S&P Global Ratings

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Summary:

Marina Coast Water District, California; Water/Sewer

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Credit Profile		
US$18.23 mil enterprise rev COPs ser 2024 due 06/01/2049		
Long Term Rating	AA-/Positive	New
Marina Coast Wtr Dist enterprise sr lien		
Long Term Rating	AA-/Positive	Outlook Revised

Credit Highlights

- S&P Global Ratings revised the outlook to positive from stable and affirmed its 'AA-' long-term rating on Marina Coast Water District, Calif.'s existing enterprise revenue debt.
- At the same time, we assigned our 'AA-' long-term rating, with a positive outlook, to the district's anticipated $18.23 million series 2024 enterprise revenue certificates of participation (COPs).
- The outlook revision reflects our opinion that there is at least a one-in-three chance that we could take a positive rating action during the two-year outlook period. The positive outlook also reflects our view that the district could sustain an improving financial risk profile through its economic expansion.

Security

The district is issuing the series 2024 COPs to finance the acquisition and construction of certain capital improvements to the water enterprise and wastewater enterprise. We view the COPs provisions as credit neutral. The installment payments are payable from and secured by the net revenue of the district's water enterprise and wastewater enterprise. Key provisions include a rate covenant and an additional bonds test, both of which are set at 1.25x annual debt service. We understand that the district is not providing a debt service reserve fund for the series 2024 COPs and, in our view, the enterprise system's financial profile, including very strong liquidity, precludes any credit risk.

Credit overview

The rating is underpinned by the district's service-area growth and improving financial profile, consistent track record of conservative budgeting and financial management, as well as its prudent approach to water-supply reliability to mitigate risks associated with climate variability and water shortages. Management reports that the Ord Community has substantial room for growth and is in the process of being redeveloped. The water enterprise has ample supply to meet medium-term demand but might require infrastructure upgrades as the Ord Community further develops. The district has enhanced its recent water supplies from a recycled water project with Monterey One Water (M1W) providing additional operating revenue starting fiscal 2023 from this new revenue stream. Given the recently approved five-year rate plan, we view the district's financial outlook as stable despite the layering of the 2024 COPs, but we note the influence of one-time, growth-related capacity fees that strengthens the district's all-in debt service coverage (DSC) metrics.

In our view, the key risks to the district's credit quality focus on its ability to manage customer growth and meet infrastructure-improvement objectives for planned capital projects. We believe management's success in securing capital grants and using accumulated capacity fees help temper risks from implementing a moderately sized capital improvement program (CIP). The district is in the process of restarting its desalination plant that can produce 300 acre-feet annually, but this facility has not been used since 2003 and would require rehabilitation prior to being placed in service again.

The rating further reflects our view of the district's:

- Diversified revenue base from water and wastewater service charges, recycled water sales, and capacity fees;
- Comprehensive water supply portfolio from mostly local sources--including reusing treated wastewater;
- Improved rate structure alignment in 2024 by increasing fixed cost recovery to 50%, insulating the district from water sales volatility during droughts;
- Improving financial metrics (projected all-in DSC average about 2.2x during the next five years as calculated by S&P Global Ratings) and liquidity reserves (averaging approximately 280 days cash on hand), which we anticipate will be sustained during the outlook period as management assumes significant annual rate increases through fiscal 2029; and
- Favorable debt ratios relative to its similarly rated peers, characterized by a pro forma 25% debt-to-capitalization ratio, coupled with a CIP totaling about $118 million through 2029.

Environmental, social, and governance

We analyzed the system's environmental, social, and governance (ESG) factors relative to its enterprise and financial risk profiles and view its social and governance risks as neutral in our credit rating analysis. Given its location in California, we view the district as facing challenges from acute and chronic environmental physical risks stemming from drought, wildfires, seawater intrusion and coastal flooding. Given the nature of hydrological volatility, asset adequacy (water shortage) is an ongoing risk. The district has completed water-service-reliability assessments, which indicate it has supply capabilities sufficient to meet expected demands from growth. Importantly, we consider the district's ability to use recycled water and the proposed restarting of its desalination facility to be credit supportive, as this supply helps insulate it from drought and shifting precipitation patterns. The environmental risk exposure is partially mitigated by the district's emergency preparedness plans. The district performs comprehensive cost-of-service rate studies every five years, and rates are adjusted annually, which we believe reduce social risk. In addition, we believe governance factors are firmed by credit-supportive management policies and practices.

