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**ADDITIONAL (VOLUNTARY) DISCLOSURE  
RATING AFFIRMED**

Dated: June 9, 2017

NOTICE IS HEREBY GIVEN that on June 8, 2017, Fitch Ratings ("Fitch") affirmed the long term 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



Brian Wong  
Debt Manager

Attachment: Fitch Ratings Press Release – Wastewater Revenue Bonds, Series 2013

# FitchRatings

## Fitch Affirms Sacramento, CA's Sewer Revenue Bonds at 'AA'; Outlook Stable

Fitch Ratings-San Francisco-08 June 2017: Fitch Ratings has affirmed its 'AA' rating on the following City of Sacramento, California (the city) bonds:

--\$29.1 million sewer revenue bonds, series 2013.

The Rating Outlook is Stable.

### SECURITY

The bonds are secured by a lien on the city's net sewer system revenues after payment of maintenance and operations expenses.

### KEY RATING DRIVERS

**SOUND FINANCIAL PERFORMANCE:** Financial performance is strong with stable revenues and good rate discipline. Debt service coverage (DSC) averaged 3.3x over the three fiscal years (FY) ended June 30, 2016. Liquidity was also strong with 624 days cash on hand (DCOH) at the end of FY 2016.

**STRONG RATE DISCIPLINE:** The Sacramento City Council has approved rate increases as need to fund increasing infrastructure investment needs related to replacement of aging assets and regulatory capital requirements. The council has approved annual rate increases of 9% from FY 2017 to 2020.

**LOW DIRECT DEBT:** Direct debt is low at \$466 per customer and expected to remain low even with borrowing of up to \$34 million over the next five years, which would double the system's outstanding debt. However, the low debt levels do not reflect the high overlapping debt from the regional sewer treatment wholesaler.

**LARGE, DIVERSE SERVICE AREA:** The utility is the monopoly provider of essential sewer services to about 60% of the state capital of California. The urban service area is large, diverse and mostly residential.

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

### RATING SENSITIVITIES

**LOW TRANSITION RISK:** The rating is sensitive to fundamental shifts in debt, financial and operating profiles, as well as changes in regulatory requirements. A sharp increase in regulatory capital requirements or reduction in strong rate discipline would put downward pressure on the rating. The Stable Outlook reflects Fitch's expectation that such shifts are unlikely.

### CREDIT PROFILE

#### FUNDAMENTALLY SOUND SERVICE AREA

The utility provides essential sewage collection services to about 60% of the city of Sacramento, California's state capital and the nation's 35th-largest city. The customer base of 76,849 accounts is largely residential, and the utility's largest customers are governmental entities. The 10 largest retail accounts provide just 6.9% of operating revenues, reflecting moderate customer concentration. The five largest customers are stable governmental entities. The Sacramento economy is growing at a healthy pace with payroll employment growth outpacing the nation over the past two years and unemployment continuing to decline. The non-seasonally adjusted unemployment rate trends somewhat higher than the national average and was 4.8% in April 2017 compared to 4.1% for the nation. The State of California is the dominant local economic force and employer. While the state provides a solid fundamental base for local economic activity, the concentration of state employment in the city leaves Sacramento heavily exposed to changes in the state's budget position and employment levels.

#### 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. Fitch calculated all-in DSC (net of transfers out of utility taxes paid to the city's general fund) was 3.7x in FY 2015

and 3.6x in FY 2016. All-in DSC is forecast to decline to a still strong 3.3x in 2017 and to average 2.5x over the subsequent five years (FY 2018 to 2022) in an issuer financial forecast. The forecast appears reasonably conservative with rate increases driving revenue gains and no operating revenues from new connections assumed. Free cash-to-depreciation (net revenues remaining after payment of debt service divided by depreciation) averaged a solid 138% over the past three years.

Liquidity is also strong with \$36.1 million of unrestricted cash and investments, or 624 DCOH at the end of FY 2016. Days cash has averaged 483 days over the past three years.

#### GOOD RATE DISCIPLINE

The Sacramento City Council has shown strong rate discipline in recent years. It approved annual rate increases of 9% from FY 2017 to FY 2020. City sewer charges represent less than half of a typical residential bill, with the majority made up of SRCSD treatment charges. The combined sewer bill equals about 1.3% of median household income (MHI), putting bills above Fitch's 1% of MHI affordability metric. The utility has faced some historical rate controversy, but recent rate packages have been less controversial with minimal formal ratepayer protests opposed and strong council majorities in favor of rates necessary to increase the level of investment in the system's aging infrastructure.

#### 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 sewage 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. Several times a year, the system releases untreated or minimally treated sewage 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 \$8 million to \$10 million per year.

#### LOW DIRECT DEBT BURDEN

The debt burden is expected to remain low. Debt per customer is very low at \$466. The utility plans to borrow up to an additional \$34 million over the next five years, pushing debt per customer to a still low \$800. The sewer system's 2018-2022 capital improvement plan (CIP) is moderate at \$63.5 million, or \$165 per customer annually. The CIP is driven by the need to replace existing assets and to continue to reduce the likelihood of 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 will fund 54% of the current capital plan. The additional debt issuance is not a concern, given the utility's very low debt, and the city has set a goal of increasing the pay-go portion of capital funding over time, which would be funded by the current round of rate increases.

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.

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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

#### Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (<https://www.fitchratings.com/site/re/898969>)

U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016) (<https://www.fitchratings.com/site/re/890402>)

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