FitchRatings

23 JUL 2024

Fitch Upgrades Yorba Linda Water District CA's Water Revs Outlook to 'AAA'; Outlook Stable

Fitch Ratings - Austin - 23 Jul 2024: Fitch Ratings has upgraded the rating on the following bonds issued by the Yorba Linda Water District (YLWD or the district) to 'AAA' from 'AA+':

--$23.9 million YLWD Financing Authority, CA revenue bonds series 2017A (issued on behalf of the district).

The district's Issuer Default Rating (IDR) has also been upgraded to 'AAA' from 'AA+'.

The Rating Outlook is Stable.

The 'AAA' revenue bond rating along with the 'AAA' IDR reflect the district's 'Exceptionally Strong' financial profile within the framework of 'Very Strong' revenue defensibility and 'Very Strong' operating risk profile, both assessed at 'aa'. The district's leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS), was extremely low at 4.0x in fiscal 2023 and is projected to decline notably to around 1.2x over the five-year horizon in Fitch's Analytical Stress Test (FAST) rating case, retaining comfortable flexibility for the upgraded rating.

The upgrade is driven by consistent improvement in leverage following the district's implementation of a multi-year rate package extending through fiscal 2026. Additionally, a recently constructed per- and polyfluoroalkyl (PFAS) treatment plant is now fully operational, which has allowed the district to shift back to local groundwater supply driving water production costs lower. The upgrade also considers the district's contract debt related to the Orange County Water District

(OCWD) and leverage is expected to remain below 5.0x through the rating case.

SECURITY

The revenue bonds are parity obligations secured by net water revenues of the district after payment of operations and maintenance expenses.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Favorable Service Area, Affordable Rates for the Vast Majority of the Population: The district retains the legal authority to adjust rates as needed without external oversight. Fitch considers the monthly residential water bill affordable for approximately 89% of the service area population based on standard monthly usage of 7,500 gallons.

The very favorable service area is characterized by very strong income levels, a moderate unemployment rate relative to the nation and midrange customer growth. Customer growth registered a five-year compound annual growth rate of 0.4% as of fiscal 2023. Income levels are about 97% higher than the national median as of 2022. The unemployment rate has decreased to 3.1% since 2020, and was 14% less than the national average in 2023.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Moderate Investment Needs:

In fiscal 2023, the system's operating cost burden was very low at $7,256 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was low at 39% in fiscal 2023. Annual capital spending relative to depreciation is weak averaging 75% over the last five fiscal years from 2019 to 2023. Spending in recent years focused primarily on rehab and replacement; OCWD covered the costs of constructing the PFAS treatment facility. Planned capital spending for the next five years should be in line with historical depreciation, allowing for stability in the currently low life cycle ratio.

Planned capex for fiscal years 2024-2028 totals around $30.6 million and will be funded with existing bond proceeds and on a pay-go basis. Projects include pump stations, well rehabs and the district has accelerated some water line replacements to address certain lines that are experiencing shorter-than-anticipated life spans. No additional debt is currently expected.

Financial Profile - 'aaa'

Leverage to Decrease. The district had extremely low leverage of 4.0x as of fiscal 2023. Leverage has been on a declining trend since fiscal 2020, improving from 4.6x to 4.0x by fiscal 2023, as continued rate increases have driven leverage lower due to FADS increasing YOY. The liquidity profile is neutral to the overall assessment with current days cash on hand of 462 and coverage of full obligations of 1.0x. Fitch-calculated total debt service coverage for fiscal 2023 was 1.1x, which excludes fixed service expense.

The FAST considers the potential trend of key ratios in a base case and stress scenario over a five-year period. The stress scenario is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case scenario, the leverage ratio is projected to decrease to around 1.0x over the next five years. In the stress scenario, which is considered the rating case, the leverage ratio is expected to decline to around 1.2x through fiscal 2028, supportive of the upgrade. The liquidity profile is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating consideration.

RATING SENSITIVITIES

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

--Leverage of more than 5.0x on a sustained basis in Fitch's rating case.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/ Upgrade

--The rating is at the highest level on Fitch's scale and cannot be upgraded.

PROFILE

The district is an upper-income suburban community located in northeastern Orange County, approximately 35 miles southeast of downtown Los Angeles. The service area predominantly covers the city of Yorba Linda (the city), in addition to portions of Anaheim, Brea, and Placentia, and unincorporated county areas. About 93% of the district's customers are residential. The district typically gets about 77% of its supply from relatively affordable local groundwater. The remaining 23% is provided via water delivered from the Metropolitan Water District (MWD) of Southern California (AA+/Stable).

The district ceased water production from all wells in 2020 after the State Water Resources Control Board lowered the allowable levels of PFAS in the state's public drinking water. The district immediately started treatment plant design, developed a financial plan to recover associated costs and construction of an ion exchange PFAS treatment plant began in March 2021.

While the treatment plant was being constructed, the district did not have access to groundwater and had to import 100% of its water supply. The district's PFAS treatment plant became fully operational in April 2022 and the district was able to return to its typical operating plan, which calls for approximately 77% groundwater and 23% import water to meet the demand on the system. As of fiscal 2023, groundwater supply totaled 86%, while the remaining 14% was imported.

Updated U.S. Environmental Protection Agency (EPA) Regulations

The EPA's enhanced focus on lead and copper lines and PFAS contaminants has led to the introduction of the Lead and Copper Rule Revisions and the proposed Lead and Copper Rule Improvements, along with specific testing for PFAS chemicals. The district has been proactive in addressing PFAS contaminants in anticipation of the EPA's regulation.

The new treatment plant is working well and the district's supply meets or exceeds all federal standards for water quality, including the new standards set by the EPA's finalized rule. They have also conducted a comprehensive lead and copper inventory which has not raised any issues or concerns.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Yorba Linda Water District (CA)	LT IDR	AAA	Upgrade		AA+
• Yorba Linda Water District (CA) /Water Revenues/ 1 LT	LT	AAA	Upgrade		AA+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub.29 Feb 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Yorba Linda Water District Financing Authority (CA)	EU Endorsed, UK Endorsed

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