S&P Global
Ratings

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Summary:

San Buenaventura, California; Water/Sewer

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San Buenaventura, California		
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Credit Highlights

- S&P Global Ratings revised its outlook to negative from stable and affirmed its 'AA' rating on the city of San Buenaventura (Ventura), Calif.'s outstanding sewer revenue bonds.
- At the same time, S&P Global Ratings assigned its 'AA' rating to the city's anticipated $105.4 million VenturaWaterPure Project (phase 1) Water Infrastructure Finance and Innovation Act (WIFIA) loan. This loan will be administered by the Environmental Protection Agency (EPA).
- The negative outlook reflects the anticipated decline in the wastewater system's financial metrics, significant increase in leverage, and our view that continued high inflation and supply chain constraints could influence the timing of project completion and further erode near-term financial metrics. If financial performance during the outlook period meets or exceeds current projections, we could revise the outlook to stable. However, if unanticipated cost pressures constrain operating margins, result in material draws on liquidity or result in heightened social capital risk, we could lower the rating.

Security

Proceeds from the WIFIA loan will be used to fund capital improvements to comply with a federal consent decree requiring the city to divert wastewater flows from its water reclamation facility between 2025 and 2030.

The WIFIA loan will be secured by net revenues of the city's wastewater system. In our opinion, the loan provisions are credit neutral. A portion of the WIFIA loan will be secured by net revenues of the wastewater system (55%) and the remainder will be secured by net revenues of the water system. The loan agreement specifies a rate covenant and additional bonds test set at 1.2x annual debt service (ADS) for senior-lien obligations and 1.1x for outstanding senior- and junior-lien obligations.

The wastewater utility had approximately $37 million of outstanding debt as of Dec. 31, 2022.

Credit overview

In our view, the wastewater system's credit quality is anchored by the city's stable, built-out service area. While we believe the wastewater system's approved rate plans set an achievable trajectory for adequate near-term financial performance, negative economic headwinds, and continued recessionary pressures could affect operating margins and overall costs of service.

The city is embarking on a sizable $669 million capital program centered on the $437 million VenturaWaterPure Project (funded by both the city's water and wastewater funds), which will allow the city to comply with a sewer system consent decree that requires the city to cease discharging wastewater into the Santa Clara River Estuary. The intention of the project is to comply with the consent decree by repurposing the wastewater and processing it with advanced water treatment to create a new potable water source.

Given the significant increase in wastewater system debt requirements to fund the upcoming capital improvement plan (CIP), we believe that strong management of long-term financial and capital planning will be a key factor supporting rating stability. As such, near-term credit drivers center on the city's execution of the CIP and its ability to meet critical milestones under the consent decree.

The sewer system's historical financial metrics have been exceptionally strong, with debt service coverage averaging more than 3.0x between 2017 and 2021. However, as debt service ramps up to fund the CIP, we expect margins to decline relatively meaningfully, which could negatively pressure the ratings.

Management forecasts wastewater system coverage declining to just more than the 1.2x rate covenant, which we consider thin relative to peers at the current rating level. In our view, the system's near-term financial performance is critical to the rating because its service costs will rise materially once the system begins amortizing the WIFIA loan in 2027, thus any cost shortfalls experienced during the outlook period could add cost pressure in later years when the city is already forecasting increased rate increases.

We do not expect the VenturaPureWater project's production costs to be materially out of line with those of other recycled water projects currently under development across the state, which we consider credit supportive. However, any political pushback related to the city's proposed water or sewer rate plans or an erosion in its social capital due to revenue raising constraints in the context of the community's economic factors, would add downside risk to the rating.

Environmental, social, and governance

The city is faced with several ongoing ESG risk factors that affect our analysis. Given near-term recessionary pressures, we believe there is heightened risk that the city's rates will rise faster than wealth and income levels for the area, which could create affordability pressure. We consider this a key risk as the city forecasts that approximately 40% of its population is low income, per the definition provided in Senate Bill 1087. Given its location in Southern California, we believe the city also faces elevated environmental risk due to the region's inherent water supply scarcity, sea level rise, wildfire, and seismic exposure.

All the city's wastewater is currently treated to a tertiary level, about 5% of which is used for landscape irrigation, the remaining of which is discharged into the Santa Clara River Estuary where the Santa Clara River meets the Pacific Ocean.

The city was engaged in litigation for several years with environmental groups and regulatory agencies regarding effluent discharge to the estuary and reached a settlement agreement with these parties in late 2011. As part of the deal, the city agreed to reduce effluent discharge to the estuary by at least 50% by 2025. We view the city's governance factors to be consistent with those of other rated utilities.

Outlook

The negative outlook reflects our view that inflationary pressures and other macroeconomic factors may drive the wastewater system's financial metrics to levels potentially inconsistent with the current rating level.

Downside scenario

We could take a negative rating action if liquidity is significantly drawn down or if net revenue is significantly insufficient relative to management's current projections on a multi-year basis.

Upside scenario

We could return the rating to stable if the city produces consistently strong financial results with minimal erosion to its market position assessment and continues to meet critical milestones under the consent decree.

Credit Opinion

San Buenaventura (population: 112,500), commonly referred to as Ventura, is approximately 65 miles northwest of Los Angeles and encompasses about 32 square miles. The sewer system's service area includes the entire city as well as certain adjacent unincorporated portions of the county. The city's population has been relatively stable during the past five years, and it is approximately 90% built out. Ventura has a diversified service economy, with employment opportunities in financial services, the nearby oil fields, and a well-developed food-processing industry. Although the city's agricultural presence adds some credit risk, the service area's mainly residential nature, and very strong income indicators provide additional rating stability.

In our view, the city maintains good operational management practices and policies. Although the consent decree adds credit risk, we note that system capacity is adequate to meet demand. The average daily flow of the wastewater system is approximately 7.2 million gallons per day (mgd), which represents roughly 62% of the system's total treatment capacity of 14.0 mgd. We understand key utility staff is experienced managing large-scale utility infrastructure projects. City procurement policies allow for construction manager at risk (CMAR) delivery, which mitigates risk related to supply chain constraints, which we consider credit supportive. In addition to VenturaWater Pure, the wastewater system has $72.9 million of capital needs planned.

Revenue and expense assumptions are reasonable, and management regularly tracks financial performance throughout the year, while presenting financial data to the city council on a quarterly basis. The city maintains formal policies relating to long-term capital planning as well as formal investment and liquidity policies. Financial and operational information is relatively easily obtained on an annual basis, as the city's budget and financial statements are readily available on the city's website.

We understand the city has adopted a rate plan in 2021, which incorporates 6%-7% per annum sewer rate increases through fiscal 2027, incorporating reasonable cost assumptions. However, the city's overall CIP has increased in size and scope since the rate plan was adopted last year, and is up more than 40% (to $669 million from $469 million), although we recognize that part of the increase is driven by management conservatism.

Related Research

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