Eastern Municipal Water District (Riverside County), California

Rating

Long Term Issuer Default Rating	AA+

New Issue

$155,700,000 Refunding Water & Wastewater Revenue Bonds, Series 2020A	AA+

Outstanding Debt

Eastern Municipal Water District (Riverside County) (CA) Refunding Water & Sewer Revenue Bonds	AAA
Eastern Municipal Water District (Riverside County) (CA) Refunding Water & Wastewater Revenue Bonds	AA+
Eastern Municipal Water District Financing Authority (CA) Water & Wastewater Revenue Bonds	AA+
Western Riverside Water and Wastewater Financing Authority (CA) (Eastern Municipal Water District Improvement Districts General Obligation Bond Financing) Revenue Bonds	AA+

Rating Outlook

Stable

Applicable Criteria

U.S. Water and Sewer Rating Criteria (April 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (March 2020)

Related Research

Fitch Rates Eastern Municipal Water District, CA's Subordinate Revenue Bonds 'AA+'; Outlook Stable (April 2020)

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New Issue Summary

Sale Date: On or around May 5 via negotiated sale.

Series: Approximately $155,700,000 refunding water and wastewater revenue bonds, series 2020A.

Purpose: Proceeds will be used to refund all or portions of the district's following variable rate obligations: refunding water and wastewater revenue bonds, series 2015A ($50 million outstanding), refunding water and wastewater revenue bonds, series 2017A ($54.81 million outstanding) and 2017B ($50.225 million outstanding), and refunding water and wastewater revenue bonds series 2018A ($94.455 million outstanding).

Security: The series 2020A bonds are subordinate lien bonds payable from installment payments from the district to the authority from net revenues on a second lien basis. The senior lien revenue bonds are secured by a first lien on net water and sewer revenues. All outstanding senior lien bonds mature on July 1, 2020, though the lien remains open. The GO bonds are payable from net system revenues after payment of all revenue obligations (senior and subordinate lien), from available reserves and from ad valorem property taxes. There are no cross default provisions or acceleration in the event of default within the legal framework of the obligations.

The 'aa+' IDR reflects the district's low net leverage (calculated as net adjusted debt to adjusted funds available for debt service [FADS]) within the framework of strong revenue defensibility and low operating risk. The district maintains rate setting autonomy and a high degree of rate affordability. The system has manageable capital needs largely based upon growth-related expansion, which has been driven by an affordability advantage over nearby coastal regions and the availability of undeveloped land within commuting distance of major Southern California employment centers. Net leverage has declined over the last five years and the district does not plan on additional borrowing in the five year horizon.

The senior lien, which is not closed, accounts for only 0.5% of total debt and matures July 1, 2020. The subordinate working lien bonds and GO bonds reflect the overall 'aa+' IDR and account for 96.4% of the total debt, and the general obligation bonds comprise 3.1%.

Key Rating Drivers

Revenue Defensibility: 'aa'; High Rate Flexibility; Favorable Service Area Characteristics: Rates are affordable and expected to remain so. The district's board has the legal ability to set rates. All revenues are derived from its monopolistic business line. Growth within the service area is higher than average, while income levels are about even with the U.S. average.

Operating Risks: 'aa'; Very Low Cost Burden and Capital Pressures: The district's operating cost burden is very low despite its reliance upon imported water and making higher than required OPEB contributions in recent years. Capital needs are manageable with a low lifecycle ratio and annual spending at least at the level of depreciation. No additional debt is expected to fund the five-year capital improvement plan (CIP).

Financial Profile: 'aa'; Net Leverage to Remain Relatively Low: The district's moderately low net leverage is expected to remain about level given no additional planned debt. The liquidity cushion and coverage of full obligations (COFO) are sound and are considered neutral to the assessment.

