City of
SACRAMENTO
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ADDITIONAL (VOLUNTARY) DISCLOSURE
RATING AFFIRMED

Dated: June 18, 2015

NOTICE IS HEREBY GIVEN that on June 9, 2015, Fitch Ratings ("Fitch") affirmed the long-term and underlying rating of "AA" with a stable outlook for the City of Sacramento Wastewater Revenue Bonds, Series 2013 debt issue.

The rating report from Fitch is attached.

City of Sacramento

Janelle Gray
Debt Manager

Attachment – Fitch Rating Report (City of Sacramento Wastewater Revenue Bonds, Series 2013)

FITCH AFFIRMS SACRAMENTO, CA'S SEWER REVS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-San Jose-09 June 2015: Fitch Ratings affirms the 'AA' rating on the following city of Sacramento, California (the city) revenue bonds:

--$30.8 million wastewater revenue bonds, series 2013.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by net revenues of the city's sewer system (the system or utility) after payment of maintenance and operations expenses.

KEY RATING DRIVERS

STRONG FINANCIAL PERFORMANCE: Financial performance is sound with stable revenues, healthy debt service coverage (DSC) and adequate liquidity.

LOW DEBT: Debt is low and expected to remain low even with an additional $48 million of borrowing over the next five years. This strength is somewhat offset by high overlapping debt from the regional sewer treatment wholesaler.

LARGE, DIVERSE SERVICE AREA: The utility is the monopoly provider of essential sewer services to the state capital of California. The urban service area is large, diverse and mostly residential.

GOOD MANAGEMENT, GOVERNANCE PRACTICES: The utility's governance is solid, with solid political and public support for the rates necessary to fund the utility's increased infrastructure investments. The utility engages in thorough financial and capital planning processes within a solid policy framework.

SOMEWHAT LIMITED OPERATIONS: The city operates a collection-only sewer system with treatment provided by the Sacramento Regional County Sanitation District (SRCSD). While much of the operating risk is borne by the treatment provider, the city retains some treatment responsibilities during extremely wet weather and retains regulatory risk related to wet weather flows.

RATING SENSITIVITIES

SUSTAINED DECLINE IN FINANCIAL PERFORMANCE: The rating could come under downward pressure if the city fails to set rates at a level that allows significant pay-go capital spending and in turn enhance ongoing financial results. The Stable Outlook reflects Fitch's expectation that rates will be adjusted as necessary to produce results consistent with the rating level.

CREDIT PROFILE

FUNDAMENTALLY SOUND SERVICE AREA

The utility provides essential sewerage collection services to about 260,000 residents of the city of Sacramento, California's state capital and the nation's 35th-largest city. The utility's service area includes about 60% of the city. The customer base of 76,657 accounts is largely residential, and the utility's largest customers are governmental entities. The 10 largest retail accounts provide just 7.5% of revenues.

The service area economy is driven by the State of California, the region's biggest employer. The unemployment rate trends slightly higher than the national average, but has fallen sharply over the past five years, declining to an eight-year low of 6% in April 2015. Median household income (MHI) is solid at 94% of the U.S. level. The individual poverty rate is elevated at 21.9%, but fairly typical for an urban area with pockets of concentrated poverty.

SOLID FINANCIAL PERFORMANCE

The majority of the utility's revenues come from flat fees on residential accounts, providing a high degree of revenue stability and predictability. Historical debt service coverage has been extraordinarily strong due to limited use of debt with all-in DSC (net of transfers out) averaging 5.3x over the three fiscal years ended June 30, 2014. Free cash-to-depreciation (net revenues remaining after payment of debt service divided by depreciation) averaged a solid 89% over the past three years.

All-in DSC is forecast to fall to a still strong 2.7x in 2015 and an adequate 1.7x in 2016. The budgeted 2016 results are weaker than expected at the time the bonds were issued because the utility delayed its 2016 rate increase in order to conduct a full rate study. It will likely adjust rates in 2017, restoring coverage somewhat. A failure to adjust rates to improve financial margins could put downward pressure on the rating.

Liquidity is solid. Unrestricted cash and investments equaled $21.5 million, or 369 days cash, at the end of fiscal 2014. Liquidity is expected to decline to still-healthy 224 days cash at the end of 2016, as the utility continues investing in capital spending while awaiting the outcome of its rate study. Given the utility's very predictable, stable revenues, cash at this level is not a significant rating concern.

GOOD RATE DISCIPLINE

The Sacramento City Council has shown strong rate discipline in recent years. It approved and implemented rate increases of 16% in 2013, 15% in 2014, and 14% in 2015 to support the current bond issue. City sewer charges represent less than half of a typical residential bill, with the majority made up of SRCSD treatment charges. The combined bill equals about 1.2% of MHI, putting bills above Fitch's 1% of MHI affordability metric and suggesting somewhat limited rate flexibility.

The utility has faced some rate controversy, but received strong political and electoral support for its need to raise rates to update its aging infrastructure. In 2010, voters defeated a ballot measure that sought to roll back water and sewer rate increases with a very solid 69% of the public supporting the utility. The most recent rate package was less controversial, generating formal written protests from less than 0.2% of ratepayers.

LIMITED OPERATING RISKS

The utility provides wastewater collection and conveyance services through two systems - a combined sanitary and storm sewer system in the oldest parts of the city and separated sanitary sewer system elsewhere. The utility's primary task is to collect sewerage and transport it to SRCSD, the regional treatment provider, suggesting a relatively low level of operational risk.

The primary operating risks relate to operation of the older combined storm and sanitary sewer system during major storms, when flows exceed the capacity of SRCSD treatment facilities. During wet weather, the system stores wastewater until flows decrease and can be handled by the treatment plant. Periodically, the system releases untreated or minimally treated sewerage into the Sacramento River. Regulatory oversight has centered on capital investments to reduce the frequency of untreated releases, and these investments appear affordable at about $10 million per year.

LOW DIRECT DEBT BURDEN

The current debt burden is very low and is expected to remain low. Debt per customer was just $499 at the end of fiscal 2014. The utility's fiscal 2015-19 capital improvement program (CIP) includes an additional $48 million of debt, pushing debt per customer to a still manageable $1,003 by 2019.

The CIP is moderate at $70.2 million, or $183 per customer annually. The current CIP is driven by the need to replace existing assets and to reduce discharges of untreated effluent during wet weather. The utility has also set a goal of cutting its pipeline replacement cycle to 100 years from as much as 400 years. Debt would fund a somewhat elevated 68% of the current capital plan. The borrowing is not a concern, given the utility's very low debt, but over time continued reliance on debt at this pace could adversely affect the rating.

Future regulatory action could increase capital demands on the system. The city's wastewater discharges flow into a river that provides much of the state's drinking water supplies and into an ecosystem that has been under considerable environmental stress. Regulatory action has forced the SRCSD (the treatment provider) to increase rates and capital spending significantly. These requirements increase the level of debt being supported by the rate base. Including a proportionate share of overlapping debt in debt ratios would push them to significantly above average. While the bulk of the debt belongs to the treatment provider, these costs are ultimately borne by ratepayers and increases in treatment costs reduce rate flexibility for the city.

GOOD MANAGEMENT PRACTICES

The utility's management is professional and experienced, and governance by the City Council is not overly politicized, with the utility's long-term capital needs driving rate policy more than concerns about the political price of rate increases. The utility's policy framework is solid, as evidenced by its shift to a 100-year replacement cycle for its pipes, an operating reserve target of 120 days cash, and a voluntary rate stabilization fund equal to 25% of debt service.

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Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 31 Jul 2013)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715275