Summary:
California Statewide Communities Development Authority
St. Helena; Water/Sewer

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Credit Profile

California Statewide Communities Dev Auth, California
St Helena, California
California Statewide Comntys Dev Auth (St Helena) wtr & wastewtr (AGM)

Unenhanced Rating A-(SPUR)/Negative
Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised its outlook to negative from stable and affirmed its 'A-' long-term rating on the California Statewide Communities Development Authority's (CSCDA) water and wastewater revenue bonds, issued on behalf of the City of St. Helena.

The bonds are secured by installment payments made by the city to CSCDA under two separate installment purchase agreements. A pledge of the city's water system net revenues secures installment payments under one agreement, and a pledge of the city's wastewater system net revenues secures the installment payments under the other. The rating on the bonds is based on the weaker of the two systems, which in our opinion is the water system.

The negative outlook reflects our view that there is a one-in-three chance we could lower the rating if projected all-in coverage does not meet management-provided projections. Although the city preapproved rate increases for the next five years, there is uncertainty around consistent execution and if the new rates will fully recover system costs.

The enterprise risk profile reflects our view of the system's:

• Service area participation in the moderate Napa metropolitan area economy; which is centered on wine and tourism-related industries;
• Standard market position, which reflects higher-than-average service rates, which are somewhat offset by the service area's very strong income metrics;
• Very low industry risk as a monopolistic service provider of an essential public utility; and
• Standard operational management practices that are focused on improvements to maintain the integrity of the water and wastewater systems while adhering to mandated environmental regulations.

The financial risk profile reflects our view of the system's:

• Vulnerable water system all-in coverage that we expect to rise to an adequate level given management’s preapproved rate increases and strong liquidity position, with unrestricted cash equivalent to about $7.6 million;
• Very strong sewer system all-in coverage that we expect to decline to strong as expected debt service rises and...
strong liquidity position, with unrestricted cash equivalent to about $3 million;

• Moderately leveraged water and wastewater system based on a pro forma debt-to-capitalization ratio of 64% for both water and wastewater; and

• Good financial management practices and policies.

We view bond provisions as credit neutral. Key bond provisions include a rate covenant and an additional bonds test set at 1.2x annual debt service. The reserve account requirements for each installment purchase agreement are set at the maximum annual installment payment.

Enterprise risk

St. Helena (population: 5,969) is located in Napa Valley, 45 miles north of San Francisco, and is home to more than 250 wineries and restaurants. We believe that customers in the service area economy participate in the Napa metropolitan statistical area, which we classify as moderate. While the economy is concentrated in wine- and tourism-related industries, income levels are very strong, in our view, with median household effective buying income (MHHEBI) of 151% of the national level in 2016. Napa County's unemployment rate has historically been lower than the state and national levels. The county's unemployment rate for November 2017 was 3.9%, which was lower than the state rate of 4.6% and in line with national rate of 3.9%.

The system's customer base is small, but primarily residential, and very diverse. The water and wastewater systems served about 2,500 and 1,767 customers, respectively, in 2016. The customer base is built out, with minimal growth expected during the next five years. From fiscal 2012 to fiscal 2016, customer growth was about 2% annually. We consider the customer base to be diverse based on the leading 10 water and wastewater customers contributing about 16% and 9%, respectively, of total operating revenues for fiscal year 2016. The largest customers are Sutter Home Winery and Vineyard Valley, which accounted for less than 6% of total operating revenues.

We view the system's market position to be standard given the service area's very strong income metrics, but weakened somewhat by the county's poverty rate and higher-than-average system rates. The city bills monthly for water and sewer services; the rates include a fixed and a volumetric portion based on water usage. The city recently had its rate consultant update the 2016 water and wastewater rate study; the updated rates rely on additional debt and lower annual operating margins and have been preapproved through 2021. The rates were updated to provide customers rate relief by restructuring future funding sources for capital projects. For a typical residential customer using an average of 11 hundred cubic feet (HCF) of water per month and 7 HCF sewerage flow, the monthly-equivalent bill is about $204. In aggregate, we view the combined service rates to be higher than those of peers in the service area, at 3.5% of the city's MHHEBI. The county's poverty rate as reported by the U.S. Department of Agriculture is 9%, which we view as somewhat elevated and a weakening factor.

