S&P Global Ratings

One California Street, 31st Floor
San Francisco, CA 94111-5432
tel 415 371-5000
reference no.: 1462551

November 15, 2016

Mid-Peninsula Water District
3 Dairy Lane
Belmont, CA 94002
Attention: Ms. Tammy Rudock, General Manager

Re: ***US$19,405,000 Mid-Peninsula Water District, California, Certificates Of Participation (Financing Project), Series 2016, dated: Date of delivery, due: December 01, 2046***

Dear Ms. Rudock:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA". S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street

New York, NY 10041-0003

The rating is subject to the Terms and Conditions, if any, attached to the Engagement Letter applicable to the rating. In the absence of such Engagement Letter and Terms and Conditions, the rating is subject to the attached Terms and Conditions. The applicable Terms and Conditions are incorporated herein by reference.

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cc: Mr. Brian D. Quint, Esq.
Mr. Bud Levine
Ms Rene Ramirez

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Summary:

Mid-Peninsula Water District, California; Water/Sewer

Primary Credit Analyst:
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Summary:

Mid-Peninsula Water District, California; Water/Sewer

Credit Profile		
US$19.405 mil certs of part (2016 Financing Project) due 12/01/2046		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Mid-Peninsula Water District, Calif.'s certificates of participation, or COPs (2016 Financing Project). The rating reflects, in our opinion, the combination of an extremely strong enterprise risk profile and a strong financial risk profile. The outlook is stable.

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

- Service area participation in the broad and diverse San Francisco metropolitan area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable service rates in the context of the service area's very strong income levels that provide management with revenue-raising flexibility; and
- Good operational management practices and policies.

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

- Strong historical financial performance that we anticipate will be good once the system begins paying debt service on the series 2016 COPs;
- Historically strong liquidity position that we anticipate will be maintained going forward;
- Moderate leverage level following issuance of the series 2016 COPs, with no additional debt plans in the near-term; and
- Good financial management practices and policies.

An extremely strong enterprise risk profile and a strong financial risk profile map to an indicative rating in our revenue debt criteria matrix of 'aa-', and we have applied a one-notch adjustment based on a favorable comparison of the district's financial risk profile to entities rated 'aa-', and also based on the service area's income metric, which is well above the median for 'aa-' rating level.

The district is issuing the series 2016 COPs to fund the acquisition and construction of capital improvements to the water system.

We view the certificate provisions as credit neutral. The certificates are payable from installment payments secured by the net revenues of the district's water system. The district's obligation to make the installment payments from net revenues is absolute and unconditional, and the district does not have any other debt obligations. Key certificate provisions include a rate covenant and additional bonds test, both of which are set at 1.30x annual debt service. We understand that the district does not intend to provide a debt service reserve fund for the certificates; however, we do not view this as a material credit weakness in light of the district's historically strong liquidity position that we anticipate will be maintained going forward.

Enterprise risk

The district is strategically situated between major employment centers in San Francisco and Silicon Valley, and we believe that residents in the service area participate in the region's broad and diverse economy. The district is located in San Mateo County about 25 miles south of San Francisco, and encompasses about five square miles. The water system's service area generally overlaps the boundaries of the city of Belmont, and management reports that the service area is largely built out although population may grow modestly in the future due to densification and infill development. The California Department of Finance most recently estimated the city's population to be about 27,834 as of Jan. 1, 2016. We view the service area's income levels as very strong based on the city's median household effective buying income (MHHEBI), which was 179% of the national median for 2015. The city's unemployment rates, most recently 2.8% for August 2016, track well below state and national unemployment rates, which were 5.6% and 5.0%, respectively, for the same period. The water system's customer base is stable, primarily residential, and very diverse. The number of customer accounts remained nearly unchanged during the past five fiscal years, and most recently was 8,047 at the end of fiscal year 2016. We consider the customer base to be primarily residential based on residential customers contributing about 90% of water service revenues. We also consider the customer base to be very diverse based on the leading 10 customers contributing about 7.8% of total operating revenues for fiscal year 2016.