Rating Sensitivities

Factors That Could, Individually or Collectively, Lead To Positive Rating Action/Upgrade:

- A sustained decrease in net leverage, which is expected given no additional planned borrowing over the five-year horizon, to less than 5.0x would likely lead to an upgrade of the IDR and subordinate debt provided stable revenue defensibility and operating risks.

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- A sustained increase in net leverage to greater than 6.0x caused by significant borrowing and/or a considerable narrowing of financial margins could pressure the rating.
- Deterioration in the district's life cycle ratio due to a sustained reduction in system reinvestment could place pressure on the operating risks assessment.

Credit Profile

As the sixth largest water district in the state, EMWD provides essential retail water, recycled water, and sewer services to a large and diverse suburban service area in western Riverside County. The service area covers 550 square miles and includes the cities of Temecula, Murrieta, Moreno Valley, Hemet, San Jacinto and Perris, as well as unincorporated areas. The formerly agricultural region suburbanized rapidly in recent decades and is close to both Orange and San Diego Counties. The top 10 water and sewer customers provide well under 10% of operating revenues.

The district's water supply is about evenly split between local sources and water imported from Metropolitan Water District of Southern California (AA+/Stable). Local water includes recycled water (36% of supply), potable groundwater (9%) and desalinated groundwater (6%). EMWD has invested heavily in local supplies and has long recycled most of its wastewater flows. This provides a highly reliable source of irrigation water that is not subject to interruptions due to weather variability and shifting environmental regulations that constrain imports. The district has also invested in groundwater production, including desalination of brackish groundwater.

Coronavirus Implications

The ongoing outbreak of the coronavirus and related government containment measures worldwide create an uncertain global environment for the water and sewer sector. While the system's performance through most recently available data has not indicated impairment, material changes in revenue and cost profile are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and government restrictions are maintained or expanded. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks.

As a result of coronavirus impacts, the district suspended shutoffs for non-payment. It noted an increase in customer accounts receivable from about 3.5% to 9%. However, the district notes that account write-offs averaged 0.4% over the prior decade and the peak during the Great Recession was 1.0%.

Revenue Defensibility

The district's revenue defensibility is strong, with all revenues derived from monopolistic businesses and midrange demographic factors. The district has independent rate-setting authority and customer charges are affordable for about 87% of the population, providing a high degree of rate flexibility. Rates are already in place for fiscal 2021 having been implemented Jan. 1, 2020. Projected combined rate increases of 3.8%-4.0% per year beginning fiscal 2021, which are subject to board approval, are not expected to pressure rate flexibility.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Assigned	Stable	4/24/20

Rating History (Second Lien)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	4/24/20
AAA	Upgraded	Stable	8/17/16
AA+	Affirmed	Stable	2/18/16
AA+	Affirmed	Stable	5/21/15
AA+	Affirmed	Stable	5/28/14
AA+	Affirmed	Stable	3/7/13
AA+	Affirmed	Stable	6/28/12
AA+	Affirmed	Stable	6/6/12
AA+	Affirmed	Stable	6/22/11
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	7/10/09
AA	Affirmed	Stable	7/17/08
AA	Affirmed	Stable	6/2/08
AA	Affirmed	Stable	3/11/08
AA	Affirmed	Stable	1/25/08
AA	Affirmed	Stable	4/12/07
AA	Affirmed	Stable	1/9/06
AA	Affirmed	Stable	12/6/04
AA	Affirmed	Stable	12/1/04

Rating History (Subordinate Lien)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	4/24/20
AA+	Affirmed	Stable	9/4/18
AA+	Upgraded	Stable	8/17/16
AA	Affirmed	Stable	2/18/16
AA	Affirmed	Stable	5/21/15
AA	Assigned	Stable	5/30/14

The district's largest single revenue source is customer charges at approximately 66%, made up of water sales (36%), sewer sales (28%) and recycled water sales (2%). Connection fees provide about 16% of total revenues, and property tax receipts 12%.

