

**RATING ACTION COMMENTARY**

Fitch Rates NY City Muni Water Fin Auth's Revs 'AA+'; Outlook Stable

Thu 17 Jun, 2021 - 4:10 PM ET

Fitch Ratings - New York - 17 Jun 2021: Fitch Ratings has assigned a 'AA+' rating to the following New York City Municipal Water Finance Authority's (NYW, or the authority) revenue bonds:

--Approximately \$400 million water and sewer system second general resolution (SGR) revenue bonds, fiscal 2022 subseries AA-1;

--Approximately \$50 million water and sewer system SGR revenue bonds, fiscal 2022 subseries AA-2.

The fiscal 2022 series AA bonds are scheduled to sell the week of June 28th. Proceeds of the bonds will be used to finance capital projects and pay costs of issuance.

Additionally, Fitch has affirmed the following ratings:

--Approximately \$890 million first general resolution (FGR) revenue bonds and various related bank bonds at 'AA+';

--Approximately \$24 billion SGR bonds and various related bank bonds at 'AA+';

--\$400 million authorized extendable municipal commercial paper (EMCP) notes, series seven and eight at 'F1+'.

The Rating Outlook is Stable.

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The 'AA+' rating reflects the combined credit quality of the New York City Water Board (the water board), as well as the authority of the board on behalf and in support of the New York City (the city) and the city's water system. The rating on the FGR and SGR bonds further reflects the pledge of system revenues to pay FGR and SGR debt service, operating expenses and any lease payment to the city. The 'F1+' rating reflects the 'AA+' long-term rating and adequate liquidity.

The combined credit quality and financial profile are strong in the context of very strong revenue defensibility and the authority's ability to pay. Fitch considers rates affordable for most customers, and operating costs have been generally stable. Projected fiscal 2021 costs include a lease payment to the city, which is not anticipated beyond the current fiscal year. The service area exhibits strong economic diversity and resiliency, although it is experiencing some pressure as a result of the coronavirus pandemic and related containment measures.

The financial profile reflects the authority's low leverage ratio, as measured by net adjusted debt to adjusted funds available for debt service (FADS) on a gross revenue basis, which has averaged 7.3x since fiscal 2016. Leverage is anticipated to remain above 7.0x given the system's significant and largely debt-funded capital improvement program (CIP).

The authority's current projections incorporate a continuing impact of the coronavirus pandemic and related containment measures on a moderating basis through fiscal 2024. The approved fiscal 2022 rate increase, and projected rate increases for fiscal years 2023 through 2025 are more modest than previously anticipated. Fiscal 2022 expenditures, including lower debt service and excluding the city lease payment, accommodate the lower revenue base. Fitch expects the system's consistent trend of strong annual surplus revenues and modest anticipated annual rate increases should provide the authority with substantial financial flexibility and capacity to maintain rating stability as the impact of the pandemic moderates.

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which revenues and costs are largely balanced. The water utility is a city agency and is responsible for setting, levying and collecting rates to transfer to the authority for bond repayment and for reimbursement.

Further, the authority has the power to require the water utility to set sufficient rates to pay the costs of operating and financing the system so that the city adequately operate and maintain the system. Fitch views the bankruptcy without state legislative approval and Fitch views the authority as remote from the city. Fitch also views the water board as

The system is the country's largest municipally owned water and sewer utility. It is operated by the NYC Department of Environmental Protection (DEP, a city agency) and provides retail water and sewer service to 835,700 customers and over 8.3 million residents within the city. It also provides wholesale service to an additional one million residents in communities north of the city. The service area includes over 300 square miles across NYC's five boroughs (the Bronx, Brooklyn, Manhattan, Queens and Staten Island) as well as communities within Westchester, Putnam, Orange and Ulster counties.

The DEP performs day-to-day system O&M and is responsible for executing the system's multi-billion-dollar capital program. Capital and maintenance needs are expected to remain large over time given the demand placed on system assets in an expansive urban setting.

