S&P Global
Ratings

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Summary:

Anaheim Housing and Public Improvements Authority, California Anaheim; Water/Sewer

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Credit Profile		
US$121.255 mil rev rfdg bnds (Anaheim) ser 2022-B due 10/01/2049		
Long Term Rating	AA+/Stable	New
US$42.785 mil rev bnds (Anaheim) (Wtr Sys Proj) ser 2022-A due 10/01/2052		
Long Term Rating	AA+/Stable	New
US$31.485 mil rev rfdg bnds (Anaheim) ser 2022-C due 10/01/2040		
Long Term Rating	AA+/Stable	New
Anaheim Hsg and Pub Imp Auth, California		
Anaheim, California		
Anaheim Hsg and Pub Imp Auth (Anaheim) rev bnds (Wtr Sys Proj)		
Long Term Rating	AA+/Stable	Affirmed
Anaheim Pub Fincg Auth, California		
Anaheim, California		
Anaheim Pub Fincg Auth (Anaheim) WS		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating to the Anaheim Housing and Public Improvements Authority, Calif.'s series 2022-A (water system project) water revenue bonds, 2022 B (taxable) and 2022 C revenue refunding bonds, issued on behalf of the city of Anaheim's water system. We also affirmed our 'AA+' long-term rating on the city's $181.4 million of water system revenue bonds outstanding. The outlook is stable.

The series A bonds will be used to support capital improvements for the system. The series B and C bonds will refund the series 2010-B, 2015-A, and 2020-A bonds. Net revenue of the water enterprise system secures the bonds. We view the bond provisions as credit neutral with an additional bonds test of 1.1x maximum annual debt service (MADS) and no anticipated debt service reserve.

Credit overview

Anaheim's water system strength is anchored by its strong management practices and a supportive rate structure that includes the ability to pass through commodity costs and reliability charges. These key factors enabled the system to maintain adequate financial metrics with all-in-coverage, which includes our calculation of fixed costs associated with its water supply, is estimated at no lower than 1.2x and cash at over 300 days of operations. Coverage of debt service is higher at 1.4x. We believe these practices will continue to support its financial metrics as management finalizes its capital projects related to per-and polyfluoroalkyl substances (PFAS) related groundwater treatment over the next two-to-three years. We do not view current all-in levels of coverage to be commensurate with peers at this time, but we believe these are likely to be short-lived and rebound with the return to more groundwater. Historically, the city's major water source has been groundwater, but 14 wells had to be taken offline due to a change in regulation which altered the allowable level of certain contaminants (PFAS) in the water. With this change, the system has had to transition to more imported water from Metropolitan Water District (MWD), which is a more expensive source, as it addresses ways to decrease the PFAS levels. While treatment facilities are being built, the rate structure allows the increases in water and capital costs to be passed through to the customer, which we believe provides the system a financial cushion. If the city's financial position weakens beyond current projections or if treatment is insufficient to provide the service area with access to a long-term groundwater supply, the rating could be pressured.

The stable outlook reflects our view of Anaheim's very strong service area characteristics, prudent rate structure, strong operational and financial management, healthy cash and adequate coverage, and water supply plans, albeit requiring enhanced treatment in the near term. Our rating assumes coverage and cash will decline for the next several years over the forecast period during the system's PFAS mitigation. We believe management will ensure that rate increases are sufficient to maintain adequate coverage and cash during this period, returning to more robust levels when the groundwater wells come back online over the next several years.

Environmental, social, and governance

We analyzed the water system's environmental, social, and governance (ESG) risks relative to its enterprise and financial risk profiles and view its environmental and social factors are modestly influential in our credit rating analysis while governance risks are consistent with those of its peers. California utilities are exposed to elevated environmental physical risks related to climate change, drought, and earthquakes. We believe these environmental risks could present unexpected costs that could result in weaker debt service coverage. While the system is addressing its groundwater contaminants, we believe it currently puts the system at an elevated environmental risk. (See "ESG U.S. Public Finance Report Card: California Governments And Not-For-Profit Enterprise," published June 16, 2021, on RatingsDirect.)

