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Ratings

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Summary:

New York City Municipal Water Finance Authority; Water/Sewer

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Credit Profile		
US$583.215 mil wtr and swr sys second gen resolution rev bnds ser 2021 DD due 06/15/2038		
Long Term Rating	AA+/Stable	New
US$200.0 mil wtr and swr sys second gen resolution rev bnds ser CC-2 due 06/15/2028		
Long Term Rating	AA+/Stable	New
US$156.72 mil wtr and swr sys second gen resolution rev bnds ser CC-1 due 06/15/2021		
Long Term Rating	AA+/Stable	New
US$116.11 mil wtr and swr sys second gen resolution rev bnds ser CC-3 due 06/15/2032		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' rating to the New York City Municipal Water Finance Authority's (NYCMWFA, or New York Water) 2021 series CC and DD (including all subseries) water and sewer system second general resolution revenue bonds. The outlook is stable.

The 2021 CC-1 and -2 bonds will provide about $450 million in new money for capital projects. The 2021CC-3 bonds and all subseries of the 2021DD bonds will refund about $928 million of existing second-resolution fixed-rate bonds for cost savings. As of February 2021, NYCMWFA has about $31.2 billion in total debt outstanding, $30.1 billion of which is second-resolution revenue debt. A first-lien pledge on the system's gross revenue secures the first-resolution debt.

Our 'AAA' long-term ratings on outstanding first-resolution bonds differ from our 'AA+' long-term rating on second-resolution bonds, reflecting both the lien priority and active use of both liens. We have applied our primary criteria to determine the entity's general creditworthiness and have applied this 'AAA' rating to the first general resolution (senior) issues.

The bond provisions include a gross pledge of revenue that results in true separation from the utility's operating function, along with the New York City Water Board's ability to raise rates (a true-up mechanism) and the segregation of funds.

A first-lien pledge on the system's gross revenue secures the first-resolution debt. A debt service reserve fund (DSRF) provides additional liquidity to the first-resolution debt. The second-resolution bonds are subordinate and do not benefit from a DSRF. Although New York Water's debt is currently rated above the U.S., the system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the entity's revenues. This, coupled with operating expense flexibility, precludes exposure to federal revenues.

Credit overview

The long-term ratings reflect the combination of a very strong enterprise risk profile, extremely strong financial risk profile, and additional credit strengths, separately identified below, related to the size and depth of the service base.

The very strong enterprise risk profile assessment reflects our view of New York Water's:

- A broad and diverse economic and customer base; however, we believe deterioration in economic conditions and high employment levels within the region and the Tri-State area, potentially leading to an annualized unemployment rate above 10% in 2020, could affect our view of the city's economic strength over the longer term;
- Rates that remain affordable, despite ongoing increases; and
- Operational management that we consider to be generally strong.

An independent consulting engineer's opinion, updated annually, indicates that the system's condition is generally very good. While replacing aging infrastructure will remain a focus, including helping remediate nonrevenue water and regulatory requirements related to the sewer system, the water supply's quality and quantity are extremely favorable. The governance and management structure has also allowed for critical decision-making with an eye toward financial integrity and maintaining operations at a high level.

The extremely strong financial risk profile assessment reflects our view of the system's:

- Currently extremely strong coverage levels, with a potential softening, depending on the trajectory of future revenue variance and expense management;
- Extremely strong liquidity position, both nominally and on a days' cash basis; and
- Financial management policies and practices we view as strong.

Interim financial results are produced and shared throughout the year and management updates its multiyear financial projections and capital improvement plan (CIP) throughout the fiscal year. There are formal policies regarding liquidity and investments, and independently audited financial statements are produced annually.

Also supporting the ratings is our opinion of the service area, which is unique in the country in that it includes major economic centers and economically supports a much larger area than the service base. We have noted risks to the economic base due to COVID-19-related recessionary effects below.

