

AUSTIN, Texas--([BUSINESS WIRE](#))--Fitch Ratings assigns the following ratings to the Metropolitan Water District of Southern California, CA's (Metropolitan, or the district) water revenue refunding bonds:

--Approximately \$29 million water revenue refunding bonds, series 2014E 'AA+';

--Approximately \$4 million taxable water revenue refunding bonds, series 2014F 'AA+';

--Approximately \$7.5 million water revenue refunding bonds (term mode), series 2014G-1 'AA+';

--Approximately \$10.6 million water revenue refunding bonds (term mode), series 2014G-2 'AA+';

--Approximately \$10.9 million water revenue refunding bonds (term mode), series 2014G-3 'AA+';

--Approximately \$11.4 million water revenue refunding bonds (term mode), series 2014G-4 'AA+'.

In continuation of Metropolitan's strategy to reduce its outstanding variable rate and swap portfolio, bond proceeds will refund outstanding variable rate obligations of Metropolitan (series 2014E and 2014G) and pay the taxable component of the swap termination costs (series 2014F). Bonds are expected to price via negotiated sale on July 15, 2014. The bonds do not have a debt service reserve fund.

The series 2014G1-4 bonds will be issued in the term mode with a final maturity date of

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July 1, 2037 but are expected to have initial mandatory tender dates of July 1, 2015 - 2018. Metropolitan has the option to require an unscheduled mandatory tender after the call protection dates, set at three months prior to the mandatory tender dates.

Fitch also affirms the following outstanding Metropolitan ratings:

--\$3.51 billion outstanding water revenue bonds and term bonds at 'AA+';

--\$566.2 million SIFMA index mode bonds, series 2009A-2, 2011A1-A4 and 2012B1-B2; term mode bonds, series 2012E2, and flexible index mode bonds, series 2013E at 'AA+'/'F1+';

--\$167.1 million special variable rate water revenue refunding bonds, series 2013D and 2014D (self-liquidity) at 'AA+'/'F1+';

--\$132.3 million waterworks general obligation (GO) bonds at 'AAA'.

The Rating Outlook on all bonds is Stable.

SECURITY

GO BONDS: The GO bonds are secured by an unlimited ad valorem tax on all property within the district.

WATER REVENUE BONDS: Revenue bonds are secured by net water revenues of the district. The series 2013D and 2014D (self-liquidity) bonds do not have a liquidity facility to support the weekly tender but instead rely on Metropolitan's own liquidity. Payment of a tender purchase for these bonds, the 2013E flexible index mode, the 2009A-2, 2011A1-A4,

and 2012B1-B2 SIFMA index mode bonds, or the series 2012E, 2014C, and 2014G term mode bonds is secured by remarketing proceeds and a subordinate pledge of Metropolitan's net revenues. Payment of principal at the final maturity or on prior redemption is secured by a senior pledge of net revenues, on parity with all other revenue bonds.

NO CROSS-DEFAULT OR ACCELERATION: A failure by Metropolitan to provide sufficient proceeds to pay the purchase price of the flexible index mode, SIFMA index mode, term mode bonds or the self-liquidity bonds at the tender date would not constitute an event of default on Metropolitan's revenue or GO bonds nor prompt an acceleration of debt.

KEY RATING DRIVERS

WHOLESALE SUPPLIER: Metropolitan is the supplemental wholesale water supplier to 18.4 million people in southern California. Revenues are provided from 26 member agencies that rely on water purchased from Metropolitan to supply their retail customers although there are no minimum annual purchase or payment amounts.

WATER SUPPLY FLUCTUATIONS: Water is provided from two independent supply sources. Supply fluctuations occur on the in-state water supply, the State Water Project (SWP). The Colorado River supplies, banking arrangements, and Metropolitan's substantial storage facilities help balance this risk. Consequently, Metropolitan has sufficient supplies to meet customer demands despite statewide drought concerns.

FLEXIBLE FINANCIAL PROFILE: Financial performance exhibits cyclicity linked to hydrological and weather conditions in the state given Metropolitan's role as the supplemental supplier and its highly volumetric rate structure. Financial margins in the past two years have been stronger given higher water sales.

RATE FLEXIBILITY: Metropolitan's revenue flexibility is evident in the 75% cumulative rate increases between 2008-2013, although rate sensitivity is likely heightened given the magnitude of recent rate actions. Higher rates improve the economics of a variety of local water supply investment options for Metropolitan's members that will ultimately reduce

sales.

LONG-TERM ANALYSIS: The 'F1+' rating assigned to the flexible index mode bonds and SIFMA index mode bonds corresponds to the long-term rating on Metropolitan's revenue bonds.

SELF-LIQUIDITY VARIABLE-RATE DEBT: The 'F1+' rating on the self-liquidity bonds reflects the liquidity provided by Metropolitan's \$896 million in unrestricted cash as of March 31, 2014 and internal liquidity provided by a \$96 million revolving credit facility, together covering the authority's maximum daily exposure to un-remarketed puts by over 1.25x.

GO BONDS: Metropolitan's GO rating of 'AAA' is based on its ability to levy unlimited ad valorem taxes on its \$2 trillion tax base, with the property tax revenues restricted to be used only for debt service on the remaining GO bonds and capital costs related to the SWP.

RATING SENSITIVITIES

PRESSURE FROM STATEWIDE DROUGHT: Pressure on financial margins could occur in fiscal 2016 if water sales fall below assumed levels, which is only expected to occur in a multi-year water rationing scenario. Metropolitan does not anticipate implementing mandatory curtailments unless the drought continues to be severe into Spring 2015.

