



New Issue: MOODY'S ASSIGNS Aa1/VMIG 1 RATING TO MWD OF SO. CAL.'S 2012 SERIES B WATER REVENUE REFUNDING BONDS; Aa1 RATINGS ON PARITY DEBT AFFIRMED

Global Credit Research - 17 Apr 2012

APPROXIMATELY \$4.6 BILLION OF DEBT AFFECTED

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
Water Enterprise
CA

Moody's Rating

ISSUE	RATING
Water Revenue Refunding Bonds 2012 Series B-1	Aa1/VMIG 1
Sale Amount	\$49,280,000
Expected Sale Date	04/24/12
Rating Description	Revenue: Government Enterprise

Moody's Outlook STA

Opinion

NEW YORK, April 17, 2012 --Moody's Investors Service has assigned an Aa1/VMIG 1 rating to the Metropolitan Water District of Southern California's Water Revenue Refunding Bonds 2012 Series B-1 and B-2. At this time Moody's has also affirmed the Aa1 rating on the district's outstanding parity debt. The outlook for the district's long-term ratings is stable.

RATINGS RATIONALE

The Aa1, long-term portion of the rating primarily reflects the critical importance of the District's water supplies to its exceedingly large Southern California service territory; the District board's continued willingness and ability to raise water rates as needed to maintain the enterprise's strong financial profile even during difficult economic times; and District management's above average financial, operational, and long-term capital planning ability. The VMIG 1, short-term portion of the assigned rating reflects the District's sound ability to pay the purchase price of tendered bonds in Index Mode from its own liquid, financial resources should anticipated remarketing proceeds prove insufficient. The bonds are secured by the District's pledge of net operating revenues from its water enterprise, on parity with approximately \$4.5 billion of outstanding water revenue bonds issued under a 1991 master resolution. The current offering, like other recent District water revenue bond issues, does not benefit from a debt service reserve fund. This slightly weakens the current offering's credit quality relative to prior issues that included the District's traditional debt service reserve requirement (50% of the standard three-prong test). Per the paying agent agreement, the District is "irrevocably committed", though not obligated, to purchase tendered bonds on the scheduled tender dates from remarketing proceeds and/or its own funds. Failure to do so would be an event of default under the paying agent agreement, though not under the district's master resolution.

CREDIT STRENGTHS

- The District provides critical water supplies to an exceptionally large and diverse service territory
- The District's rates, though increasing, are below any alternative sources of large-scale supply
- Well established, long-term capital planning capability and execution

-- Historically high current level of stored water supplies

CREDIT CHALLENGES

- Potentially increased political resistance to additional rate increases owing to the weakened economy
- Below average sales volumes in recent years, resulting in below-target operating performance
- Continuous legal and regulatory threats to long-run water supply reliability
- Substantial variable rate debt exposure; several counterparty bank's own ratings are on review for downgrade

DETAILED CREDIT DISCUSSION

RECENT DEVELOPMENTS IN THE DISTRICT'S FINANCES

While FY 2012 operating revenues are still projected to increase from last year's relatively low level, the District's current projection for fiscal 2012 shows less progress toward meeting its 2.0x debt service coverage target than had been previously expected. FY 2012 debt service coverage is now projected to be 1.70x, which is up from FY 2011's 1.48x but lower than the 1.83x the District had projected six months ago. This change is due almost entirely to a lower level of assumed sales volume. The projection is likely conservative, since the District is taking a more cautionary approach toward projecting sales volume after the last few years of consistent underperformance. This more cautious approach should improve credit quality in the long-run if it results in the adoption of rate increases that are larger than had been previously forecast.

On April 10, 2012, the district's board voted to increase rates by an average of 5.0% in each of the next two fiscal years, FY 2013 and 2014. The FY 2013 increase is less than what district staff had proposed (7.5%) but more than the district's most vocal critics wanted (0-3%). This 5% compromise position, which keeps the cost of "wholesale supplies as low as possible" according to the district's board chairman, raises the specter that the district's previous above-average willingness to raise rates when necessary may be weakening in the face of increasingly vocal criticism. While we recognize the rhetorical appeal and inherent vagueness of keeping rates "as low as possible," in the long-run such rates will not maintain the district's long-term credit quality at a level consistent with its current rating.