While we believe that NYCMWFA's budgeting practices are generally conservative and credit-supportive at the current rating, which helps to insulate the system's financial performance from negative variances and worsening financial metrics, several key factors could lead to a downgrade or negative outlook:

- If the water board does not adopt rate adjustments in a fashion that we believe will be supportive of financial metrics consistent with historical trends. While the system's available liquidity has remained relatively steady, we believe that the authority is entering a period where financial metrics, calculated either by the authority or by S&P Global Ratings, could be entering into a period of weakening. Rate-raising flexibility in the context of the COVID-19-driven recessionary effects is one elevated social factor that directly affects NY Water's revenue base. We believe management has the capacity and willingness to adjust rates when necessary, evidenced by the water board having a long history of adjusting rates annually as needed. However, we will continue to monitor the water

board's appetite for additional rate increases.

- If potential longer-term shifts in population migration and working dynamics alter the city's economic strength, which we believe could also challenge the authority's credit profile. That said, recent success in vaccine developments, despite prioritization and distribution logistics, could support growth consistent with the city's expectations of employment returning to pre-pandemic levels in the first quarter of 2024.

We consider the outlook for the rating currently stable, given our belief that NYCMWFA has significant financial capability to weather immediate revenue effects which are currently being exacerbated by the response to COVID-19. A key factor in maintaining the stable outlook is management's ability to demonstrate its ability to achieve actual financial performance that is at least as strong as forecasts indicate. Especially as the authority moves into a period of more uncertainty regarding revenue collections and economic trajectory, we view this historical trend as an even more important factor in maintaining the current rating and the stable outlook.

Environmental, social, and governance factors

NY Water is faced with a number of ongoing environmental, social, and governance (ESG) factors that affect our analysis of the bond rating, all of which have been notably affected by the current recessionary environment exacerbated by the COVID-19 pandemic.

Although New York City largely kept the virus controlled since June and transmission rates remain below those of other regions in the U.S., a recent surge has intermittently shut down the city's school system, driving more families toward all-virtual instruction and potentially leading to additional restrictions on nonessential businesses if the positivity rate and hospitalization statistics worsen. Although the governor has revised quarantine restrictions for domestic and international travelers, requiring a shorter duration and COVID-19 testing, we believe federal limitations on air passengers, as well as behavior changes toward air travel, will continue to dampen revenue trends generated from discretionary spending based on reduced tourism.

Our view of the potential for slower economic growth and a current lower risk of future recession over the next 12 months is outlined in our report "Within Reach: How Stimulus Proposals Lift U.S. GDP To Pre-Pandemic Levels" (published Feb. 1, 2021, on RatingsDirect), showing that additional stimulus lowers our estimated risk of recession over the next 12 months to 20%-25%. However, the recovery trajectory remains at risk if either stimulus or vaccine efforts do not have their intended effects.

Despite these risks, we believe that, from a financial standpoint, NY Water is relatively well-insulated, at least in the short term, from significant financial strain. Our opinion is supported by several factors, including the following:

- A large amount of liquid cash and investments that NYCMWFA reported on its balance sheet ended June 30, 2020 (using restricted cash and investments for the water board and NYCMWFA's revenue fund) of more than $1.3 billion);
- A flow of funds which stipulates a gross pledge of revenues that fully funds debt service on both first- and second-resolution bonds prior to funding operations and maintenance (O&M) for system O&M;
- Significant revenue effects already incorporated into NY Water's forecasts through 2023; and
- A significant level of capacity to reallocate expenses for capital projects that, while in the long term could lead to

increased debt service costs, would provide a short-term cushion if additional flexibility is needed. The sizable system-funded CIP totals $20.8 billion in forecast capital commitments from 2022-2031.

