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Metropolitan Water District of Southern California; Water/Sewer

Primary Credit Analyst:

Paul Dyson, San Francisco (1) 415-371-5079; paul_dyson@standardandpoors.com

Secondary Contact:

Robert Hannay, San Francisco (1) 415-371-5038; robert_hannay@standardandpoors.com

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Credit Profile		
US\$49.0 mil sifma index nts ser 2012B-2 due 07/01/2027		
<i>Long Term Rating</i>	AAA/Stable	New
US\$49.0 mil sifma index nts ser 2012B-1 due 07/01/2027		
<i>Long Term Rating</i>	AAA/Stable	New
Southern California Metro Wtr Dist wtr		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' long-term rating to the Metropolitan Water District of Southern California's (MWD) \$49 million series 2012B-1 and \$49 million series 2012B-2 water revenue refunding bonds (Securities Industry and Financial Markets Assn., or SIFMA, index mode). At the same time, we affirmed various ratings on the district's previously issued parity bonds, including our 'AAA' long-term and underlying rating. The outlook on all ratings, where applicable, is stable.

The ratings reflect our view of the district's:

- Demonstrated willingness and ability to raise rates, with recently approved increases of 5% for both 2013 and 2014, following 7.5% rate increases in both January 2011 and January 2012, and additional 3% annual rate increases planned;
- Consistently very strong reserve position, including \$395 million in unrestricted cash and investments as of June 30, 2011, equal to 189 days of operations;
- Good debt service coverage (DSC) at 1.5x, in 2011, projected by the district to rebound to more than 2.0x by 2015, supported by strong customer demand as well as a diverse mix of revenue, some of which is fixed and independent of water usage and is intended to cover MWD's fixed costs regardless of hydrology or customer demand;
- Critical service nature, with MWD-delivered water accounting for about half of the total water consumed in the region;
- Very large scale of operations as one of the chief suppliers of water to local and regional water utilities in Southern California, serving a combined population of 19 million (about half of the state's population); and
- Good storage supply as well as the ability to curtail water deliveries in drought situations, when less water is available from both major supply sources.

The bonds are secured by the net revenue of MWD's water enterprise, which delivers water on a wholesale basis. The bonds are on parity with \$4.6 billion in revenue bond debt, not including \$197 million in general obligation (GO) bonds (AAA/Stable) secured by ad valorem property taxes. We understand that the series 2012B-1 and 2012B-2 bond proceeds will be used to refund \$100 million of variable-rate obligations (series 1999B and 1999C).

The series 2012B-1 and 2012B-2 bonds are subject to mandatory tenders by the district in no less than two years

(final date to be determined), and the district may call the bonds on or after the call protection date, which is initially six months prior to the mandatory tender date. The resolution allows the district to convert (refund) the bonds at any time after the call date into a different interest rate mode, and the district's internal procedures require it to remarket the bonds no later than 90 days before the mandatory tender date. The bonds have a nominal final maturity on July 1, 2027. Until the mandatory tender date or until they are called, the district will pay an interest rate on the bonds that is reset on a weekly basis at a spread that is above or below the SIFMA index.

The 'AAA' long-term rating reflects our opinion of the district's very strong credit quality. Furthermore, in accordance with our criteria, the series 2012B-1 and 2012B-2 bonds will carry only a long-term rating because they have a mandatory tender date more than 13 months from issuance. (For more information, please see "Credit FAQ: Application of Dual Ratings in U.S. Public Finance," published Aug. 19, 2008 on RatingsDirect on the Global Credit Portal.)

According to the district, no later than 90 days prior to each mandatory tender, the district will attempt to remarket (roll) the bonds. If unsuccessful, the district will explore other options. At 90 days before tender, the district will prepare updated disclosure statements, develop a finance plan, and solicit bids from service providers. At 60 days before tender, the district will finalize a financing team, prepare documents, and begin the rating and approval process for the new financing. At 30 days to tender, the district will determine the final plan of finance and review it with the board's ad hoc committee, complete the financing documents, and provide necessary notices. If the district is not able to issue take-out bonds, we believe its cash balances provide sufficient credit leeway to redeem the bonds with cash, if doing so is required.

