

FITCH AFFIRMS SAN ELIJO JOINT POWERS AUTHORITY, CA'S REVS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-31 August 2015: Fitch Ratings affirms its 'AA' rating on the following San Elijo Joint Powers Authority, California (the JPA) bonds:

--\$6.8 million refunding revenue bonds (San Elijo Water Reclamation Facility), series 2011.

The Rating Outlook is Stable

SECURITY

The bonds are payable from loan installments made by the JPA's members (i.e. the cities of Solana Beach and Encinitas) to the trustee. Each member's obligation to pay installment payments is a first and prior lien on and pledge of net revenues of the members' respective wastewater enterprises; Encinitas' installment payments are derived solely from the city's Cardiff Sanitary Division. Based on the 2011 loan agreements, roughly 52% of the debt is to be paid by Solana Beach and 48% is to be paid by Encinitas. The bonds are also secured by a debt service reserve fund, which is satisfied with a surety policy.

KEY RATING DRIVERS

MEMBER CREDIT QUALITY KEY: The rating on the authority's bonds is informed by the credit quality of the contributing members - the sanitation enterprise fund of the City of Solana Beach (Solana Beach) and the Cardiff Sanitation Division of the City of Encinitas (Encinitas). Each member is only required to pay its proportional share of SEJPA debt service; thus the analysis of member credit quality focuses primarily on Solana Beach, which has weaker coverage levels and a higher debt burden than Encinitas.

STRONG FINANCIAL RESULTS OF MEMBERS: Both members demonstrate consistent fiscal performance in recent years, characterized by stable debt service coverage and robust liquidity.

ESSENTIAL SERVICE: The authority provides an essential service, with all wastewater flows from member service areas diverted to the JPA's facilities (the system).

GROWING DEBT PROFILE: The system's debt profile will be increasing by \$18.3 million, due to a largely debt financed, five-year capital plan. Debt per capita ratios are estimated to grow to the moderately high level of over \$703 per capita from a very low \$201 per capita currently.

REASONABLE RATES: Member user charges are moderate and should remain within Fitch's affordability benchmark, based on SEJPA's debt plans.

LIMITED BUT AFFLUENT SERVICE TERRITORY: The predominantly residential service area is relatively small, but is stable and includes high wealth levels.

RATING SENSITIVITIES

WEAKENED FINANCIAL PROFILES: Deterioration in the credit quality of Solana Beach or Encinitas and/or deterioration in San Elijo Joint Powers Authority's own financial position would pressure the rating.

CREDIT PROFILE

The JPA, established in 1963, provides residential and non-residential wastewater treatment services to a population of around 34,000 residents. The treatment facility is owned and operated by the JPA, which acts as a wholesale provider of wastewater treatment to the cities of Solana Beach and Encinitas (the members) while the members maintain responsibility for their respective wastewater collection infrastructure. Based on the loan agreements related to the series 2011 bonds, 52% of the debt will be paid by Solana Beach and 48% will be paid by Encinitas.

Located in northwest San Diego County, the JPA's service area encompasses around 19 square miles. The members' primarily residential beach communities are characterized by their desirable location, high wealth levels with high-end housing, and slow growth.

AGREEMENT WITH MEMBER CITIES

The JPA is governed by a four-member board of directors, with two members representing Solana Beach and two representing Encinitas. A general manager oversees operations of the JPA and reports to the board of directors. Management is tenured and well-qualified.

There is no step-up provision between the members on the JPA bonds, although there is a common debt service reserve pledged to the JPA bonds that may be used in the event one or both members fail to make their payments when due. Neither member has ever failed to make timely payments of their respective obligations to the JPA. Each member has agreed under their respective loan agreements to set rates and charges at no less than 1.3 times (x) annual debt service (ADS) on their portion of JPA's bonds, parity debt, and any amount required to replenish the debt service reserve on the JPA's bonds, if needed. Under the loan agreements, the members may issue additional bonds on parity with the JPA loan provided net revenues of the respective system equal at least 1.3x ADS based on a test that includes rates and charges in effect for part of the year or from expected increased revenues resulting from construction with bond proceeds. No senior debt is permitted, and no additional debt is planned by member cities at this time. The 1.3x ADS is more conservative than typically seen but this is offset by the inclusion of projected revenues.

