[Bond Case Briefs]

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[Fitch: California Water Rules to Create Winners and Losers.]

Fitch Ratings-New York-22 September 2014: Legislation signed by the governor of California last week will benefit municipal water agency credits in the long-term by stabilizing supply and raising drought resiliency, Fitch Ratings says. However, the 10- to 20-year phase-in of the requirements comes too late to mitigate the supply pressures caused by the current severe drought and could hurt ratings of agricultural water agencies in the state in the mid-term.

The legislation requires local agencies to create and adhere to plans for sustainable groundwater management to battle chronic overdraft conditions. It creates agencies with the authority to require reductions in pumping and charge fees to support groundwater projects.

The long-term implementation of this legislation will not change existing supply pressure on California's water credits, but it should be positive for urban water providers in the long term. The new rules create incentives for California water agencies to invest in alternative water supplies like groundwater recharge, maximizing usage of surface water rights, conjunctive use, waste water recycling, and conservation. These investments will boost debt levels and water bills but will be more than offset for most issuers by supply reliability improvements. If well implemented, the legislation also will lower the risk that water agencies investments in stable supplies will be negated by overuse by neighboring communities through unadjudicated basins.

Over the long term, Fitch believes the legislation will pressure some agricultural water agencies by forcing some farmland out of production, weakening customer bases. The legislative call to more effectively manage groundwater will raise the value of the agricultural water agencies' services and stimulate investments in sustainable supplies. However, adapting to these changes will be very difficult for those that lack rate setting flexibility. We expect pressures on them to emerge sooner.

Fitch does not expect the legislation to have widespread impact on tax-supported credit ratings, even in heavily agricultural regions. While some agricultural land may be lost, it generally produces small amounts of tax revenue. Fitch also believes the impact of loss of agricultural jobs is likely to be very gradual and would be masked by broader cyclical economic factors in all but the smallest, most narrow agricultural economies that tend to lack public bond ratings.

The groundwater legislation continues a long tradition of state water policymaking in which droughts force the state and its local water agencies to make major investments in long-term supply reliability. In our view these investments are among the main reasons the current extreme drought impact has had little impact on credit ratings. However, the potential for greater impacts remains as the drought lingers.

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