it affecting the system's ability to maintain budgetary balance and make debt service payments. For more information, see "All U.S. Public Finance Sector Outlooks Are Now Negative," published April 1, 2020, on RatingsDirect, and "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020 on RatingsDirect.

The enterprise risk profile reflects our view of the water 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), with an approved rate increase in fiscal 2018, although rate adjustments have not been timely in the past; and
- Standard operational management practices and policies.

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

- Financial performance that has improved since fiscal 2018 from insufficient levels in the past;
- Strong and improved liquidity position more recently that has fluctuated in the past due to insufficient financial performance;
- Highly leveraged system, with significant long-term capital needs, with a financial plan that is being revised based on the upcoming cost-of-service rate study; and
- Standard financial management practices and policies.

The stable outlook reflects our view of recent improved financial performance and adequate water supply to meet the system's demands. In support of future financial performance, the city has represented that it will develop a financial plan and implement an upcoming rate study for the water system that will support its large capital improvement plan (CIP). Because the current management-provided financial forecast indicates that there will be no significant erosion in

financial performance, we believe that this is supportive of the rating at the current level.

Environment, social, and governance (ESG) factors

The city's water supply is susceptible to elevated environmental risk related to climate change and natural cycles of drought. Additionally, recent wildfires have affected the city's service area, although none of the wells or assets were affected, and we believe the city has well-defined emergency preparedness plans. The groundwater basin within the city boundaries are subject to the provisions of the Sustainable Groundwater Management Act (SGMA), and the underlying basin is designated as a high priority basin due to overdraft conditions. We believe that SGMA could affect the city's water supply as it may be required to reduce its pumping over time to comply with SGMA requirements. In addition, the anticipated "ramp down" for pumping allocations may likely reduce groundwater pumping over the next 20 years. Officials plan to make a number of investments across its facilities and distribution network to reduce the system's environmental risks while enhancing its water supply reliability through local sources (including expansion of recycled water) in the near future. The city has reported no exposure to emerging contaminants like per- and polyfluoroalkyl substances (PFAS), which we view as favorable to credit quality.

Although there have not been any limitations on water demand, food processing, or farming in the service area or noted COVID-19 outbreaks at this time, we believe there are increased public health and safety risks due to the pandemic. Oxnard's senior management team has undergone significant transitions in the past two years, with the current hierarchy responsible for financial management in place since January 2019, and we see no signs of administrative or governance disruption. Given its recent accomplishments to address management deficiencies, we view governance risks as generally commensurate with similarly-rated peers.

Stable Outlook

Downside scenario

We could lower the rating if the water system's financial performance significantly declines below management's forecast due to unanticipated and extraordinarily large change in its CIP or higher-than-expected operating costs that could alter related financial metrics, including significant spend down of unrestricted reserves. Moreover, we could lower the rating, if economic and financial metrics are no longer consistent with the rating level, as a result of the dampening effects of the pandemic on local economic activity, or if we see signs that organizational improvement has stalled such as from additional senior management turnover.

Upside scenario

We could take a positive rating action if the city continues to make progress fortifying its organizational culture and recent investments to facilitate efficiency and transparency improvements in its internal controls, while sustaining its recent improved financial performance. In addition, to consider a higher rating, we would also assess if the city's water system continues to achieve strong financial performance and metrics that are sustainable through this economic cycle, while successfully executing its large capital plan.

Credit Opinion

Enterprise risk

Oxnard, with a population of approximately 210,000, is situated approximately 65 miles northwest 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 110% of the national median. The customer base is stable and primarily residential, having grown less than 1% annually in terms of water service accounts during the past five years. At the end of fiscal 2020, there were 42,800 accounts, of which about 86% on average were residential.

We view the system's market position as strong given the affordable service rates in the context of the service area's strong income metrics, and we believe the city has future rate-setting flexibility. The city has adjusted service rates with the new approved rates effective in September 2017 (includes a 14% increase for fiscal 2018). We understand that the city also added an automatic pass-through of wholesale water cost increases to the rate structure. We understand that the city will initiate a water utility cost-of-service rate study in early 2021 to maintain revenue sufficiency, and management expects the upcoming rate study to provide greater clarity on the funding mix for its large capital program. Residential customers currently pay a base charge dependent on water meter size and a volumetric charge based on monthly water use. For a typical residential customer using an average of 1,200 cubic feet of water, we calculate a monthly water bill of \$67.91. When annualized, this represents about 1.4% of the city's MHHEBI, which we view as affordable and not a material source of resistance to revenue raising.

