S&P Global Ratings

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Summary:

Southern California Metropolitan Water District; General Obligation; Water/Sewer

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Credit Profile		
US$100.05 mil sub wtr rev rfdg bnds ser 2018A due 07/01/2023		
Long Term Rating	AA+/Stable	New
US$65.355 mil sub wtr rev bnds ser 2018B due 09/01/2028		
Long Term Rating	AA+/Stable	New
Southern California Metro Wtr Dist wtr		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the Metropolitan Water District of Southern California's (MWD, or the district) 2018 series A subordinate water revenue refunding bonds and 2018 series B subordinate water revenue bonds. At the same time, we affirmed our ratings on the district's existing revenue bonds, including our:

- 'AAA' long-term rating and underlying rating (SPUR) on MWD's senior-lien revenue bonds,
- 'AA+' long-term rating on MWD's subordinate-lien revenue bonds,
- 'A-1+' short-term rating on MWD's senior-lien self-liquidity revenue bonds (variable-rate bonds without bank enhancement), and
- 'AAA' long-term component of the dual rating on MWD's special variable-rate water revenue bonds (variable-rate bonds with bank liquidity facilities).

The outlook, where applicable, is stable.

The ratings reflect our view of the district's:

- Role as the primary wholesaler to an extremely robust and diverse service territory in Southern California;
- Ability to draw water supplies from the Colorado River, the State Water Project (SWP), stored water, and supplemental water transfers to keep supplies and regional demands in balance;
- Strong financial management, which includes conservative financial forecasting, robust drought and resource adequacy planning, and well-delineated policies to address any contingent liabilities;
- Extremely strong member credit quality, particularly that of San Diego County Water Authority (SDCWA) and Los Angeles Department of Water and Power (LADWP); and
- Demonstrated willingness and ability to raise rates, with board-approved 3.0% rate increases effective Jan. 1, 2019, and Jan. 1, 2020, and projected 3.0% to 4.1% annual rate increases planned (not yet board approved) through 2028, which, in our view, will support sound financial metrics.

The district has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the system's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

The district is issuing the 2018 series A bonds to refund certain existing senior-lien revenue bonds for annual debt service savings, and the 2018 series B bonds to finance a portion of the district's capital investment plan.

The 2018 series A and B bonds are secured by a subordinate lien on the net operating revenues of the district's water enterprise. Following the issuance of the 2018 series A and B bonds, the district will have about $3.0 billion of senior-lien debt obligations, and about $1.0 billion of subordinate-lien debt obligations. Key bond provisions include a rate covenant and additional bonds test, both of which are set at 1.0x for the subordinate-lien bonds. MWD's board policy is to maintain 2.0x annual senior-lien debt service coverage (DSC) by net operating revenue, which we view as strong, and 1.2x fixed-charge coverage (across both the senior and subordinate liens), which we view as good, especially for a wholesaler.

We view the master subordinate resolution bond provisions to be somewhat permissive. The resolution adjusts the "assumed" debt service for certain "covered obligations" in the rate covenant, such as for any principal and interest payments under a revolving credit facility (as long as the facility is outstanding) and any mandatory tender payments of any index tender bonds (or potential variable-rate demand obligations [VRDOs]) to be issued on this lien. At the same time, failure to remarket the bonds on the scheduled mandatory tender date is considered an event of default. Given MWD's extremely strong credit quality, a failed remarketing would most likely be driven by a factor or event exogenous to the district. We understand that in the event MWD is unable to cover any mandatory tenders with the proceeds of the remarketing of the index tender bonds, MWD would refund the bonds before the scheduled mandatory tender date, requiring future market access, or by temporarily drawing upon available reserves of the district. MWD may also use available capacity under its revolving credit agreements for this purpose. The resolution also revises the assumed interest rate on variable-rate obligations for purposes of the subordinate-lien rate covenant to be equal to the average of the Municipal Swap Index of Securities Industry and Financial Markets Association (SIFMA) for the 12-week period immediately preceding the calculation date.