Riverside County's affordable housing stock and proximity to employment centers in San Bernardino, Orange, and Los Angeles counties have driven recent growth. Customer account growth over the past five years has been above average with a five-year CAGR of 1.5%. Wealth levels approximate the U.S. average while unemployment is slightly above the average. The service area will likely continue to grow as it is only about 40% developed.

The district implemented water budget-based rates in 2009, which allocates water for indoor and outdoor usage as well as a daily service charge and a water reliability capital charge to cover a portion of the fixed costs. Sewer rates are determined by the number of people per household and also include a daily service charge and capital charge.

No asymmetric rating factor considerations affect the revenue defensibility assessment.

Operating Risk

The district's operating risk is very low. The operating cost burden has remained consistently under $4,700 over the last five years despite fluctuations in water production. Imported water purchases are the district's largest expense representing about 20% of operating expenditures. In addition, the district's board made the decision to begin ramping up its contributions towards its other post-employment benefits liability several years ago and expects to more than double the payment beginning in fiscal 2020 to $18 million, or 7.3% of operating expenses.

The district's lifecycle ratio of 37% suggests low investment needs, though it has been on an upward trajectory over the last five years. The district has been investing in assets, as demonstrated by annual capital expenditures equal to at least depreciation. The five-year CIP totals $460.7 million and is focused on maintenance and growth-related expansion. As such, some projects will not go forward without growth. The district has no plans for additional borrowing over the five year horizon.

The district has received several grants to fund various capital projects. It received about $36 million to fund about half of the cost of the Perris North Program that will generate additional groundwater supply of up to 6,750 AF per year while removing certain contaminants from the basin. EMWD is constructing a third brackish groundwater desalination plant anticipated to be completed in 2021 to expand the desalination capacity to 15,000 AF per year. The district received a $22.5 million Proposition 1 grant to fund about 50% of the total project cost, at a cost of about $50 million.

The district has taken two wells out of service affecting less than 2% of the district's water supply as they exceeded the United States Environmental Protection Agency advisory for PFAS contamination. The district entered into agreements with the responsible party, the U.S. Air Force, to fund supply replacement and well treatment for one of the wells and is in talks related to mitigation for the other well. PFAS detected in the area served by brackish groundwater desalination plants is already removed by the reverse osmosis treatment process.

No asymmetric rating factor considerations affect the operating risks assessment.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

ESG Considerations

ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary — Eastern Municipal Water District

