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Fitch Rtgs: Colorado River Basin Drought Plan Will Raise Water Costs

Fitch Ratings-New York-11 April 2019: Fitch Ratings does not anticipate near-term credit effects from a recently negotiated drought contingency framework outlining water cutbacks for states in the lower Colorado River Basin. However, for some wholesale water suppliers and municipal utilities, particularly in Arizona, cuts in allocations could lead to rate increases tied to the rising cost of purchased water and could eventually pressure rate affordability.

The Colorado River Drought Contingency Plan (DCP) received congressional approval on Monday, April 8 after several years of negotiations and despite technically missing various deadlines set by the US Bureau of Reclamation (USBR). The finalization of the DCP comes after years of negotiations between states in the Colorado River Basin hoping to stabilize water levels in Lake Mead following years of drought and over allocation. The DCP will manage water shortages on the Colorado River until 2026.

Based on the terms of the DCP, Arizona would see the greatest impact of the lower basin states, with the largest cuts being absorbed by the Central Arizona Water Conservation District (CAWCD; AA/Stable), which transports water to central and southern Arizona annually through the Central Arizona Project (CAP). However, Fitch believes Arizona water users will absorb the cuts and offset the effects with rate increases. If mandatory cuts in the DCP are triggered, it is expected that rates for overall delivery of CAP water will increase by approximately 13% to 20%.

California allocation reductions per the DCP are not expected to significantly affect supplies, given the manageable near-term demand and additional supply sources, including high water storage levels in Southern California. Although the DCP allocation cuts would not significantly impact California issuers in the near term, the continued drought conditions in Colorado coupled with an uncertain State Water Project supply could stress future supplies.

Nevada would see a smaller annual cut of nearly 3% of its allocation and up to 10% if conditions worsen. Southern Nevada, which comprises more than 70% of the state's population including Las Vegas, receives 90% of its water from the Colorado River. However, the Southern Nevada Water Authority, which treats and delivers water to the region, is able to access lower levels of water in Lake Mead due to an intake that can draw water from below 1,000 feet. As such, effects are expected to be manageable.

The path to finalization of the DPC was not without some impediments. On Jan. 31, 2019, the original deadline set by the USBR, the Arizona legislature approved the state's participation in the DCP but 16 intrastate agreements included as part of legislation were not finalized by the original USBR deadline. The USBR did not consider the state's participation in the DCP complete until all internal agreements were finalized.

In addition, there was a holdout to the California portion of the plan – Imperial Irrigation District (IID) – which had indicated its support of the drought plan was contingent upon funds for Salton Sea restoration. In mid-March the Metropolitan Water District of Southern California (AA+/Stable) intervened and agreed to contribute water stored in Lake Mead through conservation to the DCP in order to complete California's part of the DPC participation, which removed the Salton Sea restoration from the DPC negotiations.

Under federal law, the USBR has the responsibility for managing the water of the Colorado River's upper and lower basins. If the DCP was not in place this year, the USBR would have moved forward independently to reduce the risk of further declines in the water supplies of the Colorado Basin.

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