MWD covers 5,200 square miles and is the primary wholesaler of water to 26 member agencies serving almost 19 million customers in Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura counties in Southern California. The district provides 40% to 60% of the water within its service area, depending on weather conditions. The leading 10 customers represent 84% of water sales revenue, with the San Diego County Water Authority the largest customer, at 20% of water sales revenues. Although no member is required to purchase water from MWD, all members must pay a readiness-to-serve charge calculated from historical purchase levels. MWD receives its water from two sources: the Colorado River and the California State Water Project. The assessed value of the service area subject to the district's ad valorem tax levy is \$2.07 trillion. This tax base supports the district's GO bonds, which are also rated AAA/Stable. The district's service territory is extremely large, offering it several advantages, including the ability to spread its costs over a large customer base. In addition, a very minor rate increase can generate several million dollars in water sales revenues.

Prior to April 2012, MWD had tentatively budgeted a 7.5% increase for January 2013 and a 5% increase for January 2014. Actual rate increases recently approved by the board on April 10, 2012 were 5% for both January 2013 and January 2014. These rate increases will mostly fund repairs to the state's aqueduct system and infrastructure. Thereafter, the district anticipates annual rate increases of 3%. These upcoming rate increases follow much larger rate increases in 2009, including a 14% rate increase in January 2009 and a 20% increase in September 2009. These rate increases were followed by a 7.5% rate increase in both January 2011 and January 2012.

Water supply and storage conditions have been volatile in recent years, and the consequences of fiscal 2010 supply restrictions, continued reduced demand (resulting from depressed economic conditions), and conservation have been declines in DSC and a need for continued moderate rate increases. Supply conditions improved significantly in 2011, with precipitation levels well above normal. But as quickly as dry conditions ended in 2011, they have returned in

fiscal 2012. As of April 12, 2012, California snowpack in the Sierra Nevada stood at 56% of the average. However, we believe that rate increases should aid financial margins that are near their lowest in a decade, and that MWD's vital position as a major supplier of Southern California's water gives it very high rate-setting flexibility. MWD has completed several major water storage projects in recent years, giving it 3.8 million acre-feet of total storage capacity, not including 1.8 million acre-feet of State Water Project storage capacity.

Water sales to its members represented 74% of MWD's total revenues in fiscal 2011, with standby charges, readiness-to-serve charges, and capacity charges together representing 11% of revenues. Operating and capital costs related to the State Water Project represent the largest portion of expenditures at \$593 million, or 43%, followed by operations-and-maintenance (O&M) costs at \$431 million, or 31%. Rates include several components, including Tier 1 and Tier 2 water supply charges, with Tier 2 designed to cover the cost of acquiring new supplies, readiness-to-serve charges, capacity and standby charges, and various other components, including a Delta surcharge related to environmental issues (which ends after fiscal 2012). Full-service treated water rates are \$794 per acre-foot, up from \$744 in 2011.

MWD's board policy is to maintain 2x annual DSC by net revenues, which we view as strong, and 1.2x fixed-charge coverage, which we view as good. But as mentioned, economic conditions, water supply restrictions, and conservation pushed DSC to less than policy levels in fiscal 2008 through 2011, and management projects DSC to remain below policy levels through 2014. Although not in keeping with MWD policy, annual DSC by net revenues has been strong in our view, at 1.8x in fiscal 2008 and 2009, 1.6x in fiscal 2010, and 1.5x in fiscal 2011, although down from a very strong 2.2x in 2007. In addition to economic conditions, water supply restrictions, and conservation, a factor that led to lower-than-historical coverage in fiscal 2010 and 2011 was reduced demand resulting from wetter-than-normal weather patterns, which also reduced the quantity of water sold. MWD also purchases a substantial amount of water during wet years (when water sales typically decrease) to store for dry years, and this increases costs and causes a decline in annual net revenues. Conversely, net revenues improve when the district sells banked water to member agencies during droughts. In the face of reduced water sales, the district has also been reducing overhead costs. With the full effect of rate increases mentioned above, the district projects DSC of 1.7x in 2012, 1.6x in 2013, and 1.9x in both 2014 and 2015. Fixed-charge coverage, which includes an analysis of fixed State Water Project capital costs, fell from 1.3x in 2009 to 1.1x in 2010, and further to 1.03x in 2011. However, the district projects it to rebound to 1.3x by 2014.

MWD's total cash position remains very strong, in our opinion. MWD had \$395 million in unrestricted cash and investments as of June 30, 2011, equal to 189 days of operations. The district has a formal reserve policy that provides for a minimum and maximum unrestricted reserve balance at the end of a fiscal year that is based on probability studies of the wet-versus-dry periods that affect MWD's water sales. Based on this study for fiscal 2011, the minimum and maximum reserve levels were \$191 million and \$483 million, respectively, with an unrestricted operating reserve balance of \$248 million.