($000, Audited Years Ended June 30)	2015	2016	2017	2018	2019
Revenue Defensibility					
% of Total Revs from Monopolistic Services	**100**	**100**	**100**	**100**	**100**
Service Area Characteristics					
Service Area Population	2,345,816	2,380,081	2,414,964	2,445,789	2,470,546
Total Customer Count	288,510	292,450	297,366	301,859	307,331
Five-Year Total Customer Count CAGR	**N.A.**	**N.A.**	**(4.1)**	**(4.0)**	**1.5**
Service Area MHI ($)	56,603	57,972	60,807	63,948	N.A.
Service Area MHI/US MHI (%)	**105**	**105**	**105**	**106**	**N.A.**
Service Area Unemployment Rate (%)	6.7	6.1	5.2	4.4	N.A.
Service Area Unemployment Rate/US Unemployment Rate (%)	**126**	**124**	**118**	**113**	**N.A.**
Rate Flexibility					
Total Monthly Bill (7,500 gallons/6,000 gallons)	N.A.	N.A.	59.68	63.51	66.39
% of Population w/Unaffordable Bill	**N.A.**	**N.A.**	**13**	**13**	**N.A.**
Operating Risks					
Operating Cost Burden					
Operating Cost Burden ($/mg)	**4,275**	**4,668**	**4,582**	**4,644**	**4,696**
Capital Planning and Management					
Life Cycle Ratio (%)	**31**	**34**	**34**	**35**	**37**
CapEx/Depreciation (%)	116	86	79	127	108
Five-Year Average Capital Expenditures/Depreciation (%)	**164**	**136**	**114**	**105**	**103**
Financial Profile ($000)					
Current Unrestricted Cash/Investments	180,866	175,841	231,268	275,611	296,641
Current Restricted Cash/Invest (Available Liquidity)					
Current Cash Available	**180,866**	**175,841**	**231,268**	**275,611**	**296,641**
Available Cash	**180,866**	**175,841**	**231,268**	**275,611**	**296,641**
Noncurrent Restricted Cash/Invest (Debt Service or Debt Service Reserve)	101,974	99,120	71,576	80,741	87,228
Funds Restricted for Debt Service	**101,974**	**99,120**	**71,576**	**80,741**	**87,228**
Total Debt	1,014,805	905,916	1,021,678	1,005,154	988,995
Capitalized Fixed Charges	144,648	123,319	140,905	161,324	148,150
Adjusted Net Pension Liability	N.A.	N.A.	210,655	150,148	145,835
Available Cash	180,866	175,841	231,268	275,611	296,641
Funds Restricted for Debt Service	101,974	99,120	71,576	80,741	87,228
Net Adjusted Debt	**876,612**	**754,275**	**1,070,394**	**960,273**	**899,111**
Total Operating Revs	200,808	206,291	221,199	240,507	241,919
Purchased Water/Sewer Services	59,040	50,334	57,512	65,846	60,469
Operating Leases	—	—	—	—	—
Other Operating Expenses	131,782	131,131	138,403	144,485	144,474
EBITDA	**9,986**	**24,825**	**25,284**	**30,177**	**36,976**
Investment Income/(Loss)	2,911	5,057	4,802	8,295	11,897
Non-Operating Revenues from Taxes	34,101	36,877	38,578	40,803	43,088
Other Cash Revenues/(Expenses)	10,017	14,252	5,162	12,445	10,617
Capital Contributions	23,048	45,175	42,264	49,205	57,005
FADS	**80,063**	**126,186**	**116,090**	**140,925**	**159,584**
Fixed Services Expense	20,664	17,617	20,129	23,046	21,164
Net Transfers In/(Out)	—	—	—	—	—

Financial Summary — Eastern Municipal Water District

($000, Audited Years Ended June 30)	2015	2016	2017	2018	2019
Pension Expense	N.A.	N.A.	11,593	17,875	17,348
Adjusted FADS	**100,727**	**143,803**	**147,812**	**181,846**	**198,096**
Net Adjusted Debt to Adjusted FADS (x)	**8.7**	**5.3**	**7.2**	**5.3**	**4.5**
FADS	80,063	126,186	116,090	140,925	159,584
Fixed Services Expense	20,664	17,617	20,129	23,046	21,164
Net Transfers In/(Out)	—	—	—	—	—
Adjusted FADS for COFO	**100,727**	**143,803**	**136,219**	**163,971**	**180,748**
Total Annual Debt Service (Automatic Calculation)	39,384	36,570	40,046	48,364	51,021
Fixed Services Expense	20,664	17,617	20,129	23,046	21,164
Adjusted Debt Service (Inc. Fixed Services Expense)	**60,048**	**54,187**	**60,176**	**71,410**	**72,186**
Coverage of Full Obligations (COFO) (x)	**1.68**	**2.65**	**2.26**	**2.30**	**2.50**
COFO exc. connection Fees (x)	**1.29**	**1.82**	**1.56**	**1.61**	**1.71**
Current Days Cash on Hand	**346**	**354**	**431**	**478**	**528**
Liquidity Cushion Ratio (Days)	**346**	**354**	**431**	**478**	**528**
All-in DSC (x)	2.03	3.45	2.90	2.91	3.13

N.A. – Not available. Note: Fitch may have reclassified certain financial statement items for analytical purposes.
Source: Fitch Ratings, Fitch Solutions, Eastern Municipal Water District (Riverside County) (CA).

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.