FitchRatings

Tagging Info

Fitch Rates Massachusetts Water Resources Authority's $62.8MM Revs 'AA'; Outlook Stable

Ratings Endorsement Policy
02 Nov 2012 5:07 PM (EDT)

Fitch Ratings-New York-02 November 2012: Fitch Ratings assigns an 'AA' rating to the following Massachusetts Water Resources Authority's (MWRA) bonds:

--Approximately $62,830,000 multi-modal subordinate general revenue refunding bonds, 2012 series E.

The subordinate general revenue bonds, 2012 series E will be privately placed with Citibank, N.A. on Nov. 8. Proceeds of the 2012 series E bonds will refund outstanding bonds with no extension of maturity dates.

In addition, Fitch affirms the following ratings:

--$3.5 billion general revenue bonds at 'AA+';
--$1.2 billion subordinate general resolution revenue bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY
The 2012 series E bonds are secured by a subordinate lien on net revenues of the authority, derived largely from wholesale rates and charges assessed on local units of government. Outstanding general revenue bonds are secured by a senior lien on net authority revenues.

KEY RATING DRIVERS

REGIONAL PROVIDER OF ESSENTIAL SERVICE: MWRA provides an essential service to a large and diverse service area with strong economic underpinnings.

STRONG PROTECTIONS ENSURE PAYMENT: Local governments served by the authority are required to pay for MWRA services as a general obligation, and non-payment is subject to a tested state aid intercept.

ABILITY TO SET RATES INDEPENDENTLY: The authority maintains independent rate-setting authority, prudent budgetary practices, comprehensive long-term planning, and vigilant project oversight and prioritization of its capital program.

DIMINISHED FLEXIBILITY: Financial flexibility has diminished over time due to significant leveraging and notably high user charges.

EXPECTED DECLINE IN CAPITAL PROJECTS: The authority's capital program continues to transition from costly court-mandated projects to ongoing rehabilitation.

IMPECCABLE COLLECTIONS: MWRA has achieved perfect collection rates of 100% since its inception.

ABUNDANT CAPACITY: The wholesale system benefits from an ample long-term water supply and sufficient excess water and sewer treatment capacity.

CREDIT PROFILE

LARGE, DIVERSE SERVICE TERRITORY
MWRA provides wholesale water and wastewater services to 61 communities located primarily in eastern Massachusetts. Almost 2.8 million people (or 43% of the population of the commonwealth of Massachusetts) reside in the authority's service areas. The largest of these is the city of Boston, which contributes one-third of MWRA's revenue derived from rates and charges (Fitch rates the Boston Water and Sewer Commission's general revenue bonds 'AA+' with a Stable Outlook). The service areas are generally economically diverse, and wealth levels are above state and national averages.

The 61 local communities included in the service area are required to pay for MWRA services as a general obligation and rate-setting is not subject to any limitations, including the state's Proposition 21/2. These protections, coupled with the authority's ability, pursuant to its enabling act, to utilize a local aid intercept to recover amounts unpaid by one of its member communities, excluding revenues of the Boston Water and Sewer Commission, provide significant operating flexibility and are important credit considerations.

HIGH RATES LIMIT FLEXIBILITY
MWRA's notably high rates are an ongoing credit concern as flexibility continues to diminish. However, the size of needed rate hikes has trended downward in recent years as annual capital spending has begun to decline to a more manageable level. Over the last five years the authority raised rates on average by a moderate 3.2% annually. For fiscals 2012 and 2013, the board adopted nominal rate hikes of 3.5% and 3.0%, respectively, in order to give ratepayers some degree of rate relief amid the economic downturn. Going forward, rates are forecast to rise by an annual average of 7% through fiscal 2017 to keep pace with rising debt service.

STABLE FINANCIAL PERFORMANCE
The authority's financial operations have remained relatively stable despite escalating debt service and a reliance on modest rate hikes. Historical debt service coverage (DSC) on senior lien obligations has been strong, averaging 1.9 times (x) over the prior five fiscal years, and all-in coverage has been adequate at just above the 1.1x threshold established by bond resolution.

Fiscal 2012 ended with a sizeable operating surplus that was prudently applied to the retirement of approximately $43.9 million of outstanding senior and subordinate lien bonds and DSC was in line with historical averages. Liquidity remained at a favorable level with unrestricted cash equal to about 300 days cash.

SUBSTANTIAL LEVERAGE TEMPERED BY IMPROVING CAPITAL CYCLE
Projected spending for capital projects spanning fiscal years 2014-2018 is estimated at $997 million is lower than historical levels and includes a significant shift in funding priorities. Estimated spending for asset protection will rise to nearly 54% of the capital program compared to 30% in the prior CIP, and costs related to the ongoing combined sewer overflow (CSO) control program will drop to just 3% versus 37% over the prior five years. Nearly all of the mandated projects included in the authority's long-term CSO control plan are complete with the balance in construction and expected to be completed by the fiscal 2015 deadline.

Fitch expects future capital costs will remain manageable given MWRA's vigilant project oversight and its board's self-imposed spending cap for capital projects. Funding for capital needs will continue to come almost entirely from long-term borrowings, including revenue bonds and state loans.

The authority's debt levels have been and will remain high for the foreseeable future due to historical borrowings. Debt to net plant is notably high at 97%, and annual debt service costs consume about half of gross annual revenues. However, the authority's capital cycle has declined substantially over the last several years with annual spending now equal to about half the amount expended each year in the 1990s. Fitch expects this trend to continue.

SOUND OVERSIGHT OF VARIABLE-RATE DEBT PORTFOLIO
Exposure to variable-rate debt and derivatives is fairly sizeable, although management's demonstrated ability to prudently monitor debt portfolio performance offsets this risk. Of the total amount of debt outstanding, approximately 22% is variable rate with each series of variable-rate bonds backed by liquidity agreements from a diverse pool of liquidity providers.

Almost two-thirds of outstanding variable-rate debt is hedged through floating-to-fixed-rate swaps. The outstanding notional amount totals $636 million, and the most recent (October 2012) mark-to-market value of the swaps totaled negative $182.7 million. Regular swap payments are on parity with subordinate bonds and events resulting in automatic termination are considered remote. Unrestricted cash adjusting for swap exposure remained at a healthy level in fiscal 2012, equal to about 183 days.

Contact:

Primary Analyst
Christopher Hessenthaler
Senior Director
+1-212-908-0773
Fitch, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Doug Scott
Managing Director
+1-512-215-3725

Committee Chairperson
Karen Ribble
Senior Director
+1-415-732-5611

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, Zillow.com, National Association of Realtors.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria' (June 12, 2012);
--'Water and Sewer Revenue Bond Rating Criteria' (Aug. 3, 2012);
--'2012 Water and Sewer Medians' (Dec. 8, 2011);
--'2012 Outlook: Water and Sewer Sector' (Dec. 8, 2011).

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
2012 Water and Sewer Medians
2012 Outlook: Water and Sewer Sector