We consider the system's operational management to be standard under our operational management assessment methodology, which indicates a somewhat favorable alignment of operations and organizational goals, although some challenges exist. The city acquires water supply from three sources: local groundwater, purchased groundwater from United Water Conservation District, and imported surface water from Calleguas Municipal Water District (CMWD), a member of the Metropolitan Water District of Southern California. In fiscal 2020, local and purchased groundwater represented approximately 62% of supply while imported surface water represented 38% of total supply. Although local groundwater is the city's least expensive option, this source is constrained by a likely reduction in its pumping over time to comply with SGMA requirements. The city has indicated that because imported surface water costs have continued to rise, the city is looking towards increasing the use of recycled water that is generated from the city's wastewater treatment plant. An expansion of its Advanced Water Purification Facility will add an additional 7,000 acre-feet a year of new recycled water supply to the city, which would partly be used for groundwater recharge in the near future.

The Fox Canyon Groundwater Management Agency (FCGMA) manages groundwater extractions in the underlying Oxnard subbasin. On Dec. 13, 2019, the FCGMA adopted a resolution adopting a groundwater sustainability plan for the subbasin that "ramps down", or reduces the pumping allocations per entity, by up to 43% over the next 20 years. Earlier in Dec. 2019, the city filed a lawsuit against the FCGMA claiming that it did not follow the California Environmental Quality Act and that FCGMA did not adhere to its own enabling legislation by arbitrarily restricting the city's water allocation despite its historical use of supplemental water (imported through CMWD) while increasing

allocations to other pumpers. We understand the city is still in negotiation with the FCGMA to resolve this matter in the near term. Given the city's planned investments in its GREAT Program and expansion of recycled water, we view the city will have operational flexibility to offset future groundwater cutbacks from the FCGMA.

Financial risk

The water system's financial performance has improved in recent years from insufficient levels in the past, and with the recent rate increase, we anticipate that financial performance will be sustainable in the near future. Based on the city's audited financial statements, we calculate that all-in coverage has improved to 1.7x in fiscal 2019. All-in coverage is our adjusted DSC metric that treats certain fixed debt-like obligations as if they were the actual debt of the utility, even if legally treated as an operating expense (our methodology differs from the indenture-based calculations). For the purpose of calculating all-in coverage, we take into consideration the system's direct debt obligations as well as a proportionate share of debt service from the city's wholesale water providers. Financial performance is estimated to remain steady in fiscal 2020, with a 1.5x all-in coverage metric based on our calculations.

Based on management's forecast, which we view as reasonable, we calculate all-in coverage during the next five years of at least 1.5x. Key assumptions in the forecast include an annual average revenue growth of 2% and a 3.7% annual increase in operating expenses, and no additional debt issuance. In our view, under scenarios that include a potential debt issuance of approximately \$43 million during the two-year outlook period, we view all-in coverage would remain at a minimum of 1.4x during the forecast. We believe the undertaking of a new rate study within the next two years will establish a clear trajectory for future financial performance in our view.

The water system has recently maintained a strong liquidity position, and we anticipate it to likely maintain strong levels in the future despite a planned drawdown for a portion of its capital plan. At fiscal year-end 2019, the system held unrestricted cash of about \$21 million, or 191 days of operating expenses. In addition, the system also held approximately \$24 million in designated capital reserves that are "restricted for infrastructure development" to be spent for capital needs. Based on the CIP and cash flows, we anticipate nominal draws on internal operating cash to fund future capital projects, and we anticipate management will continue to maintain sufficient liquidity to meet operations. The city has a reserve target of maintaining operating reserves equivalent to 25% of operating costs in its utility funds. We view the system as having a high leverage position based on a 61% debt-to-capitalization ratio. The current five-year capital plan is large, at approximately \$160 million, with a potential need for additional debt in the near future. Management reports that the financing mix for this CIP is yet to be determined, and the city anticipates additional debt financing in the near future.

Based on our financial management assessment, we view the water system to be a '4' on a six-point scale, with '1' being the strongest. While financial policies and practices exist in most areas, we view the water system's past insufficient financial performance without timely correction as a significant weakness. The long-term planning process is good, in our view, with financial and capital improvement projections as part of this financing. Financial reports and operational information are relatively easily obtained, and financial statements adhere to generally accepted accounting principles and Governmental Accounting Standards Board standards.

Ratings Detail (As Of November 2, 2020)

Ratings Detail (As Of November 2, 2020) (cont.)

Oxnard WS		
<i>Long Term Rating</i>	A/Stable	Affirmed
Oxnard WS (BAM)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Oxnard Fincg Auth, California		
Oxnard, California		
Oxnard Fincg Auth wtr (SYNCORA)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Oxnard Fincg Auth (Oxnard) WS		
<i>Long Term Rating</i>	A/Stable	Affirmed
Oxnard Fincg Auth (Oxnard) WS (BAM) (SECMKT)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Oxnard Fincg Auth (Oxnard) WS (NPFPG)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.

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