New York, June 06, 2018 -- Moody's Investors Service has upgraded Eastern Municipal Water District, CA's senior lien water and wastewater revenue bonds to Aa1 from Aa2 and subordinate lien revenue bonds to Aa2 from Aa3. Currently, the district has only one series of senior revenue bonds outstanding, the Series 2011A, with just over $13.5 million in outstanding par. The upgrade to Aa2 from Aa3 applies to the district's subordinate lien revenue bonds of which $1 billion is outstanding. The outlook on these ratings remains stable.

RATINGS RATIONALE

The rating upgrades reflect very strong senior lien debt service coverage and sound total debt service coverage levels. The senior lien also benefits from a short-term to maturity. While the senior lien remains open, there are currently no plans to utilize this lien, and the district's working, subordinate lien will effectively constitute senior obligations following maturity of senior debt in 2021. Debt service coverage has remained solid even through a historic, five-year drought and the state's imposition of mandatory water use restrictions in fiscal 2016. Coverage levels should remain favorable, supported by ongoing customer account growth, resumed increases in water use emerging from the drought, and a well-examined, rigorous rate setting strategy supported by a detailed cost-of-service rate methodology approved by the board in March 2017, which both encourages conservation as well as ensures a greater recovery of fixed costs from recurring, non-volumetric charges. Increased certainty regarding projected performance has also been strengthened by a reduction in outstanding variable rate debt.

The improved ratings also reflect the district's maintenance of favorable liquidity supported by reserve policies, and somewhat elevated leverage, offset by manageable future borrowing plans and CIP plans that will help to ensure diversification of the district's water supplies and sustainability of groundwater sources.

RATING OUTLOOK

The stable outlook reflects expectations for continued, solid financial performance supported by the district's well-tested ability to set rates to offset declines in water consumption, accommodate fixed costs, and address needed capital investments. The outlook also incorporates expectations for maintenance of sound liquidity levels.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Final amortization or closure of senior lien obligations
- Material improvement to the service area economy
- Reductions in variable rate debt or unhedged portions of future debt that would reduce uncertainty of future debt service requirements

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Materially weakened debt service coverage
- Deterioration in the district's cash position
- Sizeable issuance of senior lien obligations that negatively impacts coverage of subordinate obligations

LEGAL SECURITY

All outstanding revenue bonds are secured by the net revenues of the combined water and sewer enterprise. The rate covenant on the subordinate lien requires net revenues paid after O&M and senior lien debt service to be at least 1.15 times debt service. The additional bonds test is 1.15 times debt service on a 12-month look back over an 18-month period on outstanding bonds and proposed bonds. The subordinate lien bonds do not
have a debt service reserve fund. The rate covenant for combined senior and subordinate debt service is 1.10 times.

USE OF PROCEEDS

Not applicable.

PROFILE

Eastern Municipal Water District provides potable water, wastewater and recycled water services in the westerly third of Riverside County. The District serves seven cities and unincorporated portions of the county and covers an area of 555 square miles, serving a growing population that now exceeds 816,000. The communities of Murrieta, Temecula, Hemet, Moreno Valley, Menifee and San Jacinto represent the district's principal cities. The district's accounts include a combination of retail, wholesale, agricultural and recycled water customers with domestic retail accounts representing the majority of total sales.

The district was established in 1950 for the primary purpose of importing Colorado River water to its service area. Presently the district imports 49% of its water supply from Metropolitan Water District of Southern California (MWD) and derives the remainder from local sources (includes groundwater, desalinated water and recycled water).

METHODOLOGY

The principal methodology used in these ratings was US Municipal Utility Revenue Debt published in October 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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