DISTRICT PROVIDES CRITICAL WATER SUPPLIES TO EXCEPTIONALLY LARGE SERVICE TERRITORY

The District provides supplemental water supplies to its 26 member agencies located mostly along the urbanized southern California coast, roughly from Los Angeles to San Diego. The District's 5,200 square mile service area includes all or parts of six counties (Ventura, Los Angeles, San Bernardino, Orange, Riverside, and San Diego) and a population of about 19 million, or about half of the state's total population. The District's operations, therefore, provide not only an essential municipal service but they also have statewide political and economic significance.

While the District's water supplies are not its service territory's only supply source (hence the District's characterization as a "supplemental" water supplier), its supplies are nevertheless critical for its customers. District supplies account for between 40% to 60% of its service territory's total annual water use. Its individual member agencies' average, annual reliance on District supplies ranges from about 30% to 100%, with some members' demands quite variable around their annual averages. This annual variance is driven by local rainfall within each member agency's own service area and watershed. Member agencies do not have an annual contractual obligation to purchase any water from the District, but their high reliance on District supplies over the long-run generally obviates the need for such commitments.

A few of the District's member agencies are pursuing alternate sources of new water supplies. These efforts, however, are integrated into the District's own long-term resource planning for the region and, given the inherently tight water supply environment in Southern California, do not pose a threat to the District's fundamental water supply relationship with its member agencies. In some cases, such as seawater desalination projects, these alternate supply sources are financed in part with District subsidies.

RECENT BELOW AVERAGE FINANCIAL PERFORMANCE PROJECTED TO CONTINUE

The District's financial performance in recent years has been below average for an Aa1-rated water enterprise, but the District has consistently demonstrated a willingness to raise rates to restore its financial health. Over the 2006-

2012 period it will have raised rates by an aggregate 76%. And while it has missed its own operating target of 2.0x debt service coverage in five of the last seven years, these were arguably exceptional years in terms of reduced supply availability followed by reduced customer demand. With the lifting in April, 2011, of drought-related sales restrictions, a modest upturn in the local economy, and 7.5% rate increases effective 1/1/11 and 1/1/12, the District will likely return to meeting its coverage target in fiscal 2014 or 2015. While the district's cash-basis projections show a positive bottom line in 2012 and beyond, the district's ability to replenish its financial reserves over the next several years will likely remain quite modest.

The District's GAAP-basis financial performance in fiscal 2011--the most recent year for which audited financial information is available--was below average for a water enterprise with Aa1-rated revenue bonds. This primarily reflected well below average sales volume of 1.63 million acre-feet (maf). Sales volume through most of the prior decade had exceeded 2.0 maf annually. Only 2010 had been below this level, at 1.86 maf. Going forward, the District is projecting about 1.7 maf in annual sales for its planning purposes, but based on long-run historic demand, it expects to exceed this level, on average, in 7 out of 10 years. Sales volume may remain below average, however, in the near-term owing to the continued relatively weak economy and the lingering effect of prior year's conservation efforts.

The recent decline in local water demand has had an upside for the District's near-term financial and credit profile: increased storage supplies. As of January 1, 2012, it had almost 3.0 maf in storage, an historic high. The purchase of storage supplies have not been a pure positive however, since they have reduced the District's financial reserves. As of fiscal 2009 year end, the District's two key reserve funds (its rate stabilization and "revenue remainder" funds) totaled \$322 million. More recently, 6/30/11 cash reserves in these funds were \$248 million, or about 21% of annual revenues.

SIGNIFICANT BUT MANAGEABLE VARIABLE RATE DEBT EXPOSURE

With recent year's increased focus on fixed-rate debt issuance, the District's total outstanding variable rate debt exposure has been reduced but still remains significant at about 36% of its total, outstanding water revenue debt (as of Apr. 1, 2012). More than two-thirds of these variable rate obligations are swapped to fixed, giving the District a correspondingly large interest rate swap portfolio, but relatively predictable annual interest rate costs. The District's net variable rate exposure is just 11% of its total revenue bond debt. With the District's sound cash flow and reserves, managing fluctuating interest costs remains easily within its means. The more significant risk, though one which the District is also capably managing, is the replacement of expiring liquidity facilities. To date, the District has not experienced any significant difficulty in either finding replacement providers or in extending existing facilities. This challenge may increase in the near term, however, as the ratings of both European and U.S. banks are increasingly under pressure. Several of the district's liquidity provider banks and swap counterparties have their ratings on review for downgrade.

