FitchRatings

FITCH RATES MASS WATER RESOURCES AUTHORITY REVS 'AA+'; OUTLOOK STABLE

Fitch Ratings-Austin-14 February 2013: Fitch Ratings assigns the following ratings to Massachusetts Water Resources Authority, Massachusetts' (MWRA, or the authority) bonds:

--Approximately $300 million general revenue refunding bonds, 2013 series A rated 'AA+'.

The bonds are scheduled to sell the week of Feb. 25 via negotiation. Bond proceeds will be used to refund certain outstanding bonds of the authority for interest savings without extension of maturity.

In addition, Fitch affirms the following ratings of the authority:

--$3.5 billion general revenue bonds at 'AA+';
--$1.1 billion subordinate general revenue bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a first lien on net revenues of the authority, derived largely from wholesale rates and charges assessed on local units of government. The bonds are also secured by a cash funded debt service reserve.

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. As the authority enters into the peak years of debt service costs, end user charges will escalate further but should ultimately stabilize over time.

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

IMPECCABLE COLLECTIONS: MWRA has achieved strong 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.

RATING SENSITIVITIES

ESCALATION IN CAPITAL COSTS: A reversal in decreasing capital expenses and the corresponding funding through debt would likely weaken MWRA's credit profile.

DEBT SERVICE COVERAGE PRESSURE: A decline in total debt service coverage (DSC) could pressure the rating.

CREDIT PROFILE

LARGE SERVICE TERRITORY WITH STRONG ENFORCEMENT MECHANISMS

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) reside in the authority's service area. The largest of these is the city of Boston, which contributes approximately one-third of MWRA's revenue derived from rates and charges (Fitch rates the Boston Water and Sewer Commission's [BWSC] revenue bonds 'AA+', Stable Outlook). The service area is 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 2 1/2. 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 BWSC, provide significant operating flexibility and are important credit considerations.

HIGH RATES LIMIT FLEXIBILITY

MWRA's 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 through fiscal 2013 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. Rates are forecast to rise by an annual average of 5.8% through fiscal 2018 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 DSC on senior lien obligations has been strong, averaging over 1.9x 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 $34 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 340 days cash.

SUBSTANTIAL LEVERAGE TEMPERED BY IMPROVING CAPITAL CYCLE

Projected spending for capital projects spanning fiscal years 2014-2018 is estimated at $732 million and includes a significant shift in funding priorities from regulatory compliance projects to more renewal and replacement (R&R) of system assets. Estimated spending for asset protection will rise to over 50% of the capital program compared to 30% in the prior CIP. Conversely, costs related to the ongoing court-mandated combined sewer overflow (CSO) control plan will drop to just 4% of capital spending versus 38% over the prior five years. To date, 29 of the 35 mandated projects included in the authority's long-term CSO control plan are complete, with the balance in construction and expected to be complete by the fiscal 2015 deadline.

The authority's CIP remains sizeable but is significantly below historical spending levels driven by the cleanup of Boston Harbor in the 1990s and the completion of the majority of the CSO master plan in recent years. Fitch believes 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 98%, and annual debt service costs consume about half of gross annual revenues. 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 20% is variable rate with each series of variable-rate bonds backed by liquidity agreements from a diverse pool of liquidity providers. With this transaction, a portion of MWRA variable-rate bonds will be refunded with fixed-rate bonds, reducing the authority's variable-rate exposure to 18% of total bonds outstanding; MWRA expects to continue decreasing its variable-rate portfolio through at least fiscal 2018.

Almost 60% of outstanding variable-rate debt is hedged through floating-to-fixed-rate swaps. The outstanding notional amount totals $658 million, and the most recent (January 2013) mark-to-market value of the swaps totaled negative $174 million. Termination payments are subordinate to all debt service payments 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 212 days.

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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 the U.S. Municipal Revenue-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria', June 12, 2012;
--'U.S. Water and Sewer Revenue Bond Rating Criteria', Aug. 3, 2012;
--'2013 Water and Sewer Medians', Dec. 5, 2012;
--'2013 Outlook: Water and Sewer Sector', Dec. 5, 2012.

Applicable Criteria and Related Research:
U.S. Water and Sewer Revenue Bond Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684901
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681015
2013 Water and Sewer Medians
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695756