We believe the water system has a strong market position based on a natural monopoly in its service area and affordable service rates that provide management with revenue-raising flexibility. The rate structure includes two components: a fixed monthly service charge that is based on the customer's water meter size, and a water consumption charge that has four usage-based rate tiers. In addition, the rate structure includes a feature that enables management to pass through wholesale water rate increases to the customer base, and water shortage emergency rates that may be implemented upon declaration of a water shortage. For a typical single-family residential customer, 800 cubic feet of water usage per month results in a monthly bill of $82. When annualized, this amount is equivalent to about 1.2% of the city's MHHEBI, which is a level that we consider affordable. The district has annually adjusted rates during the past six fiscal years, and we understand that annual rate adjustments have been preapproved through fiscal year 2020. Management reports that there have not been any material payment delinquencies by the customer base.

Based on our operational management assessment, we view the district to be a '2' on a six-point scale with '1' being the strongest. This indicates, in our view, that there is good alignment between operational and organizational goals, even if some challenges exist. The district operates a water distribution system with treated water purchased on a wholesale basis from San Francisco Public Utilities Commission (SFPUC) pursuant to a long-term water supply agreement. Management reports that the distribution system is generally in good condition, which we observe indirectly based on a water loss percentage that has ranged between 5.2% and 7.1% during the past four fiscal years. The district reviews water loss reports on a monthly basis, and conducts leak surveys and corrosion control programs on a biennial basis to ensure the integrity of the distribution system.

The water system is entirely reliant on expensive imported water purchased from SFPUC pursuant to a long-term water supply agreement. SFPUC is a regional water provider for 28 wholesale customers in the San Francisco Bay Area. Under a 25-year contract executed in 2009, the district has a guaranteed water supply of about 4,358 acre-feet annually. In fiscal year 2016, the water system purchased about 2,472 acre-feet of water, which was 26% lower than water demand of about 3,336 acre-feet in fiscal year 2013. Water demand declined sharply during the past two fiscal years due to voluntary and mandatory water conservation measures implemented during this period of drought, and management anticipates that demand will remain near current levels with only modest increases going forward.

SFPUC has increased its wholesale rates substantially during recent years, including 19.6% in fiscal year 2015 and 28.0% in fiscal year 2016, as it undertakes a large and predominantly debt-financed capital improvement program. The wholesale water rate was $2.93 per hundred cubic feet (HCF), or $1,276 per acre-foot, in fiscal year 2015, and based on information provided by SFPUC in February 2016, the district anticipates that the wholesale water rate will rise to $5.33 per HCF, or $2,322 per acre-foot, by fiscal year 2020. We believe that the district is exposed to changes in wholesale rates that are likely to continue rising, although we note the district's rate structure provides a mechanism for passing through these wholesale rate increases to the customer base. For more information on the SFPUC's water system, see our report published Sept. 30, 2016, on RatingsDirect.

We understand that the district has a water shortage contingency plan that is included with its urban water management plan, but generally depends on SFPUC and The Bay Area Water Supply & Conservation Agency (BAWSCA) for regional operational and contingency planning. Given the size of the district and its staff, succession planning and cross training is limited. The district reviews and adjusts its service rates regularly, and management has routinely engaged external consultants to perform in-depth rate analyses.

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

Financial risk

The district's financial performance has historically been strong, and we anticipate that it will be good once it begins paying debt service on the series 2016 COPs. Based on the district's audited financial statements for fiscal years 2013 through 2015, we calculate that net revenues available for debt service ranged from about $1.5 million for fiscal year 2015 to about $2.2 million for fiscal year 2014. Net revenue performance during this period was driven primarily by an 8% increase in water service charges in fiscal year 2014 due to an implemented rate increase, followed by a 4.9% decrease in water service charges in fiscal year 2015 due to a 14.6% reduction in water demand from voluntary water conservation that more than offset an implemented 9% rate increase. Based on the district's substantially final, but not yet approved, financial statements for fiscal year 2016, we calculate net revenues available for debt service of about $1.8 million. Net revenues increased in fiscal year 2016 based on an 18% rate increase more than offsetting a 10.9% decrease in water demand from mandatory water conservation and a 7.9% increase in water purchase costs.

Although the district has not recently had any direct debt, we have calculated an all-in coverage metric that takes into consideration the district's proportionate share of SFPUC debt and BAWSCA debt that is indirectly paid by the district through wholesale water rates. For this four-year period, we calculate that all-in coverage declined to 1.7x for fiscal year 2016 from 2.8x for fiscal year 2013, a range that we consider strong, driven primarily by a rise in indirect debt service to about $2.8 million for fiscal year 2016 from about $950,000 for fiscal year 2013. Based on management's forecast, we anticipate that all-in coverage going forward will be about 1.2x to 1.3x, which is a range that we consider good. We believe that the assumptions used for the forecast are reasonable, including operating revenues that reflect approved rate increases, but only modest increases in water demand, and operating expenses that reflect purchased water costs based on SFPUC's wholesale water rate forecast. In the near term there could be favorable variances driven by one-time development fees related to a small number of known, large development projects, but we do not anticipate that development fees will be a significant ongoing revenue stream for the district given that the service area is largely built out.

