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Massachusetts Water Resources Authority; Water/Sewer

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Credit Profile		
US$250. mil gen rev & gen rev rfdg bnds 2010 ser A&B due 08/01/2020		
Long Term Rating	AA+/Stable	New

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' rating on senior-lien debt and its 'AA' rating on subordinate-lien debt of the Massachusetts Water Resources Authority. The outlooks are stable.

Standard & Poor's also assigned its 'AA+' long-term rating, and stable outlook, to the authority's series 2010A general revenue bonds and series 2010B general revenue refunding bonds.

In our opinion, the ratings reflect the authority's:

- Strong management, which has generated a trend of satisfactory reserves and solid liquidity over a multiyear period while successfully implementing numerous large construction projects;
- 100% collection rate from member towns, bolstered by an effective statutory collection enforcement mechanism that includes a state aid intercept;
- Adequate legal provisions, following modifications to the general bond resolution, including a senior-lien debt service coverage (DSC) ratio of 1.2x;
- Fiscal stability of Boston Water & Sewer Commission (AA+/Stable revenue debt rating), which accounts for about 30% of the authority's rate revenues; and
- Historical senior-lien coverage that has ranged from 1.9x-2.3x, before rate stabilization transfers, over the past six years.

A senior-lien net revenue pledge secures the senior-lien bonds, and a subordinate-lien net revenue pledge secures the subordinate-lien bonds. The authority pledges all revenues--defined as all income, revenues, receipts, and other funds derived by the authority from its ownership and operation of the systems, combined with any existing rights to receive the same in the future, other than certain grant receipts and other funds--as security for the bonds. As such, the authority has represented and warranted that the trustee has a first priority-perfected security interest in the revenues. Bond counsel has advised that the pledge is perfected automatically under the authority's 1984 enabling legislation.

The authority will use proceeds from the series 2010A bonds for capital projects and proceeds from the series 2010B bonds to restructure a portion of outstanding debt, and possibly refund some other debt for savings. Management has indicated that it will use about $75 million of these refunding bond proceeds to restructure debt to provide budgetary relief between fiscals 2011 and 2013. This restructuring will increase debt service in fiscals 2014 through 2022, and the authority's debt service schedule increases through 2020. Officials project that the authority will receive about $140 million in fiscal 2014 from reserves freed up by a change in the authority's legal provisions, and that these funds would be used to defease debt and lower debt service. The authority's estimates for rate revenue increases for fiscals 2011 through 2013 after the impact of the restructuring are 1.5%, 3.9%, and 3.9% respectively, compared with projections from a year ago of 6.4% per year for those three years. However, the projected rate revenue increase for fiscals 2014 and 2015 increased to 7.8% per year, compared with a projection of 5.5 and 4.6% for those two years from projections last year.

In fiscal 2009, net revenues provided 2.1x coverage on the senior-lien bonds and 1.2x coverage on the combined senior- and junior-lien bonds. At fiscal year-end 2009, the authority's unrestricted cash and investments were $93.2 million, or 131 days' operating expenses. Other reserves include $41.8 million in a rate stabilization fund and $32.9 million in a bond redemption fund, along with additional amounts in the community obligation and revenue enhancement funds, which management could draw on if a community fails to pay on time. Management will use the rate stabilization reserve to smooth rates, and it can only use the bond redemption fund to retire or prepay debt outstanding. Management projects to draw the rate stabilization and bond redemption funds down by the end of fiscal 2015.

The authority's 2010 budget required a 3.8% increase in rate revenues. Debt service is the largest component of this budget, accounting for about 65% of the total budget; while these figures are elevated, in our opinion, wholesale systems tend to have relatively high debt levels. The increase in debt service, however, should require the need for continued increases in the already above-average water and sewer rates.

The authority's recent senior-lien bonds have been sold pursuant to proposed modifications to the authority's general bond resolution that would become effective with two-thirds approval of bondholders. Authority officials expect these changes to be enacted in about five years. The authority's legal provisions would continue to provide adequate bondholder protection after the proposed changes. Under the modified legal provisions, the authority has agreed to set rates and charges so that net revenues are at least equal to 1.2x annual debt service, which is still high for a wholesale entity. Actual coverage has remained consistently above covenanted levels despite the large capital projects and resulting debt service. The rate covenant for subordinate-lien bonds would be 1.1x under the modified provisions.

Outlook

The stable outlook reflects Standard & Poor's view of the authority's sound liquidity position and its demonstrated willingness to increase rates. We expect the authority will continue to maintain satisfactory coverage and reserves as it experiences increasing debt service costs. The legal documents' legal structure is adequate and remains an important underpinning of the ratings.

