City of
SACRAMENTO
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ADDITIONAL (VOLUNTARY) DISCLOSURE
RATING AFFIRMED

Dated: March 20, 2019

NOTICE IS HEREBY GIVEN that on March 14, 2019, Fitch Ratings ("Fitch") affirmed the "AA" long-term rating with a stable outlook for the City of Sacramento 2013 Wastewater Revenue Bonds. Additionally, Fitch assigned a "AA" rating with a stable outlook to the upcoming issuance of the City of Sacramento 2019 Wastewater Revenue Bonds.

The rating report from Fitch is attached.

City of Sacramento

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Brian Wong
Debt Manager

Attachment: Fitch Press Release – City of Sacramento 2013 Wastewater Revenue Bonds and 2019 Wastewater Revenue Bonds.

FITCH RATES SACRAMENTO, CA'S SEWER REVENUE BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-San Francisco-14 March 2019: Fitch Ratings has assigned a 'AA' rating to the following City of Sacramento, California (the city) bonds:

--$27.1 million wastewater revenue bonds, series 2019.

The bonds are scheduled to price via negotiation on or around March 27. Bond proceeds will fund system rehabilitation and replacement permit compliance, sump rehabilitation and replacement, and other projects.

In addition, Fitch has affirmed the following outstanding debt:

--$28.5 million wastewater revenue bonds, series 2013 at 'AA'.

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 average debt service coverage (DSC) net of transfers of 3.3x over the five fiscal years ended June 30, 2018. Liquidity was also strong with 624 days cash on hand (DCOH) at the end of fiscal 2018.

HIGH RATES; STRONG DISCIPLINE: The Sacramento City Council has approved rate increases as needed, most recently 9% annually from fiscal 2017 to 2020, to fund increasing infrastructure investment needs related to replacement of aging assets and regulatory capital requirements. When combined with the regional treatment rates charged to customers, rates stand above Fitch's affordability threshold.

LOW DIRECT DEBT: Direct debt is expected to remain low even with the series 2019 borrowing, which will nearly double the system's outstanding debt. However, the low debt levels do not reflect the high overlapping debt from the regional sewer treatment wholesaler Sacramento Regional County Sanitation District (SRCSD; AA-/A+/Stable).

LARGE, DIVERSE SERVICE AREA: The utility is the monopoly provider of essential sewer collection 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 SRCSD. While much of the operating risk is borne by the treatment provider, the city retains some treatment responsibilities during 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

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 77,521 accounts is largely residential, and the utility's largest customers are governmental entities. The 10 largest retail accounts, which are primarily comprised of stable governmental entities, provide 7% of operating revenues, reflecting moderate customer concentration.

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 equal to 11% of utility rate fees paid to the city's general fund) was 4.4x in fiscal 2018 with a five-year average of 3.3x. The utility tax transfer approved by voters and levied on the city's water, wastewater, storm-drainage and solid-waste enterprises may be higher or lower than 11% on one or more of the enterprises provided that the total tax paid by all of the enterprises does not exceed 11% of the total gross revenues received from user fees and charges of all of the enterprises combined. The city currently levies 11% on each of the enterprises.

All-in DSC including the series 2019 debt service payments is forecast at a minimum of 2.9x net of transfers over the five years ending fiscal 2023. The forecast appears reasonably conservative with rate increases driving revenue gains and minimal operating revenues from customer growth. No connection fees are assumed. Free cash-to-depreciation (net revenues remaining after payment of debt service divided by depreciation) averaged a solid 152% over the past five years.

Liquidity is also strong with $39.4 million of unrestricted cash and investments, or 624 DCOH at the end of fiscal 2018. Days cash has averaged 532 days over the past five years.

GOOD RATE DISCIPLINE; ELEVATED RATES
The Sacramento City Council has shown strong rate discipline in recent years. It most recently approved annual rate increases of 9% from fiscal 2017 to fiscal 2020. City sewer charges represent less than half of typical residential cost, with the majority made up of SRCSD treatment charges. The combined sewer charges equal about 1.4% of median household income (MHI), putting it 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. In addition, approximately 10% of customers participate in the system's utility assistance program providing some rate relief.

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. The system releases untreated or minimally treated sewage into the Sacramento River during extreme weather events. Regulatory oversight has centered on capital investments to reduce the frequency of untreated releases and the system's five-year capital plan is focused on these projects.

LOW DIRECT DEBT BURDEN

The system's direct debt burden, which does not include any amounts borrowed by SRCSD, is expected to remain low even with the additional debt issuance. Debt per customer will increase to approximately $1,014 by year five of the forecast from a very low $423 in fiscal 2018. Debt per capita (assuming 3.3 people per customer account) will increase to a still low $296 from just $128. Leverage, as measured by debt to funds available for debt service, was just 2.0x in fiscal 2018, which is low compared with Fitch's median of 5.3x.

The series 2019 bond proceeds will fund approximately 54% of the sewer system's $59 million 2019-2023 capital improvement plan (CIP). 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 and expects to achieve this by ramping up the pay-go funding of capital over about ten years. The additional debt issuance is not a concern given the utility's very low debt. In addition, 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 SRCSD debt in per customer and per capita debt ratios would push them higher. 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.

FUNDAMENTALLY SOUND SERVICE AREA

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 historically but was equal to it at 3.7% as of December 2018. 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.

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

A January 2018 district court ruling that dismissed claims regarding payment of Puerto Rico Highways and Transportation Authority debt has raised questions about the scope of protections provided by Chapter 9 of the U.S. bankruptcy code to bonds secured by pledged special revenues. Fitch's rating criteria treat special revenue obligations as independent from the related municipality's general credit quality. The outcome of the litigation could result in modifications to Fitch's approach. For more information, see "What Investors Want to Know: The Impact of the Puerto Rico Ruling on Special Revenue Debt" available at www.fitchratings.com.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Water and Sewer Rating Criteria (pub. 29 Nov 2018)
https://www.fitchratings.com/site/re/10049877