

# RatingsDirect®

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## Summary:

### Oxnard Financing Authority, California Oxnard; Joint Criteria; Water/Sewer

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## Credit Profile

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Oxnard, California

Oxnard Fincg Auth (Oxnard) wastewtr (AGM)

*Unenhanced Rating*

BBB(SPUR)/Stable

Outlook Revised

### Oxnard Fincg Auth wastewtr VRDB (Headworks & Septic Sys Projs) ser 2004B

*Unenhanced Rating*

BBB(SPUR)/Stable

Outlook Revised

*Long Term Rating*

AA+ / A-1 / Watch Neg

Various Actions

### Oxnard Fincg Auth wastewtr (Headworks)

*Unenhanced Rating*

BBB(SPUR)/Stable

Outlook Revised

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services revised its outlook to stable from positive on Oxnard Financing Authority, Calif.'s wastewater revenue bonds, issued for the City of Oxnard. At the same time, we affirmed our 'BBB' long-term rating and underlying rating (SPUR) on the authority's existing fixed-rate wastewater revenue bonds and the long-term component of our dual rating on the authority's 2004B bonds ('AA+ / A-1'). The 'A-1' short-term component of the rating remains unchanged.

The outlook change reflects our view of the system's adequate, but still thin, coverage metrics and the recent continued decline in liquidity.

The 'BBB' ratings reflect our view of the wastewater system's:

- Total debt service coverage (DSC) that has been improving and has been at adequate levels during the past few years, but is estimated to be insufficient for fiscal 2015;
- Moderately low service rates, which provide management with some revenue-raising flexibility; and
- Stable and diverse customer base.

These strengths are partly offset, in our view, by the wastewater system's:

- Additional capital needs of about \$121 million during the next five fiscal years and the city's expectation to issue additional debt, and
- Declining liquidity over the past few years to about 91 days' operating expenses in fiscal 2015.

The bonds are payable from installment payments that are secured by the net revenues of the city's wastewater system. The city's obligation to make the installment payments is absolute and unconditional. Parity obligations

include the series 2004B, 2006, 2013, and 2014 bonds. We view the bond provisions as permissive, with the rate covenant and additional bonds test allowing a minimum DSC of 1.0x as long as there is cash of at least 25% of maximum annual debt service (MADS). System connections are generally included in system revenues as part of the indenture; however, certain connection fees that are associated with specific projects are explicitly excluded. A standard debt service reserve fund at the least of 10% of par, MADS, or 1.25x average annual debt service is provided.

Oxnard, with a population of approximately 205,000, is situated approximately 62 miles west of Los Angeles in Ventura County. Historically, the city served as a processing and service center for a surrounding agricultural region, but the city's economic base now includes a diverse mix of industrial and commercial activity, along with a base of regional commuter neighborhoods. Income indicators for the city are strong, in our view, with 2014 median household effective buying income (EBI) at 113% of the national median. However, per capita EBI is significantly lower, at 68% of the national median. During the past three years, the unemployment rates for the city have been higher than the county and national rates and marginally lower than the state rate. According to August 2015 data, the unemployment rate is 6.3%.

The customer base is very stable and primarily residential, with less than 2% annual growth over the past five years and residential customers representing about 93% of all accounts. The customer base is very diverse, in our view, with the 10 leading customers representing 12% of total revenues in 2014. The largest customer, Procter and Gamble, represents 4.5% of total revenues while all other leading customers are less than 2% of total revenues.

The city's wastewater system provides wastewater collection and treatment to the city, Port Hueneme, and the Naval Base Ventura County. The city's wastewater treatment plant (WWTP) has an average dry weather flow capacity of 31.7 million gallons per day (mgd) and a peak wet weather flow capacity of 75.4 mgd. The WWTP has sufficient capacity for the city's existing average flow of about 22 mgd. Management reports that it expects regulatory changes that will require some changes to the existing plant, but not within the next five years.

The current rate structure for residential customers includes a base charge and a three-tiered volumetric component. For fiscal 2014, the base rate for a single-family residence was \$21.07, and using our benchmark monthly usage of 1,000 cubic feet, we calculate a monthly bill of \$35.57. When annualized, the sewer rate represents approximately 0.9% of 2014 median household EBI, which we view as affordable. The city recently received approval from its council to proceed with the Proposition 218 public hearing process to increase the wastewater rates. Proposed rate increases include a 35% rate increase for fiscal 2016 followed by a 10% increase in fiscal 2017 and subsequent 8% annual increases in fiscal 2018 to 2020. If approved, the city plans to implement the first set of rate increases in March 2016.

The city currently estimates approximately \$121 million in capital improvement plan projects during the next five years, with the focus primarily on rehabilitation projects. When changes to the treatment plant are needed, the city expects reconstruction costs to be about \$400 million. Based on the current rate study projections, the city anticipates approximately \$135 million in additional borrowing in the next five years.

Total DSC, which includes the subordinate loan from the water fund, has improved during the past few years from insufficient levels seen in fiscal 2010 and 2011. As of the end of fiscal 2015, the water loan has been paid off. Total DSC for fiscal years 2013 and 2014 was 1.07x and 1.09x, respectively, and from unaudited 2015 data, coverage is expected



to be about 1.08x, which is adequate. When not including one-time connection fees, coverage was still insufficient for fiscal 2013 and fiscal 2014. With the proposed rate increases, we expect coverage to improve to at least good levels during the outlook horizon. However, this is highly dependent on the city's adoption of the proposed rate increases.

The wastewater system is exposed to sudden liquidity calls, due to its use of hedged variable-rate debt. At the end of fiscal 2015, the outstanding par of hedged variable rate debt was \$17.7 million, which represents approximately 15% of the system's \$120 million of existing debt. The variable-rate bonds are hedged by an interest rate swap provided by Royal Bank of Canada, and the city reported a fair value for the swap of negative \$4.1 million as of October 2015. We understand that a termination event is triggered if the rating on the wastewater system's bonds falls below 'BBB'.

System liquidity has been strong during the past few years, with cash consistently above 150 days' operating expenses since fiscal 2010. Cash declined, however, to \$7.5 million in fiscal 2014, representing 140 days' operating expenses. From unaudited 2015 data, cash was drawn down further, to about \$5 million, or 91 days' operating expenses, which we consider good. If the rate increases are implemented, management's forecast shows cash levels staying at good levels during the outlook horizon.

## Outlook

The stable outlook reflects our view of the wastewater system's improving coverage metrics that have been at adequate levels during the past few years. However, these improvements are partly offset by the system's declining liquidity, which we do not expect to return to strong levels during the two-year outlook horizon. The credit is further stabilized by the system's ample treatment capacity and stable customer base.

### Upside scenario

We could raise the ratings if the proposed rate increases are implemented and result in sustainable improved financial performance that is comparable to those of peers at a higher rating level.

### Downside scenario

We may lower the ratings if liquidity continues to deteriorate during the outlook horizon. We could also lower the ratings if coverage projections are not met and are insufficient.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015 Criteria Update: Joint-Support

Criteria Refined, Feb. 3, 2006

- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

#### **Related Research**

- U.S. State And Local Government Credit Conditions Forecast, Oct. 20, 2015
- U.S. Municipal Water And Sewer Utilities 2014 Sector Outlook: Learning To Do More With Less, Jan. 9, 2014
- 2014 Review Of U.S. Municipal Water And Sewer Ratings: How They Correlate With Key Economic And Financial Ratios, May 12, 2014

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