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EVENT NOTICE PURSUANT TO S.E.C. RULE 15C2-12
RATING CHANGES

Dated: June 1, 2017

NOTICE IS HEREBY GIVEN that on May 31, 2017, Standard and Poor's Global Ratings ("S&P") upgraded the long term rating to "AA" from "AA-" with a stable outlook for the City of Sacramento Water Revenue Bonds, Series 2013 debt issue.

The rating report from S&P is attached.

City of Sacramento

Brian Wong
Debt Manager

Attachment: S&P Press Release – Water Revenue Bonds, Series 2013

S&P Global
Ratings

RatingsDirect®

Sacramento, California; Water/Sewer

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Sacramento, California; Water/Sewer

Credit Profile		
US$54.475 mil wtr rev bnds ser 2017 due 09/01/2047		
Long Term Rating	AA/Stable	New
Sacramento wtr rev bnds		
Long Term Rating	AA/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating to 'AA' from 'AA-' on Sacramento, Calif.'s water revenue bonds. At the same time, we assigned our 'AA' long-term rating to the city's series 2017 water revenue bonds. The rating reflects, in our opinion, the combination of a very strong enterprise risk profile and an extremely strong financial risk profile. The outlook is stable.

We raised the rating based on the water system's improved liquidity position, and approved service rate adjustments through fiscal year 2020 that we believe will enable the water system to maintain very strong financial performance while funding capital improvements beyond fiscal year 2022 primarily on a pay-as-you-go basis.

The enterprise risk profile reflects our view of the water system's:

- Service area participation in the broad and diverse Sacramento metropolitan area economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable service rates although the county poverty rate is moderately high; and
- Good operational management practices and policies.

The financial risk profile reflects our view of the water system's:

- Very strong financial performance, with all-in coverage most recently at 1.7x for fiscal year 2016;
- Strengthening liquidity position, with unrestricted cash and investments of $102 million, equivalent to 748 days of operating expenses, at the end of fiscal year 2016;
- Moderate capital improvement program (CIP) that is primarily funded through additional leverage; and
- Good financial management practices and policies.

A very strong enterprise risk profile and an extremely strong financial risk profile map to an indicative rating in our revenue debt criteria matrix of 'aa+'; however, we have applied a one-notch unfavorable adjustment from the initial indicative rating to arrive at the final rating based on the region's susceptibility to downturns in the economy, as demonstrated during the housing recession, and the system's relatively weaker enterprise risk profile score relative to those of 'AA+' rated utilities.

The city is issuing the series 2017 bonds to finance capital improvements to the water system.

We view the bond provisions as credit neutral. The bonds are secured by the net revenues of the city's water system. Key bond provisions include a rate covenant and an additional bonds test, both of which are set at 1.20x annual debt service. For the purpose of the rate covenant, the city may include withdrawals from a rate stabilization fund with gross revenues. The city does not intend to provide a debt service reserve fund for the series 2017 bonds. The series 2017 bonds will be on parity with $204.2 million of existing revenue bonds and an $8.2 million state loan. The water system has also historically paid debt service lease revenue bonds that were issued to finance water system capital improvements and are secured by lease payments from the city's general fund, of which the remaining balance is $123 million. We understand that under the revenue bond indenture, the city is obligated to pay water system maintenance and operation costs and all debt service secured by the water system's net revenues--including the series 2017 bonds--before it is permitted to use net revenues to pay or reimburse debt service on the lease revenue bonds associated with the water system.

Enterprise risk

The city is located in Sacramento County in the northern portion of California's central valley at the confluence of the Sacramento and American rivers, about 75 miles northeast of San Francisco. The water system's retail service area is generally contiguous with the city's boundaries--it encompasses about 100 square miles and has an estimated population of 493,025. The city serves as the state's capital, and although roughly a quarter of the jobs in the area are in the government sector, we consider the Sacramento metropolitan area economy to be broad and diverse. For the period from 2015 to 2018, we expect that local economic growth will be moderate, with the average annual change in gross county product to be about 3.4%, which outpaces the national metric of about 2.5%. However, we note that the region is susceptible to downturns in the economy, as demonstrated by significant weakness during the housing recession. We view the service area's income levels as good based on city's median household effective buying income (MHHEBI), which was 93% of the national median for 2016. The water system's customer base is stable, primarily residential, and very diverse. Residential customers account for about 93% of the system's 136,130 connections, and the leading 10 customers contribute about 6.8% of total operating revenue.