Consistent with its role as a joint action agency, the JPA has limited financial cushion with typically minimal coverage of all debt service, although liquidity has been strong at over 500 days cash on hand. Given this limited cushion, the credit quality of the members and their financial performance is an important rating factor.

AFFORDABLE RATES, STRONG COLLECTION PROVISIONS

Solana Beach and Encinitas both have raised rates in recent years, enhancing the financial performance of their respective utilities. Member wastewater charges are billed and collected by the county along with property taxes. Wastewater service rates are relatively reasonable, providing the members sufficient ongoing rate affordability if needed. Encinitas annual sewer fee totals \$622 as of fiscal 2014 and registers an affordable 0.7% of median household income (MHI), and Solana Beach's annual sewer fee totals \$588 for fiscal 2014 and also registers an affordable 0.8% of MHI.

AMPLE TREATMENT CAPACITY/GROWING DEBT PROFILE

The JPA treatment facility's capacity totals 5.25 million gallons per day (mgd), well in excess of the 3.0 mgd average daily flows. This excess capacity is projected to exceed demand at build-out of the members' service areas, which is projected by 2030. The JPA's 2016-2020 capital improvement plan (CIP) totals just over \$22 million. The CIP focuses on land outfall evaluations (\$5.2 million) and necessary system maintenance (\$17.2 million). The JPA and the city of Escondido are joint owners

of and users of the outfall, at 21% and 79%, respectively. The JPA plans to debt finance \$18.3 million of its related CIP costs, with the city of Escondido funding \$4.1 million related to its share of the land outfall evaluation costs. The planned debt issuance will increase the system debt burden to a moderately elevated \$703 debt per capita in fiscal 2016 from a very low \$201 debt per capita as of fiscal 2015. The elevated level is still in line with the median for the rating category, and the JPA benefits from very rapid amortization with all outstanding bonds maturing within 10 years. The additional CIPs for each member appear manageable.

The JPA is not permitted under the trust indenture to issue additional bonds payable by revenues from the members under the current loan agreement. The financing details regarding the planned \$18.3 million debt issuance are still in the preliminary stages and lien status and allocation of member participation has not yet been determined. Fitch anticipates the new issuance structure to not be appreciably different from the current structure.

ROBUST LIQUIDITY, STABLE COVERAGE FROM SOLANA BEACH

Solana Beach produced solid ADS coverage of 1.8x on an all-in basis for fiscal 2014, while reporting senior lien coverage (Solana Beach's portion of the JPA's debt) of over 2.2x since fiscal 2006. Liquidity was very strong at over 1,000 days cash on hand for fiscal 2014. The city has increased rates by 2.5% for fiscal 2014 and anticipates future annual 2.5% rate increases through fiscal 2020. These rate adjustments should keep coverage levels in line with historical norms. Solana Beach's debt ratios are average, but could become elevated depending on the level of participation in the JPA's future bond issuance. Solana Beach's debt outstanding consists of \$3.6 million in JPA debt and approximately \$8 million of its own sewer system revenue secured debt, which is subordinate to the repayment of JPA bonds.

ENCINITAS FINANCIAL METRICS EXCEPTIONAL

Encinitas' financial results have remained excellent through the last five years. All in coverage has averaged 4.0x and liquidity is very robust at over 2,000 days of cash on hand. Fiscal 2014 saw strong DSC of 4.7x. Encinitas has no other debt outstanding except that of the JPA, resulting in a low debt burden of \$181 per capita.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014)

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

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 31 Jul 2013)

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

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