The district's capital program is moderately large, at \$1.5 billion (fiscal 2013 through 2017), following \$188 million in capital spending in fiscal 2012. Major capital projects include oxidation retrofit facilities at its treatment plants, Colorado Aqueduct improvements and refurbishments, and a major overhaul of its Weymouth Water Treatment Plant. The district does not intend to fund any portion of the capital improvement plan (CIP) from additional GO bonds, but instead will keep revenue bonds and cash as funding sources. To fund a portion (65%) of the CIP, MWD anticipates issuing an additional \$180 million in fiscal 2013, \$180 million in fiscal 2014, \$200 million in fiscal 2015, \$180 million in 2016, and \$190 million in fiscal 2016, for a total of \$930 million. Additional parity debt is

subject to a 1.2x additional bonds test (ABT) based on maximum annual debt service (MADS). MWD does not intend to fund a debt service reserve fund in connection with the various series of bonds being issued.

A comprehensive investment policy, the primary objective of which is preservation of capital, governs the district investments. The district has a total of \$437.2 million in SIFMA index notes, not including the 2012 bonds or \$127 million in variable-rate bonds designated as "self-liquidity" bonds. Included in MWD's \$4.6 billion in revenue bond debt is \$1.7 billion in variable-rate debt, of which \$1.1 billion is swapped to fixed rate. The district policy limits net variable-rate debt to 40% of total debt.

Outlook

The stable outlook reflects our anticipation that rate increases and generally improved supply conditions (although somewhat dry again in 2012) will allow for DSC to return to its historically stronger levels, although we still consider 1.5x DSC good. Dips in annual DSC to less than MWD's target coverage of 2x as a result of economic, conservation, and weather-related demand fluctuations should not affect the rating, especially because in our view MWD has prudently built up a large rate stabilization reserve and retains strong rate flexibility. The stable outlook also reflects our opinion that MWD will be able to find new sources of affordable water to meet long-term rising demand while maintaining its very strong financial position. In our view, Southern California's dependence on MWD for water is likely to remain strong, and we believe that MWD's ability to supply needed water is critical to the health of the Southern California economy, creating a large political incentive to meet future water demand. The outlook additionally reflects our anticipation that MWD will likely meet the challenges related to its moderately high capital needs over the next five years. We could lower the ratings in the unlikely event that the district's DSC experiences additional significant declines or MWD's liquidity position significantly deteriorates.

Operations: Water Supply And Storage Conditions Are Ample

The district routinely faces several challenges in completing its mission to supply its service area and members with adequate and reliable high-quality water to meet present and future needs in a cost-effective and environmentally responsible way. These challenges include a growing population, increasing competition for low-cost water supply, variable weather conditions such as periods of drought, and increasing environmental regulations. Recently, the largest hurdles to the district's main source of supply include drought and court decisions to protect fish in Northern California. A statewide drought emergency was officially declared on Feb. 27, 2009, after dry weather conditions that began in 2007, but above-normal precipitation occurred from January 2010 through March 2011. The drought emergency was officially lifted on March 31, 2011. Although snowpack as of April 26, 2011 reached 185% of the average, a year later (April 12, 2012) snowpack is at just 56% of the average. Likewise, for the Colorado River, supply conditions have been volatile, with precipitation in the Upper Colorado River Basin from October 2011 through April 2012 at 76% of the norm, with snowpack 39% of the norm -- all after a well-above-average year in 2011.

As the largest member agency of the California Department of Water Resources (DWR), the district receives about 1.9 million acre-feet of water annually from the State Water Project under a 100% allocation. But actual water received from 2002 through 2012 varied significantly, from a low of 908,000 acre-feet to 1.8 million acre-feet. For calendar 2010, DWR's allocation to State Water Project contractors, including the district, was just 50% of contracted amounts, reflecting pumping restrictions related to the biological opinions for Delta smelt and Chinook

salmon as well as continued recovery from below-average precipitation. The 50% allocation for 2010 was, however, significantly higher than the originally announced 5% allocation. As a comparison, deliveries varied from a low of 35% in 2008 to 80% in 2011. An allocation of 100% -- difficult to achieve even in wet years -- last occurred in 2006. DWR's first estimate for 2011 was that it would be able to deliver 25% of requests. But on April 20, 2011, DWR raised its 2011 allocation to 80% because of near-record precipitation and water content in mountain snowpack. The allocation for 2012 was initially set at 60% given drier weather conditions realized over the previous six months, and was lowered further to 50% in February 2012 as dry weather persisted.