We view the water system's market position as strong based on its affordable service rates although the county does have an elevated poverty rate. The water system has two residential rate structures: one for metered customers and a second for nonmetered customers. As of July 1, 2016, about 50% of the system's customers are billed based on metered service, and we understand that the city intends to install water meters systemwide by December 2020--well ahead of the Jan. 1, 2025, deadline required by state law. For a typical residential customer, we understand that the typical monthly bill is currently $50.30, which is equivalent to 1.5% of the city's MHHEBI when annualized. The county poverty rate as reported by the U.S. Department of Agriculture is 18.3%, which we view as moderately high and a potential source of resistance to revenue raising. The city generally raises water rates on an annual basis although service rates remained unchanged for fiscal years 2012 and 2016. Most recently, the city council approved 10% annual rate increases for fiscal years 2017 through 2020. Under a ballot measure approved by voters in 1998, 11% of rate revenue collected is transferred to the city's general fund as a general tax, and this portion of revenue is not pledged to debt service on the water revenue bonds. We understand that there have not been any material payment delinquencies by the customer base.

Based on our operational management assessment, we view the water system to be a '2' on a six-point scale, with '1' being the strongest. The system's water supply portfolio is about 86% surface water and 14% groundwater. The city has rights to divert surface water from the Sacramento and American rivers, with certain limitations under an agreement with the U.S. Bureau of Reclamation and a separate agreement with other local water utilities. The city diverts the water at two sites adjacent to treatment plants within the city, and each source is treated at a separate water treatment plant: the Sacramento River Water Treatment Plant or the Fairbairn Water Treatment Plant. The system also has a reliable groundwater supply pumped by wells located within the service area. According to the city, the system has an existing production capacity of 260 million gallons per day (mgd), compared with recent average daily demand of 95 mgd and peak day demand of 143 mgd. Under its capital program, the city expects production capacity to increase to 280 mgd by the end of 2017. Management believes the city has sufficient water supply and infrastructure to satisfy demand through at least 2030.

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for the water system to be very low, the most favorable assessment possible on a six-point scale, with '1' being the best.

Financial risk

The water system's financial performance has been consistently very strong during the past three fiscal years, and we believe this level of performance will be sustainable going forward. Based on the city's audited financial statements, we calculate that all-in coverage was 1.9x, 1.7x, and 1.7x for fiscal years 2014 through 2016, sequentially. Financial performance during this period was primarily driven by the 10% annual rate increases implemented in fiscal years 2014 and 2015 that increased operating revenue by 11% to about $98.5 million for fiscal year 2016 from $88.8 million for fiscal year 2013. The implemented rate adjustments more than offset reduced water demand--a 31% decline to 27.7 billion gallons for fiscal year 2016 from 40.2 billion gallons for fiscal year 2013--driven by water conservation during the drought. The impact of water conservation on operating revenues was also dampened in part by the fact that about 50% of the customer base remains on flat-rate nonmetered service, and for metered customers the monthly service charge component of the bill is currently $26.84, or roughly half of a typical monthly bill. During this period, total debt service--including debt service on general fund lease revenue bonds issued for the water system--increased to $26.7 million for fiscal year 2016 from $12.8 million for fiscal year 2013 as the water system began paying debt service on the series 2013 bonds.