Stable Outlook

Downside scenario

We could take a negative rating action if the city draws down unrestricted liquidity beyond planned levels or if the contaminant changes resulted in a permanent change in the nature of the city's water supply. An erosion in median household effective buying income (MHHEBI) or county GDP (or an increase in county poverty rates) would also likely result in a negative rating action given the likely need for additional rate increases over the next several years to accommodate the increase in purchased water.

Upside scenario

While unexpected, we could take positive rating action if after the PFAS issues are resolved, fixed charge coverage levels increase to comparatively high levels and the city's overall market position improves, either from gains in area economic indicators such as incomes or a reduction in the poverty rate.

Credit Opinion

The system provided water services to roughly 350,000 people, with 17,700 million gallons of water in 2021. The vast majority of the service population is within the boundaries of the city of Anaheim, with an area economy featuring a mix of services including manufacturing, trade, and entertainment (including Disneyland). The city is mostly built out and after years of population growth, the area is seeing some small declines as people move elsewhere. The area benefits from high income levels and comparatively moderate rates, thus providing some flexibility to absorb the higher prices of imported water for the medium term.

When comparing the costs of water for Anaheim, its current costs, including the more expensive mix with higher levels of imported water, we find that based on typical water usage within the service area of 1,600 cubic feet of water per month, the typical residential water bill is $71.66. While this is higher than in previous years, we believe it is still comparatively moderate within the region. We consider the monthly bill affordable at 1.35% of Anaheim's MHHEBI. The city's rate-setting and structure are major contributors to the overall strengthening of the system's rating. While rates are approved on an annual basis rather than through pre-approved multiyear rate schedules, we still view the rate structure as very strong. The ability to pass through costs and maintain appropriate fixed-charge components reduces the political risk and provides greater revenue certainty.

The system groundwater supply comes through Orange County Water District (OCWD) which has a comparatively lower cost relative to imported water source alternatives. However, since 2020, when the California Department of Water Resources changed its level of allowable PFAS, the city has transitioned a majority of its water supply to being imported from major wholesaler MWD. Rate increases from MWD are often passed through to retailers like Anaheim and can raise overall water costs for these providers. The city's water mix is currently 26% from groundwater wells with the remainder from imported MWD water. This balance is close to the opposite of the city's historic balance and is unlikely to be the balance in two to three years once the PFAS treatment is addressed.

The city has sufficient supply to meet its average and peak capacity. For 2021, the average daily distribution of water is 51.3 MGD and peak is 64.7 MGD. The total available supply between MWD and the wells currently online was 185 MGD. In our view, given the diversity of the water supply, particularly as the well come back on line over the next years, coupled with the mostly built-out nature of the area, we believe the existing supply is likely to be sufficient for outyears. However, if the state or region has a prolonged drought, the confluence of lower water supplies from MWD and reduced groundwater could challenge the city's supply adequacy.

As the city addresses its water quality, it is maintaining adequate all-in coverage when accounting for fixed costs associated with supply from its providers OCWD and MWD. All-in fixed coverage does not dip below 1.2x and we anticipate that coverage will begin to rebound in 2022 and strengthen in the out years. We anticipate cost recovery rates from now on. Cash is also strong and was at $76 million in fiscal 2021 when including the $24 million line of credit.

The city's five-year capital plan addresses not only the treatment projects for its groundwater for PFAS, but also updates to water mains, well pumps, and storage. The $240 million plan is expected to be funded in part from cash, bonds, and reimbursements from OCWD. As part of that plan, the system is expected to spend $135 million on water treatment facilities, for which $124 million is expected to be reimbursed by OCWD. Roughly $54 million is anticipated to be funded with bond proceeds. Management intends spend some of its surplus cash on capital projects and will maintain what we view as strong levels, unlikely to go below 160 days or close to $33 million (excluding its LOC). Additionally, management has a policy of a minimum of 120 days of operations.

The utility also has an operational contingency plan, which includes an adopted drought management plan that is incorporated into its urban water management plan. Given the cyclicality of water supply in Southern California, the drought management plan is critical to our assessment of management. We view the city's infrastructure maintenance as very strong as well. We understand that the utility uses both SCADA and hydraulic models for tracking the maintenance and condition of the system's assets.

Related Research

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