

RatingsDirect®

Summary:

San Elijo Joint Power Authority, California; Water/Sewer

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Credit Profile

San Elijo Jt Pwr Auth

Long Term Rating

AA+/Stable

Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA+' long-term rating (SPUR) on the San Elijo Joint Power Authority (SEJPA), Calif.'s outstanding wastewater revenue bonds.
- The outlook is stable.

Credit overview

The rating affirmation is based on our view of SEJPA's consistent financial performance and the stable financial performance of the member participants, Solana Beach and the Cardiff Sanitary Division (Encinitas). Each participant owns half of the San Elijo wastewater treatment facility, and has strong finances and a flexible customer base with strong economic fundamentals. The rating is based on a weak-link structure; however, we view the credit characteristics of both member participants as comparable. The SEJPA wastewater treatment facility treats sewage from Solana Beach and the Cardiff Sanitary Division, which is either processed and discharged into the ocean or recycled and sold as recycled water for landscape irrigation, which is of increasing importance in the San Diego area due to vulnerability to drought risk. Operation and maintenance (O&M) expenses at the facility are allocated on the basis of percentage of use, as indicated by measured flows. Also benefiting the rating is the economies of scale due to the 2017 expansion of wastewater treatment services and reclaimed water sales to neighboring beach communities, as well as ample wastewater treatment capacity and an economic base with strong underlying fundamentals. Furthermore, the authority has completed the first two phases of its long-term capital improvement plan (CIP) and plans to complete Phase 3 in 2025.

Based on our calculations, the Cardiff Sanitary Division of the city of Encinitas posted extremely strong all-in debt service coverage (DSC) of its loan payments to SEJPA of 1.7x in fiscal 2022. The division maintained all-in DSC of no less than 2x in the past five fiscal years. It also maintains unrestricted cash balances of \$9.9 million, equivalent to 1,131 days of operating expenses at fiscal year-end 2022, down from \$13.5 million in fiscal year 2016. Including Solana Beach's direct sanitation system debt and loan payments to the SEJPA, Solana Beach posted all-in DSC of 2.8x in fiscal 2022, and DSC no lower than 1.7x in the past five years. The sanitation system has also historically maintained a very strong liquidity position, in our view, with unrestricted cash of \$11.1 million as of the end of fiscal year 2022, or about 1,367 days of operating expenses. The authority has generally maintained coverage at or above 1.5x over the past four years when including member capital contributions, and currently maintains liquidity of around \$13.2 million. Given the ongoing capital projects, SEJPA could possibly spend down some of its liquidity reserves; however, management

does not project liquidity to drop in the near term.

Environmental, social, and governance

We view environmental risks as elevated, given California's frequent droughts and water scarcity challenges, as well as wildfire and seismic risk. Despite this environmental risk exposure, which is a negative credit consideration in our analysis, the authority's active pursuit of recycled water somewhat mitigates this risk, in our view. The authority continues to successfully work with its member agencies to induce the development of new local supply, including the aforementioned recycled water for irrigation and brackish groundwater treatment. In addition to maintaining comprehensive and credit-supportive policies and practices, SEJPA performs long-term capital planning, has rate-setting autonomy, and maintains cyber security controls to ensure adequate asset risk and resiliency, and this supports our view that governance is neutral in our credit analysis. Finally, given the low wastewater rates relative to incomes in the service areas of its members, we view social risks as credit neutral. We understand the authority is currently approved to increase rates by 3.9% annually through fiscal year 2026 and will continue recommending updates to its future rate plans to meet revenue sufficiency in the future. That said, we do not believe this will significantly increase affordability pressures or social risks, given the current wastewater bill is less than 0.75% of local incomes for members.

Outlook

The stable outlook reflects our view of SEJPA and its member participants' stable operations and consistently strong liquidity position. During the two-year outlook period, we anticipate that the authority and its members will continue to raise rates to fund the wastewater CIP in line with management's current forecasts. The outlook also reflects our anticipation that SEJPA will produce strong financial metrics due to its pre-approved rate plans, and that the economic stability of the customer base will further reinforce SEJPA's credit quality.

Downside scenario

If any member's credit profile were to significantly decline such that we believe it would have a substantial effect on the authority's credit profile, or if the authority's financial position were to erode materially due to the ongoing capital projects or operating cost inflation, we might lower the ratings.

Upside scenario

We do not anticipate taking a positive rating action during the two-year outlook period, barring changes in our opinion of the participants' creditworthiness. In the longer term, we could consider raising the rating on the SEJPA debt if we raise the ratings on its members.

Credit Opinion

The members are primarily residential beach communities located about 20 miles north of San Diego and are characterized by their desirable location and high wealth levels. Both communities are largely built out. The number of wastewater accounts in Solana Beach is about 2,800 and, in Cardiff Sanitary Division, about 7,300. We understand that residents can commute throughout the San Diego metropolitan statistical area for employment opportunities. We view

the customer base's income levels as very strong, based on the median household effective buying incomes (MHHEBIs) of about 162% of the national median in Solana Beach, and 164% of the national median in Encinitas. Wastewater bills for Solana Beach and Encinitas come out to approximately 0.74% and 0.62%, respectively, of each city's MHHEBI. The unemployment rate in Solana Beach was 3.4% in November 2022, and in Encinitas it was 2.7%, lower than the state's and the nation's rates.

Solana Beach and Encinitas have each entered into separate loan agreements to finance their respective shares of the SEJPA's outstanding debt. Each city has pledged net system revenues (defined as gross revenues less O&M expenses) from its respective wastewater collection system. However, neither city is responsible for the other agency's installment nor is obligated to make up any deficiencies for the other. While the authority has chosen not to establish a debt service reserve fund for the series 2017 bonds, its strong liquidity mitigates any credit risk.

The SEJPA provides recycled water to the Santa Fe Irrigation District, the San Dieguito Water District, Del Mar, and Olivenhain Municipal Water District, none of which have financial participation with respect to the wastewater treatment facility bonds or loan agreements of the authority. The SEJPA maintains separate capital plans for the wastewater treatment program and the recycled water program. The first two phases of the capital plan implemented in 2017 have been completed, and Phase 3 has begun construction. Management projects Phase 3 will cost \$12.1 million through 2025 and expects it will be funded through member capital contributions; Phase 4 of the CIP is estimated to cost around \$12 million and will likely be funded through a combination of grants, accumulated capital cash, and a potential private placement loan.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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