

Rating Action: Moody's assigns Aa1 to California Dept. of Water Res. (Water Enterprise) revenue bonds, Series BF; outlook stable

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New York, September 02, 2022 -- Moody's Investors Service has assigned a Aa1 rating to the State of California Department of Water Resources Central Valley Project Water System Revenue Bonds Series BF. The bonds are expected to be issued in the approximate par amount of \$264.3 million. Concurrently, Moody's has affirmed the Aa1 ratings on the California Department of Water Resources' (DWR or Department) close to \$3.1 billion in outstanding parity senior lien obligations. Moody's maintains Aa2 ratings on DWR's outstanding subordinate commercial paper notes. The outlook is stable.

Please click on this link http://www.moody's.com/viewresearchdoc.aspx?docid=PBM_PBM907843047 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

The Aa1 rating reflects the strength of the Department's revenue pledge, supported by payments from 29 contractors who together provide water to roughly 69% of the state's population. Despite the State of California's (Aa2 stable) ongoing drought and DWR's cuts to water deliveries, contractor payments supporting operations and debt service are protected given the strong take-or-pay nature of the water supply contracts irrespective of the amount of water delivered. These contract provisions serve to maintain consistent debt service coverage and sound liquidity despite the state's record drought conditions, which have forced significant cuts to water deliveries in 2021 and 2022 and required some contractors, most notably the Metropolitan Water District of Southern California (Aa1 stable), to request additional allocations for health and safety purposes.

The rating also incorporates the strong credit quality of the largest contractors. While there have been no historical payment delays on the part of contractors, the additional security offered by strong step-up provisions would enable the Department to withstand a significant amount of delinquencies, lowering the potential of default even in the event of a missed payment by one of the smaller, non-rated contractors. The combined size and reliability of DWR's contractors also serve to offset risks associated with DWR's sizeable capital investment needs to ensure adequate future supplies, the largest of which involves a proposed project to improve Delta conveyance facilities currently being studied by the Department, with possible total project costs estimated at \$16 billion or more.

RATING OUTLOOK

The stable outlook reflects the time-tested strength of the underlying water supply contracts and the share of contract payments supported by the highly-rated Metropolitan Water District of Southern California. Water deliveries have fallen below requested amounts over the past decade due to limited water supply availability, with water deliveries in 2021 and 2022 near historical lows. Nevertheless, the bonds' strong security provisions will serve to support stable debt service coverage and liquidity. The stable outlook also assumes successful extension of contracts past current expiration dates in 2035.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Substantially increased long-term water delivery reliability
- Effective resolution of contract extension with contractors

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Failure to reach agreement on contract extension with remaining contractors
- Continued drought conditions requiring ongoing significant cuts to water deliveries

- Capital project costs that significantly increase water charges

LEGAL SECURITY

Payment of principal and interest on the bonds is secured by a pledge of revenues derived from payment obligations under water supply contracts with 29 participating contractors. The majority of annual debt service on outstanding obligations is additionally secured by step-up provisions requiring at least an additional contribution of up to 25% of debt service on the part of participants. These step-up provisions are enhanced by the presence of larger contractors with strong credit quality. Contractors are billed in advance for debt service. Senior lien bonds are additionally secured by a debt service reserve equal to one-half maximum annual debt service.

USE OF PROCEEDS

Series BF bond proceeds will refund \$149.2 million of DWR's outstanding Series AT bonds and retire approximately \$128.5 million of outstanding commercial paper notes. Proceeds of the Department's Water System Revenue Bonds, including proceeds from Series BF are used to fund a debt service reserve account equal to one-half year MADs. The Series AT bonds are the only remaining series of long-term variable rate bonds, and following this refunding, DWR will have no long-term variable rate debt.

PROFILE

The California Department of Water Resources is a department within the Natural Resources Agency of the State of California and is responsible for the construction and operation of the State Water Project. The Director, the Lead Deputy Director, the Deputy Director for the State Water Project, and the General Counsel are each appointed by the Governor. The State Water Project incorporates a massive statewide system of aqueducts, dams, reservoirs, pumping stations and electric generation facilities running from Oroville Dam, north of the city of Sacramento (Aa2 stable) to a terminus in Riverside County (Aa2 stable) and delivering water supplies to 69% of the state's population.

METHODOLOGY

The principal methodology used in these ratings was US Municipal Utility Revenue Debt Methodology published in April 2022 and available at <https://ratings.moodys.com/api/rmc-documents/386721>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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