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Fitch: Rates Key for California Water Utilities Amid Continued Conservation.

Fitch Ratings-San Francisco-04 February 2016: California's water and sewer utilities will see weaker financial margins in Fiscal 2015 and 2016 as the state's mandated conservation targets hit water sales, says Fitch Ratings. Many utilities will opt for rate increases or alternate rate structures in the next several years to mitigate the financial impact of lower demand.

"Capital-intensive issues like infrastructure investments and regulatory mandates don't dissolve in a drought, so even if mandated conservation ends tomorrow, many of California's water utilities still have important questions to answer regarding how they generate revenue," said Shannon Groff, Director in Fitch's U.S. Public Finance group.

On Feb. 2, 2016, the State Water Control Resources Board extended the state-wide conservation mandates through Oct. 31, 2016.

Utilities that already have flat rate structures in place or are quick to adopt them will be better positioned to adjust to lower demand, especially given uncertainty around the drought's length. Fitch believes many utilities will implement rate changes by Fiscal 2017, which will help their financial metrics recover from the expected dips in Fiscals 2015 and 2016.

Historically, California's water and sewer sector has enjoyed healthy margins and strong credit quality, supported by political and public support for rate adjustments. However, this flexibility continues to be tested as rates move higher.

Fitch downgraded three California utilities - Millbrae, Fresno and Contra Costa Water District - over the past two years due to a combination of lower water sales, large capital programs and reduced rate flexibility. However, upgrades still outpaced downgrades, while the majority of ratings remained stable.

In addition, Fitch has released its Fitch Analytical Comparative Tool (FACT) for the Water and Sewer Sector. FACT is an interactive Excel-based analytical tool for comparing an institution's key financial metrics to median calculations on a notch-specific rating basis, compared to entities rated within the same rating category and against Fitch's portfolio of credits.

The full report, 'California Water and Sewer Sector: 2016 Update,' and the FACT are available at www.fitchratings.com.