The water system provides an average of approximately 1 billion gallons per day (bgd) from three upstate aqueducts that span as far as 125 miles north of the city. Demand has steadily declined over time due to water efficiency measures, but has represented a stable 75% of available yield from three city-owned upstate reservoir systems. The sewer system collects and treats an average of approximately 1.2bgd of wastewater at fourteen in-city wastewater treatment plants for virtually the entire city. Average annual flows approximate 70% of the 1,805mgd treatment capacity.

Structural and Legal Protections

Fitch believes NYW bondholders benefit from strong legal protections that include the statutorily defined nature of the authority, bankruptcy remoteness and the gross pledge of system revenues.

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A large portion of annual debt service obligations is covered by scheduled payment dates by the system's revenue from water and sewer revenues and carry-forward surplus cash. The revenue for FYE 2020, enough to pre-pay roughly two thirds of fiscal year debt service. At FYE 2021, the authority estimates it will have surplus revenues, or over 60% of projected fiscal 2022

Only after monthly required deposits under the SGR will funds be released for other purposes, including debt service and to reimburse the city for O&M expenses.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Rate Flexibility, Economically Diverse Service Area

Revenue defensibility is supported by the system's role as an essential service provider to an exceptionally large, diverse and economically important service area. The water board has independent rate-setting authority, and rates are considered affordable for over three quarters of the NYC service area population. Bondholders are further afforded a gross lien on system revenues and strong legal protections.

Operating Risks 'aa'

Very Low Operating Cost Burden, Elevated Capital Needs

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a low life cycle ratio that should also remain stable given spending.

Financial Profile 'aa'

Generally Stable Leverage Expected to Continue

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The authority's leverage ratio, measured as net adjusted debt to adjusted FADS on a gross lien basis, was 7.6x in fiscal 2020 and is representative of historical and expected future performance. Ongoing rate adjustments and the resumption of normal consumption levels over the next five years should allow FADS to increase at a rate commensurate with increasing carrying costs, and should keep leverage consistent with the current assessment.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A sustained decline in leverage to below 5x in Fitch's base and stress cases within the context of current revenue defensibility and operating risks assessments.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An increase in the authority's leverage ratio that trends above 8x through Fitch's base and stress cases;

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--A delay in rate-setting that jeopardizes the authori

--Coverage of full obligations that generally falls belc

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BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Utilities, and Industrials have a best-case rating upgrade scenario (defined as measured in a positive direction) of three notches over three years and a worst-case rating downgrade scenario (defined as the 97th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

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SECURITY

The fiscal 2022 series AA bonds are special obligations of NYW issued under the SGR and payable solely from and secured by a subordinate lien on gross revenues of NYW. Outstanding water and sewer system FGR bonds are payable solely from and secured by a first lien on gross revenues of NYW. The SGR bonds currently being issued will not have a debt service reserve fund.

REVENUE DEFENSIBILITY

Revenue defensibility is very strong and assessed at 'aa'. All revenues are derived from monopolistic businesses and the system serves an expansive and diverse customer base with midrange demographic factors. Rate flexibility is also very strong as the water board has independent in-city rate-setting authority and charges are affordable for more than 75% of the service area population based on Fitch's standard bill calculation of 7,500 gallons of water consumption and 6,000 gallons of sewer flows per month.

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sewer rates were held flat in 2021. The fiscal 2022 rate has been approved; anticipated rate increases of 5.9% in 2022 are not expected to impair existing affordability levels.

The city's unique economic profile and its historically strong service area and broad customer base, along with its containment efforts have had a significant impact on revenues. By elevated changes in residency, reflecting a high level of

Historically, the city unemployment rate was approximately 12.3%. In 2020, the rate was 12.3%, approximately 152% of the state's national unemployment rate. Despite underlying economic weakness in the service area, system consumption has thus far experienced a relatively modest decline as higher residential usage has partially offset declines in non-residential metered consumption. Revenues projected for fiscal 2021 are consistent with projections from September 2020.

OPERATING RISKS

The operating risks profile is assessed at 'aa'. The system's operating cost burden is very low, averaging \$3,000 per million gallons of water produced/sewer flows over the last five years. The lifecycle ratio reflects solid historical system reinvestment. This low cost of service is representative of a mature system, the substantial volume of the billion-plus gallons of annual water flows facilitated by gravity and the avoidance of operating a water filtration process for over 90% of the system's potable drinking supply. O&M costs are paid as incurred by the city then reimbursed by the authority on a monthly basis following required deposits for FGR and SGR debt service.

