FitchRatings

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Fitch Rates New York City Muni Water Finance Auth's Revs 'AA+'; Outlook Stable

Fitch Ratings - New York - 22 Feb 2024: Fitch Ratings has assigned a 'AA+' rating to the following New York City Municipal Water Finance Authority's (NYW or the authority) revenue bonds.

Water and sewer system second general resolution (SGR) revenue bonds fiscal 2024 series BB consisting of the following:

--Approximately $206.5 million subseries BB-1;

--Approximately $550.0 million subseries BB-2.

The fiscal 2024 series BB bonds are scheduled to sell the week of March 4 through negotiation. Proceeds of the bonds will be used to pay costs of system improvements, refund certain outstanding bonds, and to pay costs of issuance.

Fitch has also affirmed the following ratings:

--Approximately $405.7 million first general resolution (FGR) revenue bonds and various related bank bonds at 'AA+' (pre-refunding);

--Approximately $26.4 billion SGR revenue bonds and various related bank bonds at 'AA+' (pre-refunding);

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

The Rating Outlook is Stable.

The 'AA+' rating on the FGR and SGR bonds reflects the combined credit quality of the authority and the New York City Water Board (the water board), as well as the authority's role as the issuer of revenue bonds on behalf of and in support of the expansive New York City (the city) water and sewer system (the system). The financial profile is very strong and assessed at 'aa' in the context of historically very low leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS) on a gross revenue basis. The 'F1+' short-term rating on the extendable commercial paper notes primarily reflects the 'AA+' long-term rating and adequate liquidity.

Bondholders are afforded strong protections through a statutory framework providing a gross lien on pledged water and sewer revenues, along with Fitch Rating'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. The credit profile is further supported by the very strong revenue defensibility and operating risk profile, both assessed at 'aa'.

Leverage was in the mid-7.0x range through fiscal 2020 (FYE June 30). The adverse impact of the pandemic on the service area and resulting weaker collections drove leverage to 8.3x in fiscal 2021. Additionally, the system's previously projected rate increase was not adopted that year in light of the widespread economic strain, further reducing revenue-generating capacity.

In fiscal 2022, leverage improved to 8.0x, reflecting an increase in revenues driven by the 2.76% rate increase combined with a higher rate of consumption, slowing rate of delinquencies and the elimination of the lease payment to the city (discussed in more detail below). Total debt service was lower in fiscal 2022, the result of prior years' cash defeasances and the benefits of the low interest rate environment on certain variable-rate debt service. Fiscal 2023 results showed further improvement with leverage declining to 7.3x, driven by better than projected revenues, including the impact of an amnesty program in place for fiscal 2023.

The authority's projections through fiscal 2028 date from June 2023, prior to city's January 2024 request for a rental payment of $145 million in fiscal 2024 and $295 million (the maximum amount) in fiscal 2025. Although the rental payments have not yet been formally incorporated in the projections, the impact of these payments is largely mitigated by better than anticipated fiscal 2023 results.

Based on the authority's assumptions from June 2023, and including the city's requested lease payments in fiscal 2024 and 2025, leverage is anticipated to rise and reach 8.3x in fiscal 2028, in line with levels previously anticipated; leverage would be declining in the absence of the lease payments. Fitch anticipates updated projections as a result of the water board's fiscal 2025 rate setting process will more explicitly incorporate the fiscal 2024 and 2025 requested lease payments, and any additional lease payments, if requested.

Fitch does not differentiate between the FGR and SGR liens as they are both afforded strong support from gross revenue pledge and benefit from the subordination of O&M payments. Since 2020, the authority has historically prefunded in excess of $1.0 billion of debt service, further reducing risk to subordinate lien bondholders.

SECURITY

SGR 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 FGR bonds are payable solely from and secured by a first lien on gross revenues of NYW.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Strong Rate Flexibility, Favorable Service Area with Unique Economic Profile

The water board retains the legal authority to adjust rates as needed without external oversight. Revenue defensibility is further supported by the system's monopolistic provision of water and sewer services to its favorable service area. The service area is characterized by a stable customer base, median household income that approximates the nation and weaker, but improving, unemployment rates relative to the nation.

Fitch also considers the city's unique economic profile as an international center for numerous industries and an anchor for the service area. Rates are considered affordable for almost 80% of the service area population, using Fitch's standard monthly usage of 7,500 gallons for water and 6,000 gallons for sewer.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Elevated Capital Needs

In fiscal 2023, the system's operating cost burden was considered very low at $3,497 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was a low 37% in fiscal 2023. Capex outpaces annual depreciation, with a five-year average of 182% for the five years ended fiscal 2023.

The system's capital improvement plan (CIP) for fiscal years 2024 through 2028 approximates $15.4 billion of system funds, while associated estimated actual spending is expected to be lower at around $12.0 billion for the same period. Approximately 38% of the CIP is related to water pollution control projects, including plant upgrades and reconstruction. Water distribution approximates 22% of the CIP, water supply and transmission approximate 19%, and sewer programs approximate 18%. Estimated capital spending averages $2.4 billion annually during these five years, well in excess of historical depreciation, supporting a continued low life cycle ratio.