MWD is the main water wholesaler to 26 member agencies serving approximately 18.9 million customers in Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura counties in Southern California. The district provides 40% to 60% of the water within its 5,200-square-mile service area, depending on water conditions. The leading 10 customers represented about 85% of water transaction revenues and water volume in fiscal 2017, with the SDCWA the largest customer, at about 20% of water transaction revenues and 25% of water volume. Although no customer is required to purchase water from MWD, all members must pay a readiness-to-serve charge calculated from historical purchase levels.

The district's service territory is extremely large, offering it several advantages, including the ability to spread its costs over a large customer base. In addition, a very minor rate increase can generate millions in water transaction revenues. MWD filters and disinfects an average of 1.7 billion to 2.0 billion gallons of water per day at five treatment facilities, with a total maximum treatment capacity of 2.4 billion gallons per day. About 50% of MWD's delivered water requires treatment.

On May 21, 2018, the California Department of Water Resources notified the State Water Contractors that it had increased its calendar year 2018 allocation of SWP water to 35% of contracted amounts, or 669,025 acre-feet for MWD. This level is down from the 60% and 85% allocations for 2016 and 2017, respectively, but above the 5% and 20% allocations for 2014 and 2015, respectively, which was experienced during the most severe portion of the most recent drought. Based on the 35% SWP allocation and the availability of the district's other water supplies, such as Colorado River water, management anticipates that the district's water storage levels will likely remain stable relative to the preceding year at about 2.5 million acre-feet (MAF) of dry-year storage as well as 626,000 acre-feet of emergency storage.

For 2017, the district's water transactions totaled 1.54 MAF, which was the lowest level since 1999 and down from the 10-year high of 2.26 MAF in 2008. For forecasting purposes, the district assumes that water transactions will gradually rise to 1.80 MAF in 2021 and then remain stable thereafter, based on Colorado River Aqueduct diversions of about 0.8 MAF to 0.9 MAF annually and SWP allocations of 50% annually. Although we believe these assumptions are reasonable as long-term averages, we expect that year-to-year actuals will vary significantly based on annual hydrologic conditions. In particular, demand from LADWP varies significantly depending on water availability from the southern Sierras, which feeds the Los Angeles Aqueduct.

We believe that recently implemented rate increases and board-approved future rate increases (as well as future rate increases, subject to board adoption) should allow the district's overall financial margins to remain sound in the near term, and that MWD's critical role as a key water supplier should provide it with revenue-raising flexibility. The district has adopted annual rate increases since 2004 and most recently adopted 3.0% rate increases effective Jan. 1, 2019, and Jan. 1, 2020. Based on the 10-year forecast, management anticipates annual rate increases of 4.1% for 2021 through 2028, which, along with the board-approved rate adjustments for fiscals 2019 and 2020, are anticipated to be sufficient to fund the district's 64.6% share of the WaterFix project.

MWD's near-term capital program is manageable, in our view, at $1.15 billion (or about $230 million per year on average; or $138 million in pay-as-you-go funding and $92 million in debt funding per year) through fiscal 2023. Major capital projects include Colorado River Aqueduct improvements and refurbishments, distribution system renewal and replacement projects, system reliability projects, and various projects at its Weymouth Treatment Plant and Diemer Treatment Plant.

The proposed California WaterFix (the revised approach to the Bay Delta Conservation Plan), a comprehensive plan for the Bay-Delta to address environmental and water supply issues, if implemented, would entail substantial infrastructure investment in the Delta and implementation of other conservation measures. The current draft of the plan contemplates using two 30-mile-long tunnels to convey water underneath the environmentally sensitive Bay Delta. We anticipate that SWP contractors will pay much of the California WaterFix cost, largely through the repayment of future bond issues. In particular, on April 10, 2018, MWD's board approved funding up to 64.6% of the total project costs--about $10.8 billion of the $16.7 billion (in 2017 dollars) total project costs--which is up significantly from prior estimates of about 25% to 30% of the total project costs. The change is attributable to MWD taking on the share of capacity that was left (uncommitted) by the contractors of the U.S. Bureau of Reclamation's Central Valley Project. On May 14, 2018, MWD and two other districts that agreed to fund the project formed a new agency, the

Delta Conveyance Design and Construction Joint Powers Authority, which will be responsible for the design and construction of the project. We understand that a separate joint powers authority will likely be formed within the next year to facilitate financing the project, and that the participating agencies will be responsible for their proportionate share of the new debt.