Water supply, in our view, is sufficient to meet system demand. The water system's primary source of supply is the 2,400 acre-foot reservoir at Bell Canyon, which is owned by the city. In an average year, approximately 1,000 acre-feet of water is treated and distributed from this source. In 2017, the maximum and average daily deliveries were 2.3 million gallons per day (mgd) and 1.9 mgd at the Louis Stralla Water Treatment Plant, which is a conventional plant with coagulation, sedimentation, and filtration. The peak and average daily demands were about 65% and 54% of total treatment capacity, respectively, which are enough to meet the minimal customer growth and the expected increase in demand. In addition, the city is able to pump groundwater from two wells; however, to preserve groundwater for the
deep-root systems of the area vineyards, management limits the amount of groundwater that is pumped. The city has also entered into an agreement with the city of Napa, under which the city is required to purchase 600 acre-feet of water annually during the term of the agreement, which expires in 2035. During the past three years, the city has not used more than the required purchase amount.

Wastewater treatment capacity is sufficient for current flows. The wastewater system's designed average dry weather flow (ADWF) capacity is 0.5 mgd, and the plant can treat up to 2.8 mgd during wet weather. The ADWF in fiscal year 2016 was 0.403 mgd, or 81% of capacity. During dry weather conditions, the plant discharges to spray irrigation fields, and during wet weather, when irrigation fields are saturated, the plant discharges to the Napa River. In reissuing the 2016 National Pollutant Discharge Elimination System permit, the Regional Water Board found that requiring the discharger to build an outfall to nontidal waters (more than 40 miles away) or not discharge under any circumstances, including wet weather, would impose an undue burden. We understand that, in granting the exception, the discharger must provide equivalent protection when discharging to the Napa River by providing advanced secondary treatment by 2021, which could include more stringent biochemical oxygen demand and total suspended solids effluent limitations. While management indicates that it may be able to meet the permit terms through additional inflow and infiltration mitigation and operational changes, the capital costs, in our view, will not be known until a feasibility report is completed later this year.

Based on our operational management assessment, we rate the water system a '4' on a six-point scale in which '1' is the strongest. This indicates, in our view, that operational management and organizational goals are generally well aligned but that some challenges may exist. The city has water conservation guidelines and procedures for establishing water emergency phases. We understand that the city continues to provide transparency to its customers through annual water quality reports and updates on the city's website. We view rate-setting practices as reactionary based on two years of below 1.0x coverage (in fiscals 2015 and 2016). In fiscal 2016, the city preapproved rates, which were then revised downward in November 2017, which raises the concern of support for sufficient rate increases in the future. The new rates have been preapproved through 2021, which we view positively.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the system to be very low, the most favorable assessment possible on a '1' to '6' scale, with '1' being the best.

Financial risk
We view the water system's all-in coverage as vulnerable given the most recent fiscal year with below 1.0x coverage; we expect coverage to reach sufficiency in 2018 because of the significant 2017 and 2018 rate increases. All-in coverage is our internally adjusted debt service coverage metric that we believe best tracks the use of every dollar of utility operating revenues, regardless of lien position, accounting treatment, or ultimate purpose. This includes the payments to Napa for water. Based on the water system's audited financial statements, we calculate all-in coverage was 1.5x, 0.7x, and 0.5x for fiscal years 2014 through 2016, a range that we consider extremely strong to vulnerable. Based on draft 2017 financials, all-in coverage was vulnerable, at 0.6x. According to management, the coverage metrics from fiscal 2015 to fiscal 2017 were lower because the city capitalized interest on the series 2012 bonds prior to fiscal 2014 but did not have high enough rate increases to offset the future total debt service payments. The 3% annual rate increases from 2013 to 2016 were not sufficient to support the total debt service payments, which began in 2015. Based on management's updated 2016 rate study projections and the preapproved rates through 2021, we
expect coverage to reach sufficiency in fiscal 2018 and to stay stable during the next five years. We understand the city plans to issue additional debt to have a mix of funding sources for the water system’s total capital improvement plan (CIP). As is characteristic of smaller utilities with a somewhat narrow customer base over which to spread its fixed costs, a minor escalation in expenses could have a disproportionate impact on either system’s future all-in coverage, in our view.