Legal Provisions

The proposed changes to the general resolution include:

- The debt service reserve requirement for senior bonds would be reduced to 50% of maximum annual debt service on an aggregate basis from the current level of 100% of average annual debt service on a series basis.
- The community obligation and revenue enhancement fund would be eliminated, abolishing the supplemental coverage ratio requirement. The community obligation and revenue enhancement fund coverage requirement is currently 0.1x DSC, and the total DSC requirement is 1.3x when combined with the primary coverage requirement.
- The investments permitted for the debt service funds and debt service reserve funds will be expanded to include

more investments, including securities repurchase agreements. Investments in the debt service reserve funds will no longer be limited to 15 years.
- The purpose of the renewal and replacement reserve fund will be defined more narrowly as a fund for emergency needs, the balance of which a consultant engineer determines. Any renewal and replacement reserve fund requirement in excess of $10 million can be covered by a line of credit, such as a commercial paper (CP) program, rather than having to be funded with cash and investments.

The modification to the general resolution would free up about $140 million of reserves. Management expects that it would use the amounts released from the debt service reserve fund, due to the debt service reserve requirement reduction, to redeem bonds.

Rates/Charges

For fiscal 2009, the authority's rates and charges increased by a combined 4.5%. Continued debt service costs and the authority's capital improvement program (CIP) financing needs, however, have led to a projection of higher rate increases (5.9%) for the next five fiscal years, assuming no commonwealth debt service assistance.

The elevated residential water and sewer bill remains a concern; the monthly rate for 7,500 gallons of combined water and sewer service is an estimated $103 in fiscal 2011 and $126 in fiscal 2015. Households in the authority's service area, however, tend to use closer to 5,000 gallons monthly, which results in an estimated fiscal 2011 monthly bill $70; and the service area's high income levels provide more rate-paying ability.

Capital Improvement Plan/Debt

Massachusetts Water Resources Authority has completed most of the major projects in its CIP, including the Deer Island harbor wastewater treatment plant, the MetroWest water supply tunnel, and the John J. Carroll water treatment plant. The authority's remaining focus on its capital plans consists primarily of combined-sewer-overflow projects. The CIP projects $897.0 million of projects for 2010-2013, which is large but represents a significant reduction from capital spending in the late 1990s. This reduction indicates the authority's shift to becoming a more straightforward utility operation. Forecasting further out, the authority has recently completed a master plan for the repair and replacement of existing infrastructure and enhanced water system redundancy. The plan identified $3.1 billion in system needs over the next 40 years.

Debt Derivative Profile: '2'--A Low Credit Risk

Standard & Poor's has assigned Massachusetts Water Resources Authority a debt derivative profile (DDP) overall score of '2' on a scale of '1'-'4', with '1' representing the lowest risk and '4' the highest risk.

The overall score of '2' reflects our view that the authority's swap portfolio is a low credit risk due to:

- A low degree of involuntary termination risk under the authority's swaps due to a wide ratings trigger spread, and
- The strong economic viability of the swap portfolio over stressful economic cycles.

These strengths are offset by:

- The narrower ratings trigger spread between three of the swap counterparties and their respective credit events, and
- A lack of an adopted swap policy.

The authority's interest rate swaps outstanding are all floating- to fixed-rate agreements with a total notional value of $845 million.

The authority replaced the swap agreements it had with two Lehman Bros. entities with new agreements with Barclays Bank PLC (AA-/Negative/A-1+) and Wells Fargo Bank N.A. (AA/Negative/A-1+). Under these swap agreements, the authority will pay a fixed rate and receive floating payments based on the Securities Industry and Financial Markets Assn. Index. The fixed rate ranges between 4.47% and 6.94% for the swaps effective from 2008 through 2030 and is 6.94% for a forward-starting swap effective from 2030 through 2037. In addition to these, the authority has floating- to fixed-rate swap agreements outstanding with Citigroup Financial Products, with a credit support guarantee from Citigroup, Inc. (A/Negative/A-1); Morgan Stanley Capital Services, with a credit support guarantee from Morgan Stanley (A/Negative/A-1); and Goldman Sachs Capital Markets L.P., with a guarantee from Goldman Sachs Group (A/Negative/A-1).

All documents list a 'BBB+' rating trigger as an additional credit event for the counterparties. There is an additional credit event if the rating on the authority declines to 'BBB+', which Standard & Poor's sees as remote due to the authority's strong 'AA' credit profile. The swaps are perfectly hedged. The authority has not adopted a debt derivative policy; authority officials, however, are aware of the risks associated with the agreements and have had an active swap program to help diversify the debt portfolio for more than 20 years. Of the authority's debt outstanding, approximately 15% is true variable-rate debt or CP. Due to the low degree of termination risk, we did not factor in the swaps' value-at-risk as a contingent liability for the authority.

Related Criteria And Research

USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Ratings Detail (As Of April 23, 2010)		
Massachusetts Wtr Resources Auth multi-modal subord		
Long Term Rating	AA/NR/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
Long Term Rating	AA-/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
Long Term Rating	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
Long Term Rating	AA/NR/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
Long Term Rating	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
Long Term Rating	AA/A-1+/Stable	Affirmed

Ratings Detail (As Of April 23, 2010) **(cont.)**		
Massachusetts Wtr Resources Auth sub (MBIA) (National)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth gen rev		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth gen rev bnds		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.