S&P Global
Ratings

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Summary:

Monrovia, California
Monrovia Financing Authority; Water/Sewer

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

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Credit Profile		
Monrovia Financing Authority, California		
Monrovia, California		
Monrovia Fincg Auth (Monrovia) wtr/swr (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings raised its underlying rating to 'A' from 'A-' on Monrovia Financing Authority, Calif.'s series 2016 water and sewer revenue bonds, issued for the City of Monrovia.
- The outlook is stable.
- The upgrade reflects the water system's improved financial performance in recent years following the implementation of a rate plan in 2018 that led to greater revenue stability and improved all-in debt service coverage (DSC).
- The existing balance of the series 2016 bonds is approximately $30 million as of June 30, 2023.

Security

The financing agreements between the authority and the city contractually obligate the water and sewer systems to cover their proportionate share of the debt service on the bonds. However, neither has any liability or responsibility for the payments of the other system, and therefore the rating reflects a "weak link" approach that assesses the credit quality of each of the two utilities. We believe the cash-flow streams from the collection-only sewer system are more stable and predictable than those of the water system; therefore, we based our rating on the bonds on our assessment of the water system.

We view the bond provisions as credit neutral. Key bond provisions include a rate covenant set at 1.2x annual debt service and an additional bonds test at 1.2x debt service in the preceding year.

Credit overview

The rating reflects our expectation that the utility systems will maintain a strong financial profile by generating healthy all-in coverage and liquidity margins as the city progresses through the funding of its capital projects. The water system is in the middle of a capital cycle to address potential capital projects including construction of a treatment system for removal of per- and polyfluoroalkyl substances (collectively known as PFAS) from water produced in three of its five groundwater wells that will enhance its water supply reliability in the future. The rating is tempered by the system's significant capital needs, but we recognize these capital projects are also critical to remediate future anticipated water quality and state notification levels related to PFAS. The city received considerable grant monies in recent years and will be initiating a comprehensive cost-of-service rate study to develop a rate plan around funding its capital needs. In our view, the city's utility credit profile will center on greater clarity regarding the system's financial plan to offset anticipated fixed costs, or any potential declines to operating margins from inflation and increased operating expenses. The city's utilities' current five-year capital plan is approximately $12 million.

While the system's cash reserves were robust in recent years, management's coverage of all the fixed obligations of the utility system, including debt service on the existing bonds and transfers to the general fund, particularly for the water utility, are adequate at this rating level. We view "all-in" DSC of each system's fixed obligations to be important because it provides what we think is the best picture of the total use of all operating revenues, and therefore each system's ultimate financial capacity.

Environmental, social, and governance

We analyzed the utility systems' environmental, social, and governance (ESG) risks relative to its enterprise and financial risk profiles and view its social and governance risks as neutral in our credit rating analysis. Like peers in the western U.S., Monrovia faces challenges from acute and chronic environmental physical risks stemming from wildfires, drought, and flooding events. The city's water supply is susceptible to elevated environmental risk related to physical risks and natural cycles of drought as well as potential water quality issues from PFAS exposure. However, these physical risks have been comparatively mitigated given its well-defined emergency response and preparedness plans. Officials plan to make several investments across its facilities and distribution network to reduce the system's environmental risks while enhancing its water supply reliability through additional treatment facilities.

In addition, the city maintains cyber insurance and has been reinforcing its cyber-security practices, which also helps underscore management's focus on risk management issues. Social capital risks are manageable, in our view, given affordable rates, which provide revenue-raising flexibility against the backdrop of the service area's demographics.

Outlook

The stable outlook reflects our expectation that the city will adjust its utility service rates, conscious of rate affordability, to produce stable net revenues and all-in DSC similar to recent history without eroding its cash position during the two-year outlook period.

Downside scenario

We could take a negative rating action if the utility systems' financial performance significantly declines to insufficient levels due to unanticipated and extraordinarily large change in its capital plan or higher-than-expected operating costs that could alter related financial metrics, including a significant spenddown of unrestricted reserves. Also, if rate affordability pressures constrain management's flexibility to make timely rate adjustments, we could consider a negative rating action.

