FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Massachusetts Water Resources Authority Revenue Bonds 'AA+'; Outlook Stable

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Fitch Ratings - Austin - 31 Jul 2020: Fitch Ratings has assigned a 'AA+' rating to the following Massachusetts Water Resources Authority (MWRA, or the authority) bonds:

--Approximately $160 million general revenue bonds, 2020 series B.

The bonds are scheduled to sell via competitive bid as early as the week of Aug. 12. Proceeds will be used to fund a portion of the authority's capital program and pay costs of issuance.

In addition, Fitch has affirmed the following MWRA ratings:

--$3.1 billion general revenue bonds at 'AA+'.

--$578 million subordinate general revenue bonds at 'AA'.

Furthermore, Fitch has assigned an Issuer Default Rating (IDR) of 'AA'.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The assignment of a 'AA' IDR and affirmation of the 'AA+' and 'AA' ratings on the senior lien and subordinate lien bond ratings, respectively, reflects the authority's very strong purchaser credit quality, supported by its independent rate-raising ability and unlimited ability to reallocate costs. The authority and its purchasers benefit from very favorable demographics within the primary service area of the Massachusetts Commonwealth (IDR: AA+/Stable). The operating risk profile of the authority is very strong given a very low operating cost burden and a very low life-cycle ratio. The authority' net adjusted debt to adjusted funds available for debt service (net leverage) has declined year over year for the past five years. Net leverage registered 9.9x in fiscal 2019, and is expected to continue to decline over the next five years. The ratings are supported by the authority's capital program, which has transitioned from costly court-mandated projects to ongoing rehabilitation and water system redundancy.

Fitch makes a one-notch distinction between the senior and subordinate lien obligations given that the difference in the financial profile between the two liens is considered meaningful and acceleration in the general bond resolution is reserved for senior lien bondholders; subordinate bondholders are precluded from direct remedies until such time as there are no senior bondholders.

Coronavirus Considerations

In response to the current pandemic, the authority adopted a 1% revenue increase for its 2021 current expense budget in May 2020. The adoption of the CEB was earlier and lower than typical to provide purchasing entities with certainty of the authority's assessment as they went into their own budget setting season. The 1% increase in rate revenue assessment is lower than the 3-3.6% typically adopted by the authority. The authority also approved a one-time exemption to its community loan program that allows purchasing entities to restructure their loan repayments to the authority to provide cash flow relief. A very limited number of purchasing entities took advantage of this program, and the restructuring does not forgive any portion of the loans, so the authority will still collect all loan payments.

The outbreak of the coronavirus has created an uncertain environment for the water and sewer utility sector. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments related to the severity and duration of the outbreak, and incorporate revised expectations for future performance and assessment of key rating drivers as necessary.

CREDIT PROFILE

MWRA provides wholesale water and wastewater services to communities located primarily in eastern Massachusetts. About 3 million people (or 44% of the population of the commonwealth) reside in the authority's service area. The largest of these is the city of Boston (IDR AAA/Stable), which contributes approximately 30% of MWRA's revenue derived from rates and charges. Fitch currently rates the Boston Water and Sewer Commission's (BWSC) revenue bonds 'AA+'/Stable. The service area generally is economically diverse, and wealth levels tend to be above the national average.

The authority's ample water supply is drawn primarily from the Quabbin and Wachusetts reservoirs and the Ware River. Under present operating rules, the authority's water sources can supply a safe yield of approximately 300 million gallons daily (mgd), which has not been exceeded since 1989. Demand continues to decline due to improvements in water efficiency and increased conservation efforts, making current supply more than sufficient to meet demand through at least 2060. The system operates two relatively new water treatment plants with a combined treatment capacity of 428mgd, which is more than sufficient capacity to meet the average demand of less than 200mgd.

Retail customers of the authority collect and convey wastewater to MWRA, which provides transport and treatment at its two wastewater treatment facilities for combined average daily flow treatment capacity of 364mgd. Average daily flows for the past five years register just over 300mgd.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Purchasers and Very Strong Revenue Defensibility

Very strong purchaser credit quality is evidenced by a Purchaser Credit Index of 1. Revenues are derived from wholesale agreements that provide for full cost recovery. The authority retains independent legal ability to raise assessments without external approval.

Operating Risks 'aa'

Very Low Operating Cost Burden

The authority's operating cost burden is very low and capital costs are focused on system renewal and water system redundancy, and no longer focused on court-mandated projects.

Financial Profile 'aa'

Very Strong Financial Profile

The authority's financial profile is very strong, characterized by declining net leverage and ample reserves. The authority's strategic refinancing program contributes to the continuous decline in net leverage, despite ongoing debt financing of capital expenditures.

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:

--Continued favorable trend of leverage closer to 6x.

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

--Failure or interruption of the continued expected downward trend in leverage to below 9x over the next few years.

--Sustained elevation of the life-cycle ratio above 45%, combined with annual capital spending consistently less than 80% could ultimately pressure the capital planning and management assessment and the overall operating risks assessment.

--Deterioration of the credit quality of the largest purchasers of authority services could pressure the revenue defensibility assessment.

--COFO below 1x that is not supported by current days cash on hand at 120 days or more.

--The senior lien rating could converge at the subordinate lien level if there is a significant erosion of the financial cushion afforded to senior bondholders that results in a lack of meaningful difference in the probability of payment default between the two liens.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th 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].

SECURITY

The bonds and parity general revenue bonds are payable from a first lien on net revenues of the authority, derived largely from wholesale rates and charges assessed on local units of government. The subordinate lien bonds are payable from a second lien on net authority revenues, subordinate only to the authority's lien securing its senior lien obligations.