The water system has historically maintained a strong liquidity position, and we anticipate that it will likely decline to fund a portion of the CIP but that it will stay strong. Despite the decline in all-in coverage, unrestricted cash has stayed stable during the past three fiscal years. At the end of fiscal year 2016, the water system held unrestricted cash of about $7 million, equivalent to approximately 630 days of operating expenses. We understand that the city expects to fund a portion of the CIP from cash on hand. Based on management-provided projections, we understand the amount of cash spent annually will fluctuate during the next five years between $130,700 and $3.3 million annually. Given management’s projections, we expect cash to decline but to exceed $2.5 million annually during the next five years.

We view the sewer system’s all-in coverage as very strong, although we expect coverage will thin as debt service is layered in to fund wastewater system improvements to comply with environmental regulations. Based on audited financials, we calculate coverage at 3.2x, 2.7x, and 2.8x for fiscal years 2014 through 2016. Based on draft 2017 financials, we expect all-in coverage of 2.5x. Based on management-provided projections, which include layered-in future debt service, we expect coverage to decline to between 1.0x and 1.9x during the next five years. We would expect operating expenses in relation to wastewater treatment to rise as additional debt service is layered in to fund capital improvements.

The sewer system has historically maintained a strong liquidity position, and we anticipate that liquidity will likely decline to fund a portion of the CIP but that it will stay strong. At the end of fiscal year 2016, the sewer system held unrestricted cash of about $3 million, equivalent to roughly 533 days of operating expenses. We understand that the city expects to fund a portion of the CIP from cash on hand. Based on management-provided projections, we understand the amount of cash spent annually will fluctuate between $40,000 and $1.9 million annually during the next five years. Given management’s projections, we expect cash to decline but to stay above $1.1 million annually during the next five years.

The water system’s CIP is large, in our opinion, and totals about $19 million through fiscal 2022. We view the water system’s debt burden as moderate given the pro forma debt-to-capitalization ratio of about 64%. Management expects to fund the projects through a mix of debt, pay-go, cash reserves, and interfund loans. The main project is the Upper York Creek Dam Removal project, which is estimated at about $4 million. We understand that about $1.6 million of this project will be funded from the general fund. The city noted the water system does not have to pay back the general fund for this loan. Furthermore, the city expects to fund 30% of the total CIP with future debt and the rest from a mixture of cash and pay-go.

The sewer system’s CIP is large, in our opinion, and totals about $13 million through fiscal 2022. We view the sewer system’s debt burden as moderate, given the pro forma debt-to-capitalization ratio of about 64%. Management expects to fund the projects through a mix of debt, pay-go, and cash reserves. The main project is the wastewater treatment plant phase 1 upgrades per the state cease-and-desist order. Furthermore, the city expects to fund 70% of the total CIP.
with future debt and the rest from a mixture of cash and pay-go from rate increases.

Based on our financial management assessment, we rate the water system a '3' on a six-point scale in which '1' is the strongest. In our view, financial practices exist in most areas, but management may not formalize or monitor all of them on a regular basis. Revenue and expense assumptions are reasonable although largely based on inflationary adjustments. Management provides interim financial reports to the city council on a quarterly basis. In addition, management produces annual financial statements that comply with generally accepted accounting principles, although the 2017 audit is more than 180 days after the close of the fiscal year, which we believe provides less transparency.

**Outlook**

The negative outlook reflects our view that there is a one-in-three chance that we could lower the rating if projected all-in coverage does not meet management-provided projections. Although the city preapproved rate increases for the next five years, there is uncertainty around consistent execution and if the new rates will fully recover system costs.

**Upside scenario**

We could revise the outlook back to stable if rate increases prove enough to support debt and system improvements.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.