

APPENDIX "E"

"Standard and Poor's Rating Services FRCD rating letter."

[Attached behind this cover page]

RatingsDirect®

Summary:

Florin Resource Conservation District, California; Water/Sewer

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Summary:

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Credit Profile

Florin Res Conservation Dist wtr (National)		
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Upgraded
Florin Res Conservation Dist Wtr		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has raised its underlying rating on the Florin Resource Conservation District, Calif.'s (FRCD) senior-lien debt to 'A' from 'BBB+'. At the same time, Standard & Poor's raised its rating on the utility's 2014A water revenue refunding bonds (second senior lien) to 'A-' from 'BBB'. The outlook is stable. The lower rating on the 2014A bonds reflects their subordination relative to the senior-lien debt.

The upgrades reflect the October 2015 California Superior Court order that established that the district extinguished all of the office building bondholders' claims related to its ownership of the Susan Gaines Mitchell office building. Although the office building bonds' revenue stream was distinct from the water system bonds' revenue stream, the building's bonds and those of the water system were issued in FRCD's name. The water utility operates as the Elk Grove Water District (EGWD). It is a department of the FRCD and not a distinct legal entity. The district was in technical default on the office building bonds because its revenues were insufficient to cover tax payments and maintenance obligations. Before the order, we considered the district's technical defaults on the office building bonds as clouding the rating on the water utility bonds.

After selling the building, FRCD delivered to the building's bondholders the sale's residual proceeds. The payment to bondholders was net of property tax arrears, deferred maintenance, and transaction fees, and was insufficient to satisfy all of the bondholders' claims. Nevertheless, the court ruled that the payment of available funds extinguished the building bondholders' claims. Consequently, we view the decision as lifting the cloud on the water system bond rating and precluding claims from the building's bondholders.

EGWD covers 13 square miles in Sacramento County, including a portion of the community of Elk Grove, Calif. Elk Grove is the county's second-largest city. As of fiscal year-end 2015 (June 30), the district reported \$52.7 million of water system debt. The water debt is nearly evenly split between its closed senior lien and the subordinate lien created in connection with the sale of the 2014A refunding bonds. FRCD has covenanted that it will not issue more senior-lien water debt with priority ahead of the subordinate lien.

The following factors support the ratings:

- EGWD's debt service coverage (DSC) ratio has been sound but somewhat uneven since 2010. DSC of all obligations was 1.7x in 2010, 1.6x in 2011, 1.9x in 2012 and 2013, 1.4x in 2014, and 1.3x in 2015. The most recent years' ratios were below earlier projections of about 1.7x, which was partially attributable to drought conditions and water use restrictions that eroded some of the benefits of rate increases. Based on the utility's financial projections that assume annual rate adjustments of 4% to 6%, we have calculated DSC of about 1.4x in 2016-2018 and 1.5x by 2019.
- The district plans to finance its water utility capital projects exclusively with internally generated funds without adding debt, which should help DSC as existing debt amortizes.
- The water utility maintained strong unrestricted cash and investments balances of at least \$11.5 million in 2013-2015, representing about 1.4 years' operating expenses, but these balances will likely decline as the capital program proceeds.
- Residential customers accounted for 87% of fiscal 2015's water consumption, which we view as tempering the system's exposure to volatility, other than weather. Moreover, more than 65% of a residential customer's monthly bill represents fixed charges that temper the revenue stream's exposure to weather.

Standard & Poor's believes the following factors constrain the rating:

- We consider water rates to be high and have calculated monthly residential water rates of \$72 for our benchmark 6,000 gallons. The utility raised rates 3% in 2014 and again in 2015 after maintaining level rates since 2010.
- California's drought emergency could erode water demand, but the base charges' significant contributions to the revenue stream mitigate this exposure.

The utility sells water to retail customers in two service territories. EGWD's service area 1 customers receive the utility's treated groundwater in a 4.9 square mile service area. Customers in the 7.6 square mile service area 2 principally receive treated surface water that the utility purchases from the Sacramento County Water Agency (SCWA). In 2015, the utility served about 12,300 customers. It has transitioned its flat-rate customers to metered rates in conformity with California law. The utility projects about 50 years of sufficient water supply from its groundwater and SCWA resources. The SCWA contract does not expire until June 2052.

Outlook

The stable outlook reflects our view of EGWD's strong, but variable DSC levels, robust liquidity, projections of declining debt balances, and plans for annual rate increases.

Upside scenario

If FRCD can achieve strong financial DSC and liquidity metrics as its capital program proceeds, we could consider raising the rating.

Downside scenario

We could lower the rating if California's drought erodes consumption and financial performance.

Related Criteria And Research

Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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