The district has also soundly managed its self-liquidity long-maturity put bond program, of which about \$437 million is currently outstanding. As noted above, the current offering will add an additional \$100 million to that figure. Since selling its first SIFMA Index Maturity bond, the district has successfully remarketed various series on average three months in advance of the scheduled mandatory tender date. The range has been from a low of 62 days to a high of 146 days. The district has not had a failed remarketing, and even with the additional \$100 million it has very strong liquidity coverage ratios. Given the district's very large variable rate exposure and swap portfolio, however, above average coverage ratios would be expected to maintain a VMIG 1 short-term rating.

CHALLENGING LONG-RUN WATER SUPPLY ENVIRONMENT LARGELY MITIGATED BY THE DISTRICT'S STORAGE SUPPLIES

Rainfall variations and increasingly stringent regulatory constraints imposed on the District's two main water supply sources--the federal Colorado River System and the California State Water Project (SWP)--result in highly variable annual deliveries to the District. Last year's well above normal precipitation increased supplies available to the District and boosted reservoir levels statewide, but the current year has so far been far below normal. The Colorado River watershed experienced below normal rainfall for most of the last decade. What actually constitutes "normal" rainfall for this watershed is subject to considerable debate. Depending on the historic timeframe evaluated, "normal" could be substantially lower than the level currently assumed. The District's SWP supplies will likely remain subject to significant regulatory constraints for the foreseeable future, notwithstanding last year's modest easing of some constraints related both to legal decisions and increased rainfall. SWP supplies are channeled through the Sacramento-San Joaquin Bay Delta, an environmentally sensitive estuary. Issues related to the long-term environmental health and competing uses of the Bay Delta remain contentious, and potentially very expensive to

solve. As the largest contractor for SWP supplies, the District will likely be a major contributor to any reengineering of the Delta to improve its environmental health and supply reliability.

The District has to date very capably addressed its long-run supply challenges, primarily by improving its own storage capacity and delivery system integration. As indicated above, the District currently has historically high amounts of water in storage, so it is well positioned for any near-term supply challenges.

Outlook

Moody's outlook on the District's water revenue bond ratings is stable. While the District's near-term operating results will be below average for an Aa1-rated water enterprise, the District continues to have generally demonstrated a willingness and ability to raise rates as necessary to maintain above average credit quality.

What Could Change the Rating - UP

Given the District's already very high rating and the likely continued, challenging water supply environment in California, upward rating movement is unlikely. However, significantly improved water supply reliability and a reduction in the variability in the District's annual financial performance could provide upward rating pressure.

What Could Change the Rating - DOWN

* Consistently weak financial performance relative to the District's Aa1 rated peers, whether from reduced sales/supplies or unwillingness to raise rates on a timely basis.

* Sufficiently reduced supply reliability such that the District's storage supplies could not reasonably be expected to be replenished on a timely basis.

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

The Global Scale Credit Ratings on this press release that are issued by one of Moody's affiliates outside the EU are endorsed by Moody's Investors Service Ltd., One Canada Square, Canary Wharf, London E 14 5FA, UK, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that has issued a particular Credit Rating is available on www.moody.com.

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moody.com.

Information sources used to prepare the rating are the following: parties involved in the ratings, parties not involved in the ratings, public information, confidential and proprietary Moody's Investors Service information, confidential and proprietary Moody's Analytics information.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see the ratings disclosure page on www.moody's.com for general disclosure on potential conflicts of interests.

Please see the ratings disclosure page on www.moody's.com for information on (A) MCO's major shareholders (above 5%) and for (B) further information regarding certain affiliations that may exist between directors of MCO and rated entities as well as (C) the names of entities that hold ratings from MIS that have also publicly reported to the SEC an ownership interest in MCO of more than 5%. A member of the board of directors of this rated entity may also be a member of the board of directors of a shareholder of Moody's Corporation; however, Moody's has not independently verified this matter.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moody's.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moody's.com for the last rating action and the rating history.

The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moody's.com for further information.

Please see www.moody's.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Analysts

Eric Hoffmann
Lead Analyst
Public Finance Group
Moody's Investors Service

Michael Wertz
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA



© 2012 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE

SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the

heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. ("MJKK") are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, "MIS" in the foregoing statements shall be deemed to be replaced with "MJKK". MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.