Financial Profile - 'aa'

Leverage Remains Elevated for the Rating; Neutral Liquidity

The authority's leverage (on a gross lien basis) was 7.3x in fiscal 2023, declining from the peak of 8.3x in fiscal 2021. Fiscal 2023 results reflect increased liquidity available for debt service, collections that benefitted from the rate increase and an amnesty program that realized $105 million. The liquidity profile is neutral to the assessment and reflects coverage of full obligations (COFO) of 1.6x and current cash on hand of 391 days, when incorporating carry forward revenues. (Carry forward revenues include available funds that are restricted at the fiscal year end.)

The FAST considers the potential trend of key ratios in a base case and stress case over a five-year period. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case, leverage approximates 8.1x in fiscal 2024 and after rising to 8.2x in fiscal 2026 declines to 8.1x in fiscal 2028. In the stress case, leverage reaches 8.2x in fiscal 2024 and gradually increases through the five-year horizon to 8.3x in fiscal 2028. In consideration of the significant construction funds that would likely be available in each year given the cyclical nature of issuing and spending down that the system demonstrates, leverage is closer to 8.2x in the stress case. Although near-term leverage has declined from previous estimates, a sustained pause in the trend of declining leverage or a reversal of this trend is likely to have negative rating implications. The liquidity profile is anticipated to remain neutral to the assessment.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Failure to realize a declining leverage trend over the short term.

--Leverage that stabilizes around 8.5x in Fitch's base or stress cases.

--Sustained weakness in FADS stemming from a delay in rate-setting or an increase in expenses that weaken the liquidity position.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A sustained decline in leverage to below 5.0x in Fitch's base and stress cases within the context of current revenue defensibility and operating risk assessments.

PROFILE

The authority was created as a public benefit corporation in 1984 to issue bonds, notes and other financing instruments to fund capital improvements to the city's system. Fitch considers the authority an issuer that benefits from a contractual framework in which revenues and costs are largely balanced. The water board leases the system from the city and is responsible for setting, levying and collecting customer rates and system revenues to transfer to the authority for bond repayment and to the city for O&M reimbursement.

In addition to reimbursement for O&M, the city is entitled to an annual lease payment, most recently received in fiscal 2021. In January 2024, the city requested a lease payment of $145 million and $295 million for fiscal years 2024 and 2025, respectively; no lease payment has been requested for fiscal years 2026 through 2028. The maximum annual lease payment is 15% of the authority's annual debt service; the maximum lease payment ranges from about $283 million in fiscal 2024 to about $373 million in fiscal 2028.

The authority has the power to require the water board to charge and collect sufficient rates to pay the costs of operating and financing the system, as well as to enforce that the city adequately operate and maintain the system. The authority may not file for bankruptcy without state legislative approval, and Fitch views the authority as bankruptcy-remote from the city. Fitch also views the water board as bankruptcy-remote from the city.

The system is the country's largest municipally owned water and sewer utility. It is operated by the New York City (NYC) Department of Environmental Protection (DEP, a city agency) and provides retail water and sewer service to approximately 835,700 accounts and about 8.3 million residents within the city. It also provides wholesale service to approximately 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 significant over the long term 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 and has been a stable 75% of dependable yield from three city-owned upstate reservoir systems. The sewer system collects and treats an average of approximately 1.2 bgd of wastewater at 14 in-city wastewater treatment plants for virtually the entire city. Average annual flows approximate 70% of the 1.8 bgd design 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. While these layers of legal protection do not completely shield FGR and SGR bondholders from the operational risks of the city's massive water and sewer enterprise, they limit diversion of revenues to general city operations.

A large portion of annual debt service obligations is consistently funded well in advance of scheduled payment dates by the restricted revenue fund, which consists of both current year revenues and carry-forward surplus cash. The authority carried forward about $1.7 billion into fiscal 2024, sufficient to pre-pay approximately 90% of fiscal 2024 combined FGR and SGR debt service of about $1.9 billion.

After monthly required deposits under the SGR are satisfied and held by NYW's trustee, funds will be released for other purposes, including the cash-defeasance of additional debt, reimbursement to the city for O&M expenses and the lease payment (if any).

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

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
New York City Municipal Water Finance Authority (NY) [Water, Sewer]					
• New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues (2nd Lien)/2 LT	LT	AA+	Affirmed		AA+
• New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues/1 LT	LT	AA+	Affirmed		AA+
• New York City Municipal Water Finance Authority (NY)	ST	F1+	Affirmed		F1+

ENTITY/DEBT	RATING	RECOVERY	PRIOR
/Water & Sewer Revenues/1 ST			

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	◈
NEGATIVE	⊖	◈
EVOLVING	◎	◆
STABLE	○	

Applicable Criteria

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub.03 Mar 2023) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

New York City Municipal Water Finance Authority (NY)	EU Endorsed, UK Endorsed

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