The district has historically maintained a strong liquidity position, and we anticipate that it will maintain a strong liquidity position going forward. Based on the district's audited financial statements, the district held unrestricted cash and investments of no less than $3.6 million, equivalent to 156 days of operating expenses, at the end of each of the past three fiscal years. More recently, the district reports in its substantially final, but not yet approved, financial statements for fiscal year 2016 an unrestricted liquidity position of about $4.3 million, or 178 days. Although the district's rate study indicates that unrestricted liquidity will be maintained at about $3.2 million through fiscal year 2021, management reports that the forecast does not take into consideration about $1.2 million of development fees that are anticipated to be received within the next two years. We understand that management's recommendation would be to use surplus revenues to fully fund the district's reserves--maintaining a balance of about $5 million going forward--and using amounts in excess of reserve targets for capital projects. Based on a static balance of $5 million, we calculate that liquidity would decline to about 149 days at the end of fiscal year 2021 from 182 days at the end of fiscal year 2017 based on rising operating expenses; however, we anticipate that the district will maintain a strong liquidity position and adjust its reserve policy and targets in 2017.

The district's capital improvement plan is manageable and does not require any additional borrowing during the next five years, but could require additional borrowing thereafter. We understand that the district's 10-year master plan includes about $52 million of capital projects. During the next five years, management plans to fund capital projects from about $20 million of series 2016 COPs proceeds, $2.5 million of surplus revenues, and development fees to the extent received. We understand that the capital projects during this period are primarily for renewal and replacement of existing infrastructure. Given the district's limited surplus revenue generation and the amount of remaining capital projects during the second half of the 10-year period, we anticipate that additional leverage would likely be required to fund the master plan if these capital projects remain within the 10-year time horizon and there is not a significant shift toward pay-as-you-go funding in the future. The district does not have any other existing debt obligations, and we view the district's leverage ratio as moderate based on a debt-to-capitalization ratio of about 51% following the issuance of the series 2016 COPs.

Based on our financial management assessment, we view the district to be a '2' on a six-point scale, with '1' being the strongest. This indicates, in our view, that there is good alignment between financial and organizational goals, although the district's policies and practices are not comprehensive. We understand that the district previously experienced a loss of funds, but it has taken corrective action and implemented recommendations following an internal controls audit in 2012 with a follow-up review in 2013. Revenue and expenses assumptions are reasonable, and interim financial reporting is provided to the district through semiannual presentations to the district board although significant variances may be discussed on an as-needed basis. We understand that the district performs long-term financial planning that is independent of the work conducted by the district's rate consultant; however, this internal forecast is not published or disseminated. The 10-year system master plan is updated every three to five years while capital budgeting focuses on current-year needs. The district's reserve policy was adopted and last reviewed in 2007, and management anticipates updating the reserve policy in 2017. The district does not have a debt management policy, but we understand that management may recommend a policy to the board in 2017 in conjunction with other strategic planning. Financial and operational information is relatively easily obtained, as the district's budget, financial statements, and rate studies are readily available on the district's website.

Outlook

The stable outlook reflects our view of the district's service area that is affluent and largely built out, combined with relatively simple operations as a distribution-only water system. During the two-year outlook horizon, we anticipate that the district will continue to raise service rates in line with the forecast--particularly to pass through wholesale water rate increases from SFPUC to the customer base--and also update its reserve policy with targets that would maintain, in our view, a strong liquidity position on a ratio basis taking into consideration the anticipated rise in operating expenses.

Upside scenario

We could take a positive rating action if the district materially outperforms its financial forecast and we believe the stronger financial metrics are sustainable going forward, such as if the district had ongoing capital needs and funded a more significant portion on a pay-as-you-go basis, thereby providing wider margins for coverage.

Downside scenario

We could take a negative rating action if the district underperforms its forecast, such as if wholesale water rates increase more rapidly than forecast and the district does not maintain discipline in passing through the cost increases to the customer base, or if cash reserves are drawn down to fund capital improvements or other expenses.