Based on the city's financial projections, we anticipate that all-in coverage will remain very strong despite additional leverage to finance the water system's capital program. The city's forecast incorporates assumptions that we believe are reasonable, including implementation of the approved 10% annual rate increases through fiscal year 2020, operating expense growth that reflects negotiated bargaining agreements, and additional debt service related to a state revolving fund loan. Based on this forecast, we anticipate that all-in coverage will range between 1.7x and 2.1x between fiscal years 2018 and 2021 and then decline to about 1.6x for fiscal year 2022 when total debt service increases by 22% to $40 million as compared to the prior fiscal year as the state revolving fund loan begins amortizing.

The water fund's liquidity position has been strengthening during the past three fiscal years, and we anticipate that it will remain very strong going forward. Based on the city's audited financial statements, the water fund's unrestricted cash and investments balance increased to about $102 million, equivalent to 748 days of operating expenses, at the end of fiscal year 2016 from $52 million, or 427 days, at the end of fiscal year 2013. Given that the city intends to continue increasing service rates while funding a majority of the CIP through additional leverage, we anticipate that the water fund's cash reserves will remain very strong absent a shift in capital finance strategy.

The water system's CIP is moderate, in our view, with $292 million in projects during the next five years. The plan is focused on treatment plant rehabilitation, water meter installation, water main replacement, groundwater well rehabilitation, and other projects. The series 2017 bonds will provide about $62.5 million of funding, and a state revolving fund loan is anticipated to provide an additional $173.2 million of funding. According to management, continued annual capital spending will be needed after this five-year capital program given the water system's aging infrastructure. We view the water system's pro forma leverage level to be moderate based on a debt-to-capitalization ratio of about 58% after incorporating the series 2017 bonds and the state revolving fund loan.

Based on our financial management assessment, we view the water system to be a '2' on a six-point scale, with '1' being the strongest. In our view, revenue and expense assumptions are reasonable, and management reports that the water system's financial performance is presented to the city council on a quarterly basis in a consolidated city report along with other enterprise funds and the city's general fund. Management presented a water system financial plan to the city council in March 2016 that included the four-year rate plan and a 10-year overview of the 30-year water infrastructure investment program. We understand that the city does not have an adopted reserve policy, but informally has a minimum 120-day working capital reserve for the water system. The city has adopted a formal debt management policy in compliance with the requirements of Senate Bill 1029. The city produces financial statements in accordance with generally accepted accounting principles and actively maintains its website, from which financial and operational information is easily accessible.

Outlook

The stable outlook reflects our view of the water system's operational flexibility, coupled with its very strong liquidity position. During the two-year outlook period, we anticipate that the city will continue adjusting water rates as preapproved while making progress on the CIP, particularly with respect to metering the customer base.

Upside scenario

We could take a positive rating action if the metropolitan area economy continues to diversify and strengthen, as demonstrated by rising income levels and a declining poverty rate.

Downside scenario

We could take a negative rating action if the water system significantly underperforms the forecast or unexpectedly and materially spends down cash reserves.

Leased Water Assets

The city has a master lease program under which it has issued bonds for various purposes, including financing water system improvements. The bonds are secured by lease payments from the city's general fund. The lease revenue bonds associated with the water system represent about $123 million of the $606 million existing lease revenue bonds. Although water system revenues are not pledged to any lease revenue bonds, in practice these revenues have been used to pay debt service on lease revenue bonds used to finance water system improvements. Under the revenue bond indenture, the water system must pay operating costs and all debt service secured by water revenues, including the series 2013 and 2017 bonds, before it is permitted to pay or reimburse debt service on the lease revenue bonds associated with the water system.

Under the master lease program, the city has leased a pool of assets, including portions of its Sacramento River water treatment plant. If the city were to fail to make any portion of its lease payments under the entire program, the trustee has the right to re-let a portion of the leased property, including potentially the water system assets. Any disruption in the use of the Sacramento River water treatment plant, which represents about 54% of the system's sustainable capacity, could negatively affect water supply and water revenues. Therefore, in our view, under the lease revenue bond structure the water system has some exposure to the financial position of the general fund. However, given S&P Global Ratings' current rating on the city's general fund-backed debt and the water system's somewhat diversified water supply portfolio, we do not view this exposure as a key credit weakness at this time.