As of May 2018, MWD's water transactions forecast for fiscal 2018 is 1.59 MAF, 110,000 acre-feet under budget. The district's financial projections for fiscal 2018, based on preliminary financial results through March 31, 2018, and revised projections for the balance of fiscal 2018, reflect lower water transaction revenues that are estimated to be $94.6 million, or 7%, below budget, based on the revised water transaction projections. Overall projected expenses for the 12 months ending June 30, 2018, are $1.6 billion. This is $95 million, or 6%, less than budgeted expenses.

The combination of lower-than-budgeted water transaction revenues and expenses result in projected fiscal 2018 all-in (aggregate senior and subordinate revenue bond) DSC to be 1.5x. As calculated by S&P Global Ratings, MWD's all-in DSC was 1.6x in fiscal 2017, up from 1.4x in fiscal 2016. At the same time, we understand MWD is also projecting fixed-charge coverage--which includes the portion of SWP capital costs and WaterFix costs not paid from dedicated property taxes--to decline to about 1.2x by fiscal 2028 based on substantially rising costs associated with the WaterFix project. MWD's board policy is to maintain 2.0x annual senior-lien DSC by net operating revenue, which we view as strong, and 1.2x fixed-charge coverage (across both the senior and subordinate liens), which we view as good, especially for a wholesaler.

MWD has historically held a strong liquidity position in part to serve as a natural hedge against its variable-rate debt exposure. The total unrestricted reserve position (which consists of the Water Rate Stabilization Fund and the Revenue Remainder Fund) at the end of fiscal 2017 was $401 million, equivalent to 158 days of operating expenses, down slightly from the prior-year balance of $475 million. We understand the district does not plan to spend down its cash reserves, and we view strong reserves (and the maintenance of the dedicated credit facilities) as necessary if the district can't refund or remarket (or is unsuccessful in doing so) the $315 million of senior-lien self-liquidity weekly VRDOs or the $271 million of subordinate index tender bonds. Based on the 10-year forecast, management anticipates that unrestricted reserves will remain stable through 2019 and then gradually rise to more than $600 million by 2023.

Outlook

The stable outlook reflects our view that Southern California's continued dependence on MWD for water will likely remain strong, and that MWD's ability to supply needed water is critical to the health of the Southern California economy, creating a large political incentive to meet future water demand. The outlook additionally reflects our anticipation that MWD will raise rates sufficiently to manage through its capital needs during the next five years. We could lower the ratings or revise the outlook to negative, or both, in the unlikely event that the district's DSC or liquidity position significantly deteriorates.

Ratings Detail (As Of May 29, 2018)		
Southern California Metro Wtr Dist spl var rate wtr rev rfdg bnds		
Long Term Rating	AAA/A-1+/Stable	Affirmed

Ratings Detail (As Of May 29, 2018) (cont.)		
Southern California Metro Wtr Dist subordinate wtr rev rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Southern California Metro Wtr Dist var rate wtr rev rfdg bnds		
Long Term Rating	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist var rate wtr rev rfdg bnds		
Long Term Rating	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist water rev rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtrwks GO rfdg bnds ser 2014A dtd 12/11/2014 due 03/01/2016-2021		
Long Term Rating	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds ser 2017A due 06/30/2046		
Long Term Rating	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds (2008 Authorization) due 07/01/2024		
Long Term Rating	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds		
Short Term Rating	A-1+	Affirmed
Southern California Metro Wtr Dist wtr (FGIC) (SEC MKT)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist WTRSWR		
Long Term Rating	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist WTRSWR		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist WTRSWR		
Long Term Rating	AAA/Stable	Affirmed
Southern California Metro Wtr Dist WTRSWR		
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Long Term Rating	AAA/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,