Outlook

The positive outlook reflects our view of management's conservative capital-finance strategy, diverse water supply, adequate treatment capacity, as well as its improving economic and financial profile. The outlook also reflects our view of the district's continued customer growth that will likely diversify its customer base while improving its liquidity position. Supporting this view is management's commitment to steady annual rate adjustments to offset rising cost-of-service as it progresses through its CIP.

Downside scenario

Should the district's service area experience a sustained material negative shift in economic momentum that erodes its market position assessment, we could revise the outlook to stable. In addition, should the size or scope of its long-term CIP become larger than expected--to the point that all-in DSC and cash reserves would likely materially underperform its financial projections, we could revise the outlook to stable.

Upside scenario

We could raise the rating, if the district's economic profile significantly strengthen, as demonstrated by customer diversification and rising incomes while maintaining financial metrics at a level that we consider sustainable as it progresses through its CIP. Given that there are no disproportionately large programs in its capital budget such as regulatory mandates, and that ongoing growth shares in the cost of related capital investments, we anticipate that the district will adjust its rate plans to consider actual service-area growth and service demands.

Credit Opinion

The district provides water and wastewater services to approximately 41,000 residents in two distinct communities: the City of Marina and the Ord Community, formerly the Fort Ord military base. The service area is in Monterey County about 80 miles south of San Francisco and 25 miles south of Santa Cruz along the California coast. While the Central Marina service area (5.6 square miles) is generally built-out, the Ord Community (about 45 square miles, of which the district's service area is about 16 square miles) has substantial room for growth and is in the process of being redeveloped. Within the Fort Ord service area is California State University Monterey Bay as well as the Fort Ord National Monument.

The district's customer base is growing and primarily residential, but moderately concentrated. We anticipate the growing base will provide additional customer diversification over the long term. Management forecasts that projected connections will increase by about 3.5% annually during the next five years as development activity in the Ord Community increases. Residential customers make up about 92% of system connections, which we believe contributes to revenue stability. We consider the customer base to be moderately concentrated based on the leading 10 customers accounting for about 39% of water service revenue. The leading customers are the City of Seaside and Monterey Bay Military Housing.

We view management's financial forecast assumptions as reasonable, although our expectations are tempered by the potential for development to progress less quickly than forecast or for development-related fees to be received less evenly than assumed. We understand that the forecast incorporates the district's approved rate increases and assumed growth in the customer base. Based on the recent rate redesign, water rates are increasing between 6% and 39% over the next five-year period. Based on management's forecast, we anticipate that all-in coverage will average above 2.0x through fiscal year 2029. In our coverage calculation, we allocate a portion of the capital and debt cost related to M1W's advanced water purification facility to the district as fixed charges.

Marina Coast Water District, Calif.--Economic and financial data					
		Fiscal year-end			
	Most recent	2023	2022	2021	Median (AA-)
Economic data					
Water customers	10,530				12,715
Sewer customers	10,051				12,120
MHHEBI of the service area as % of the U.S.	106.0				100.0
Unemployment rate (%)	3.7				3.6
Poverty rate (%)	12.1				10.5
Water rate (6,000 gallons or actual) ($)	93.0				39.0
Sewer rate (6,000 gallons or actual) ($)	40.6				41.0
Annual utility bill as % of MHHEBI	2.3				1.2
Operational Management Assessment	Good				Good
Financial data					
Gross revenues ($000s)		20,595	18,812	17,598	14,461
Total operating expenses less depreciation ($000s)		17,363	12,817	13,675	10,316
Net revenues available for debt service ($000s)		21,702	11,271	7,853	--
Debt service ($000s)		3,821	3,495	3,494	--
S&P Global Ratings-adjusted all-in DSC (x)		5.2	3.0	2.1	2.0
Unrestricted cash ($000s)		14,165	11,551	7,524	14,565
Days' cash of operating expenses		298	329	210	534
Total on-balance-sheet debt ($000s)		55,378	59,436	56,566	28,615
Debt-to-capitalization ratio (%)		20.3	23.0	22.8	31.1
Financial Management Assessment	Good	--	--	--	Good

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Related Research

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