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Moody's: Drought Will Have Little Impact on California Water and Sewer Utilities' Financial Health.

New York, September 17, 2014 — Drought conditions and water conservation measures will not seriously impact the credit quality of California water and sewer utilities, at least through 2016, says Moody's Investors Service in a new report. Rate increases will largely be offsetting the decline in sales volumes the utilities are projecting.

"In the early years of the three-year drought, sales volumes and gross margins have actually increased," says Moody's Michael Wertz, an Assistant Vice President and Analyst. "Therefore, the utilities' projected sales volume decline will typically lead to a return to normal financial performance, not the below-average performance the unusual severity of the drought might suggest."

In a recent survey of Moody's-rated California water and sewer utilities, which the rating agency summarizes in the report "California Water and Sewer Utilities' Rate Increases Will Largely Offset Drought's Financial Impact," Moody's finds the utilities on average expect an approximately 10% decline in water sales because of the drought, a significant difference from the 20% reduction in water usage the California governor is targeting. Only 16% of respondents report amending their scheduled rate increases in direct response to the drought and conservation measures.

Moreover, the drought has actually helped the operating performance of the utilities. Because a substantial portion of water in California is used for irrigation and landscaping, the lack of rainfall has led to greater use of utility water to make up for the lack of rain, driving up water sales and revenues.

Moody's says net revenues and debt service coverage reached three-year highs for both water and sewer systems in 2013.

But conservation measures are now cutting into volumes. In terms of financial performance, however, planned rate increases — averaging 5.3% in fiscal 2015 and 4.1% in fiscal 2016—will generally make up for the loss in volumes, according to the utilities.

Regardless of volumes, a key credit strength for the utilities is the fact they have unlimited authority to adjust rates without outside regulatory approval.

For more information, Moody's research subscribers can access this report at http://www.moody's.com/viewresearchdoc.aspx?docid=PBM_PBM175532.

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