REVENUE DEFENSIBILITY

Revenue defensibility is very strong at 'aa', supported by the authority's independent rate-setting authority and ability to reallocate costs among purchasing entities to provide for full cost recovery. The assessment is also supported by the very strong purchaser credit quality, represented by a Purchaser Credit Index of 1. The largest purchasing member communities include BWSC, Newton, Quincy and Cambridge, which make up more than 40% of authority revenues.

Authority revenues are derived from assessment on the 61 local communities included in the service area, which are required to pay for MWRA services as a general obligation. Furthermore, 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 BWSC and other special-purpose local bodies), provide significant revenue protection.

Over the five years through fiscal 2020, the authority raised rates on average a moderate 3.3% annually and just 3.1% in fiscal 2020. The fiscal 2021 rate adjustment was lowered to 1% to provide rate relief during the current pandemic. Continuous conservative budgeting practices and cost containment measures allowed for a lower fiscal 2021 rate adjustment without compromising operations or financial performance.

Future annual rate adjustments are expected to return the historical norms of about 3.5%. However, MWRA's long-term rate forecasts continue to trend below prior estimates. Combined rates originally were projected to climb by as much as 5.2% annually by 2021 but are now estimated to increase by no more than 3.6% through fiscal 2025. Actual rate adjustments may be less, as MWRA has prudently been applying surplus revenues to level off near-term escalations in debt service costs.

OPERATING RISKS

Operating risk is assessed as very strong at 'aa', supported by a very low operating cost burden in conjunction with moderate life-cycle investment needs that are supported by adequate capital investment. The operating cost burden is very low, averaging $2,600 per million gallons (mg) for the past five years and comfortably below the 'aa' assessment threshold of $6,500 mg. Operating costs are expected to increase based on inflationary costs and generally stable demand but will likely remain within the 'aa' assessment for the foreseeable future.

The spending for capital projects spanning fiscal years 2020-2024 is estimated at about $1.3 billion and includes a significant shift in funding priorities from regulatory compliance projects to renewal and replacement of system assets and water redundancy. Since 2003, the MWRA's board has adopted five-year spending caps for capital spending. The 2019-2023 cap of $984 million is up from the prior 2014-2018 cap of $791 million. Despite the uptick in expected spending, 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 revolving fund loans.

The authority's CIP remains sizable but is significantly below historical spending levels, which were driven by the cleanup of Boston Harbor in the 1990s and the completion of the majority of the combined sewer overflow (CSO) control plan in recent years. With all court-mandated CSO projects substantially completed in 2015, the average capital expenditures have reflected a slowdown in capital investment, with the five-year capital expenditures/depreciation averaging just 63%. This has resulted in an increase in the life-cycle ratio. While not currently a concern, Fitch would become concerned with the level of capital investment if the life-cycle ratio were to climb and remain above 45% and capital investment continued to remain below 80%.

FINANCIAL PROFILE

The financial profile is very strong, assessed at 'aa'. The authority's net leverage continues its downward trend, totaling 9.9x for fiscal 2019, down from 12.5x in fiscal 2015. The authority's continuous declining net leverage is supported by strategic defeasing of outstanding debt obligations from the budget surplus and refinancing opportunities. Since fiscal 2006, the authority has defeased over $650 million in debt service. The liquidity profile is considered neutral to the assessment. The authority's liquidity cushion of 167 days for 2019 offsets concerns that COFO for the year registered just under 1x.

Fitch notes the meaningful difference between Fitch-calculated debt service coverage (DSC) on the senior lien compared to the all-in DSC as support for the one-notch differential between the senior and subordinate liens. Historical Fitch-calculated DSC on senior lien obligations has averaged 1.7x since 2016, while all-in DSC has been generally sum sufficient. The Fitch-calculated all-in DSC includes subordinate public debt and privately placed state revolving fund loans.

Management forecasts point to continued stable financial margins based on the authority's conservative budgeting practices. DSC is expected to remain near historical norms and generate surpluses that the authority expects to use to defease future debt maturities. MWRA's positive variances are driven by conservative budgeting estimates (particularly with regard to variable interest rate costs) and tight expenditure controls.

Fitch Analytical Stress Test (FAST)

Based on the authority's financial forecast, planned capital spending and debt financing, 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.

Net leverage in the FAST base case declines year over year, falling to 7.8x by fiscal 2024, with a slight slowing of this trend in fiscal 2021 due to the reduced rate assessment adopted in response to the coronavirus pandemic. The FAST stress case reflects a similar trend of net leverage with only a slight difference of 8.1x by fiscal 2024. Fitch expects leverage to continue this downward trend past the 2024 forward look. This expectation is supported by the authority's conservative budgeting, long-range rate forecasts and continuous defeasing of debt.

Management's demonstrated strong credit quality, historical access to the market and ability to prudently monitor debt portfolio performance is credit neutral in relation to the 14% of variable-rate debt the authority manages as part of its debt portfolio. Of the total amount of debt outstanding, approximately 14% (as of 7/1/2020) is variable rate with each series of variable-rate bonds backed by liquidity agreements from a diverse pool of liquidity providers with varying expiration dates. MWRA has reduced its exposure to variable debt over the past few years and expects to continue gradually decreasing its variable-rate portfolio.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

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, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Massachusetts Water Resources Authority (MA)	LT IDR	AA Rating Outlook Stable	New Rating	
• Massachusetts Water Resources Authority (MA) /Water & Sewer Revenues (2nd Lien)/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
• Massachusetts Water Resources Authority	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. 27 Mar 2020) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub. 03 Apr 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Massachusetts Water Resources Authority (MA)	EU Endorsed

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