CREDIT PROFILE

Metropolitan is a wholesale water supplier in southern California to 26 member agencies, many of whom have some form of local water supply. The largest three members (54% of water revenues in 2013) include the San Diego County Water Authority (senior lien revenue bonds rated 'AA+' by Fitch), Orange County Water District (revenue bonds rated 'AAA'), and Los Angeles Department of Water and Power (water bonds rated 'AA').

Significant developments to water supply sources and the demand profile from members have occurred since the beginning of California's last drought in 2007-2009. Greater variability and uncertainty exists on Metropolitan's in-state water supply, the SWP. Demand level from members has declined from pre-recession levels although it continues to exhibit a high degree of annual variability. Finally, Metropolitan's significant rate increases have prompted regional investment in new local supplies that will further reduce demand for water sold by Metropolitan.

Metropolitan's members are not required to buy minimum amounts of water from Metropolitan but instead use the imported water supply to supplement their other sources. However, Metropolitan's role in the region is crucial in that it supplies 40%-60% of Southern California's water supply. Fitch expects Metropolitan to remain a key water supplier although over the long term there may be further pressure on demand.

Metropolitan absorbs much of the regional demand variability, as the 'high-cost' resource, due to conservation and efficiency investments as well as weather conditions. The swing in annual demand can exceed 200,000 acre-feet (AF). With Metropolitan's primarily volumetric rate structure (89% in 2013), the district must operate with a strong financial cushion to absorb the revenue implications of demand variations.

HIGHER WATER SALES IN 2013 and 2014; STRONG FINANCIAL MARGINS

Dry conditions in the past two years (prompting a drought declaration by the Governor in January 2014) led to strong water sales for Metropolitan, given lower availability of the members' local supplies. Water sales in fiscal 2013 were 1.86 million acre-feet (MAF) and are projected to be as high as 1.97 MAF in fiscal 2014. This exceeds the 1.7 MAF budget target that Metropolitan adopted in 2011 for fiscals 2013 and 2014 after water sales declined to just over 1.6 MAF in 2011 and 2012. Wetter conditions in those years resulted in lower purchases from members.

Financial performance in fiscal 2013 exceeded budget expectations. Debt service coverage in fiscal 2013 was 2.4x and is expected to be at or above this level in fiscal 2014. The additional revenue has led to improved reserves that exceed maximum reserve targets established by the board. In April the board authorized the transfer of excess reserves of

\$100 million into the replacement and refurbishment fund, \$100 million into the OPEB trust, and any remaining excess amounts to a water management fund. While excess reserves can be remitted to members, this has not occurred since 2009.

Fitch views the decision of utilizing a portion of reserves for capital purposes positively given the need for additional system investment and the potential for subsequent years to be leaner in the event of lower water sales.

STRONG FIXED-CHARGE COVERAGE

Fixed-charge coverage was 1.8x in fiscal 2013, in excess of Metropolitan's internal target for rate-setting of 1.2x. Fitch uses fixed-charge coverage as the key financial metric for Metropolitan (a proxy for total debt service coverage) and the district uses this calculation for internal rate-setting as well. The fixed-charge calculation includes the amount of SWP costs that are a capitalized expense as if they were paid as debt service. This expense is paid to the state for SWP expenses and is a cash outflow, much as principal on debt-financed assets is paid but not considered an 'operating expense' of the system.

POSITIONED TO MAINTAIN CREDIT QUALITY DURING CA DROUGHT

The SWP has provided just less than half of Metropolitan's water supply in recent years with the Colorado River supply providing the remainder. The SWP allocation for the 2014 water year was 5%, reflecting some of the driest conditions on record in the state. Metropolitan's supplies from the Colorado River and its substantial stored water position at present will allow it to meet the water demand of members through calendar 2014 without triggering any mandatory cutbacks.

MWD has made substantial investment in its physical storage facilities and inter-agency water storage agreements in the past 20 years. Storage capacity is nearly four times what it was in 1994. Metropolitan currently has 5.93 MAF in storage capacity.

Stored water was used in the last drought of 2007-2009 but stronger hydrological conditions recently allowed Metropolitan to add to its stored water in 2011-2013. Storage reached a high point of 3.36 MAF on Jan. 1, 2013. Metropolitan used around 405,000 AF in 2013, but is very well positioned going into the dry 2014 water year to replace the reduced allocation from the SWP with stored water, if necessary.

Conservative rate-setting based on 1.75 MAF water sales should continue to preserve healthy financial operations even though Metropolitan may sell less water in fiscal 2015 if drought conditions continue beyond this year.

CASH RESERVES MITIGATE RISK

Metropolitan's reserves provide a strong degree of financial flexibility. As of March 31, 2014, there was \$896 million in unrestricted cash including the operating and maintenance fund, or 413 days of operating cash based on fiscal 2013 operating expenses. However, reserves are used to mitigate other risks, such as providing self-liquidity for \$167 million in variable-rate bonds after the series 2014D issuance.

The unrestricted cash amount above excludes \$126 million that is set aside for disputed amounts paid by the San Diego County Water Authority, which are the subject of ongoing litigation. The litigation relates to the rate methodology used to allocate costs between members. Although customer equity issues regarding rate-setting at such a large wholesale agency with so many members are consistent with the district's history, Fitch views the tension between the two entities as a potential credit concern.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Revenue-Supported Rating Criteria' (June 16, 2014);

--'U.S. Water and Sewer Revenue Bond Rating Guidelines' (July 31, 2013);

'Tax-Supported Rating Criteria' (Aug. 14, 2012);

'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14,

2012);

--'Rating U.S. Public Finance Short-Term Debt' (Dec. 9, 2013).

Applicable Criteria and Related Research:

Rating U.S. Public Finance Short-Term Debt

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724680

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

U.S. Water and Sewer Revenue Bond Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715275

Revenue-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=837708

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