Stable Outlook

Downside scenario

We believe that NYCMWFA's financial risk would become more significant if the economic impacts exacerbated by the COVID-19 pandemic become protracted and operating revenues continue to be pressured downward without any revenue enhancements or expenditure controls to mitigate the situation. If this scenario occurs, we could take downward rating action if we believe the financial metrics are no longer consistent with the current rating. From a practical standpoint, as NY Water is an ongoing operating utility, we analyze all water and sewer financial benchmarks from the perspective of revenues, net of O&M expenses, available for debt service, despite our view that the gross pledge of revenues adds significant bondholder protections.

Historically, positive financial variances have been extremely important, in our view, to help maintain robust debt service coverage (DSC) metrics that both well exceed bond covenant minimums and provide additional flexibility for NY Water to deploy its cash as an offset to current debt service costs and for other purposes, such as funding its CIP. If we believe that this flexibility will no longer be available over a longer-term horizon, then the rating or outlook could face negative pressure. Additional base-rental payment requests from the city for future fiscal years could place additional stress on the financial metrics.

Upside scenario

Given the application of our "Assigning Issue Credit Ratings Of Operating Entities" criteria (May 20, 2015), we do not consider there to be upward rating potential on the second general resolution debt, unless the senior lien is closed and the amount of senior-lien obligations remains minimal relative to total debt outstanding.

Credit Opinion

Enterprise risk profile

The very strong enterprise risk profile assessment reflects the very deep and diverse economic and customer base the authority serves. The large base provides substantial resources to management that allow for economies of scale as management addresses capital and operational challenges. Given the service area's diversity and size, median household effective buying income (MHHEBI) levels tend to skew toward the average, at about 100% of the national level, which represents the weighted-average of MHHEBI in all five boroughs. The actual utility bill is about 2% of this average MHHEBI, a level we consider affordable.

Financial risk profile

The extremely strong financial risk profile assessment reflects the DSC results, liquidity levels, and overall financial management policies and practices. DSC on first-resolution and combined first- and second-resolution debt, as calculated by management, was 37.1x and 6.5x, respectively, for fiscal 2020. The authority projects combined senior and subordinate DSC will remain steady at a still-healthy minimum 3.1x through 2025. Because the forecast is

predicated on conservative assumptions, we have observed that actual financial results tend to be in line with, if not outperform, the projections. The fiscal 2021 projection includes a $137 million base-rental payment made to the city for the 2021 fiscal year.

Our rating incorporates a fixed-charge coverage metric that analyzes coverage from the perspective of gross revenues, net of O&M expenses, available for debt service. While we understand that the much higher lien-based coverage produced by management is consistent with the gross pledge of revenues that, in our view, adds significant bondholder protections, the fixed-charge metric is a benchmark that adds comparability across all of our rated water and sewer utilities. We calculate this figure to be about 1.8x in fiscal year 2020, and consider the following in the calculation:

- Gross revenues that include operating revenues, interest earnings, and interest rate subsidy provided by both the federal government (the Build America Bonds subsidy), the New York State Environmental Facilities Corp., escrow releases related to economic debt defeasances, and $1.07 billion of carryforward revenues from the previous fiscal year used to support debt service;
- A net out of all operating expenses used for authority operations, water board expenses, all other O&M expenses, and any base-rental payments made to the City of New York; and
- Gross debt service due.

Despite the different benchmark for coverage calculations, we still consider this lower metric to be consistent with the current rating level, especially since this coverage produces a significant amount of cash flow.

Liquidity, in our view, remains a major strength. This puts total cash reserves equivalent at about 300 days' operating expenses. While the authority has interest-rate swaps that, as of the end of fiscal 2020, carried an unfavorable mark-to-market valuation of $155 million, we believe that the cash position is ample to address even the worst-case scenario of contingent liquidity risks, no matter how remote.

In addition to the cash position, New York Water's cash flows are also notable: it is our understanding that the debt service funds held with the trustee are typically fully funded within the first few months of the fiscal year, allowing management to deploy its cash as it best sees fit, which, according to management, could also be deployed to defease debt outstanding or used for other purposes.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020