MWD's second major water source is the Colorado River aqueduct, which provides MWD with as much as 1.25 million acre-feet of water annually, and MWD also has fourth- and fifth-priority rights to as much as 1.2 million acre-feet of unused water from the river. After the driest 11-year period on record through 2010, conditions have improved significantly over the past two years, with improved snowpack and runoff adding to water levels at Lake Powell and Lake Mead. MWD also has ample storage and treatment capacity, in our view, with total storage capacity of 5.54 million acre-feet and stored water at 2.3 million acre-feet as of Jan. 1, 2011, up from 1.6 million acre-feet a year earlier. Storage at year-end 2011 rose to a record 2.984 million acre-feet, with management anticipating minimal change for 2012. MWD filters and disinfects an average of 1.7 billion to 2.0 billion gallons of water per day at five treatment facilities, with a total maximum treatment capacity of 2.6 billion gallons per day. About 70% of MWD's delivered water requires treatment.

Swaps

Standard & Poor's believes that MWD's interest rate swap portfolio represents a very low credit risk because of highly rated swap counterparties, a low degree of involuntary termination risk because of a moderate ratings trigger spread, and strong management oversight, including a formally adopted swap management plan, monthly review of the swap portfolio, and counterparty diversification requirements. MWD has entered into 17 swap agreements with four counterparties for a combined notional amount of \$1.4 billion, consisting of \$1.15 billion of fixed-payer swaps and \$250 million of basis swaps. The notional amount of the swaps accounts for approximately 29% of MWD's total revenue debt. Under the terms of the district's swap portfolio, we estimate that moderate basis risk may occur in stressful economic cycles. The counterparties and MWD have the same additional termination event of a downgrade to less than 'BBB-'. Involuntary termination for the district is remote, in our view, because of the very broad ratings trigger spread between the rating and the credit event.

Bond Provisions

To issue additional parity revenue bonds, according to the indenture, MWD must demonstrate that net operating revenues for the past fiscal year or 12 of the past 24 months, or projected net operating revenues for the first year after financed water improvements have been completed, are at least 1.2x future MADS on previously issued and proposed bonds. The district may adjust revenues for changes in water rates or board-approved charges as well as projected revenues from additions to the water system. MWD may also exclude any principal payments it so designates in calculating MADS. For test purposes, we calculate variable-rate interest at the lesser of the prime rate or a maximum 12% rate if debt is secured by a credit facility that, if drawn upon, has a parity lien on net revenues. On the other hand, for variable-rate debt secured by a credit facility whereby a draw thereon has a junior-lien claim on net revenues, variable-rate interest is calculated at 1.2x the rate on previously issued variable-rate debt. Likewise,

for debt not supported by a credit facility, variable-rate interest is calculated at 1.2x the rate on previously issued variable-rate debt.

MWD covenants to charge fees to provide sufficient net operating revenues after O&M expenses, to cover debt service on bonds as well as other required charges, liens, or encumbrances payable out of net operating revenues.

Related Criteria And Research

- USPF Criteria: Short-Term Debt, June 15, 2007
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept.15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Ratings Detail (As Of April 18, 2012)		
Southern California Metro Wtr Dist special var rte wtr rev rfdg bnds ser 2010A		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist var rate rev bnds ser 2000 B-3 dtd 09/20/2000 due 07/01/2035		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist var rate rev bnds ser 2000 B-4		
<i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist wtr		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds (2008 Authorization) due 07/01/2024		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev bnds 2003 authorization ser B-3 due 10/01/2005-2015 2017-2019 2021-2029 ser B-4 due 2031		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds		
<i>Short Term Rating</i>	A-1+	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds ser 2008A-1 due 07/01/2037		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr rev rfdg bnds 2004 dtd 02/19/2004 ser 2004 A-1&2 due 07/01/2023		
<i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr (AGM)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Southern California Metro Wtr Dist wtr (FGIC) (SEC MKT)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Ratings Detail (As Of April 18, 2012) (cont.)		
Southern California Metro Wtr Dist wtr 1999B <i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr 1999C <i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr 97 BC <i>Long Term Rating</i>	AAA/A-1+/Stable	Affirmed
Southern California Metro Wtr Dist VRDB ser 2000 B-2 <i>Long Term Rating</i>	AAA/A-1/Stable	Affirmed
Southern California Metro Wtr Dist wtr <i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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