Regarding the latter program, were the system to have to filter water from its Catskill-Delaware watershed system, construction costs are estimated to exceed \$6 billion to build a filtration plant. Instead, the system operates under a filtration avoidance determination (FAD), last authorized for 10 years in 2017, that requires land acquisition, updated wastewater infrastructure and stream banks stabilization in the watershed in lieu of filtration. The estimated remaining capital costs associated with the 2017 FAD are \$227 million.

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previous years of heavy spending, including regulatory average system lifecycle remains well below Fitch's 4 Although elevated facility age is common among large evaluated annually by a third-party engineering consulting condition, the highest of rankings.

The five-year fiscal 2021-2025 CIP totals \$13.7 billion \$10.1 billion. The CIP focuses on extensive renewal and to vital infrastructure, ongoing extension of the city's upstate aqueduct and ongoing upgrades to treatment historically, the CIP will be funded primarily through the issuance of long-term debt.

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FINANCIAL PROFILE

The authority's financial profile remains very strong and is assessed at 'aa'. Since 2016, the authority's leverage ratio has remained ranged from 7.0x to 7.7x, averaging 7.3x over the period. In calculating the authority's leverage ratio, Fitch employs an alternative calculation whereby FADS is calculated on the basis of gross revenues, which excludes O&M costs from the calculation, compared with a net revenue basis, which is typically used in Fitch's leverage calculation. This alternative calculation reflects the protection afforded bondholders through a statutory framework providing a gross lien on pledged water and sewer revenues, along with Fitch's expectation of the remoteness of either the authority or water board filing for bankruptcy protection, or being included in a city bankruptcy proceeding if one were to ever occur. Calculating FADS based on a standard net revenue pledge, the authority's leverage ratio would increase to 13.2x for fiscal 2020 and an average of 12x since fiscal 2016.

Fitch Analytical Stress Test (FAST)

Fitch expects the authority's performance to remain relatively stable and consistent with the current rating even through a stress scenario. The FAST considers the potential trend of key ratios in a base case and a stress case. The stress case is designed to impose capital costs 10% above expected levels and evaluate potential variability in projected key ratios.

The FAST base case is informed by the authority's forecast, most recently updated in May 2021, and continues to reflect the impact of the coronavirus on revenues and capital

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the stress and base case, moderating in subsequent years. Any sustained change to this expected trend could result in a downgrade of the rating.

The authority's forecast includes a lease payment of \$100 million permitted through a formal lease agreement between the authority and possession of the NYC system for the duration of our forecast. This allows for the city to collect rent on the system asset. The annual debt service on the authority-issued bonds is \$100 million.

The city requested and received a lease payment in 2020 for the first time since 2010 and both the fiscal 2020 and 2021 payments approximate half the level of historical payments and 3.5% of revenues. No additional payments beyond fiscal 2021 are currently budgeted nor included in Fitch's scenario analysis.

The system's liquidity profile is considered neutral to the rating. The authority typically carries only minimal unrestricted assets each year; however, it generates an average \$1 billion in surplus revenues that are restricted to pre-pay a portion of subsequent year's debt service costs. This practice results in stronger ongoing average daily cash flow available to pay for remaining debt service costs, O&M payments and unforeseen emergency costs than indicated by the Fitch's liquidity metrics.

Coverage of full obligations, which includes prior year's principal payment plus current year interest expense for debt service costs, was 1.4x in fiscal 2020. The overall liquidity profile is expected to remain neutral to the rating in the upcoming years.

SOURCES OF INFORMATION

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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Unless otherwise disclosed in this section, the highest rating is '3'. This means ESG issues are credit-neutral or have no impact on the credit rating of the entity, either due to their nature or the way in which they are managed. For more information on Fitch's ESG Relevance Score, visit [fitchratings.com/esg](#).

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ENTITY/DEBT	RATING	OUTLOOK	ACTION	PREVIOUS RATING
New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues (2nd Lien)/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 23 Feb 2021\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub. 18 Mar 2021\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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