Upside scenario

During the two-year outlook period, we anticipate that the city will complete and implement the upcoming rate plan while also monitoring demand to guard against underperformance. We could raise the rating if the water utility materially widens margins for the system and sustains a track record of stronger all-in coverage and liquidity metrics on a basis that we believe is commensurate with financial metrics at a higher rating level.

Credit Opinion

Monrovia serves a population of over 38,000 and is at the edge of the San Gabriel Mountains in northern Los Angeles County, about 20 miles northeast of downtown Los Angeles. City residents have the option of commuting to nearby Los Angeles for work, and we believe that the city's residents participate in the region's broad and diverse economy. The utility service area generally overlaps the city's boundaries, and management reports that the city is largely built-out, although the city grew modestly in recent years due to densification and infill development.

Enterprise risk

Our assessment of the utility system's enterprise risk profile reflects our view of the city's above-average income levels and affordable rates, a natural monopoly in its service area, and a good operational management framework.

We consider the customer base of each system to be primarily residential, based on residential customers contributing about three-quarters of water and sewer service revenues. We also consider the customer base to be very diverse based on the leading 10 water service customers contributing about 2.6% of operating revenues for fiscal year 2022.

We understand that planned operational system improvements, which focus on the replacement of aging mains and meters, might reduce the city's production needs over time but believe that these savings could be offset by the rising costs associated with the purchase of additional water rights from those agencies that draw groundwater from the adjudicated San Gabriel Groundwater Basin. Wastewater treatment is conducted by the Los Angeles County Sanitation Districts at the San Jose Creek Treatment Facility. Sewer rates are low in part because all treatment is handled by the county, which charges for services through a separate rate on customers' property tax bill.

Financial risk

Our assessment of the system's financial risk profile reflects our view of the utility's improved financial position in recent years, above-average leverage ratio, and good financial management framework.

Both systems' financial position has improved in recent years, with the water system all-in DSC averaging above its 1.2x rate covenant in the past three years, with capital outlays funded through operations, and deficiencies between operating revenues and expenses drawn from unrestricted reserves. The water system's debt-to-capitalization ratio (a measure of leverage) is above-average at 52%. S&P Global Ratings-calculated all-in coverage reflects fixed costs from water purchase or leasing rights in the basin, adjusted operating and maintenance expenses including general fund transfers, and excludes any one-time grant monies received in net revenues. While the city has a formal policy that establishes a 30% reserve for enterprise funds, we believe that its practice of sending sizable transfers to the general fund could affect future financial metrics for the utilities if adequate rate adjustments for cost-of-service requirements are not considered in a timely manner.

Monrovia, Calif.--Economic and financial data					
		Fiscal year-end			
	Most recent	**2022**	**2021**	**2020**	**Median (A)**
Economic data					
Water customers	9,062				4,744
Sewer customers	8,773				4,488
MHHEBI of the service area as % of the U.S.	123.0				83.0
Unemployment rate (%)	3.8				4.5
Poverty rate (%)	14.1				13.9
Water rate (6,000 gallons or actual) ($)	77.7				40.0
Sewer rate (6,000 gallons or actual) ($)	10				42.0
Annual utility bill as % of MHHEBI	1.3				1.2
Operational Management Assessment	Good				Good
Financial data (Water system)					
Adjusted operating revenues ($000s)		15,516	14,227	13,101	4,663
Adjusted operating expenses less depreciation ($000s)		12,310	12,237	11,266	2,762
S&P Global Ratings-adjusted all-in DSC (x)		1.78	1.2	1.23	1.5
Unrestricted cash ($000s)		7,280	6,065	6,015	2,562
Days' cash of operating expenses		216	181	195	360
Total on-balance-sheet debt ($000s)		24,863	25,500	26,111	10,573
Financial Management Assessment		Good	--	--	Standard

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Related Research

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