

RatingsDirect®

Massachusetts Water Resources Authority; Joint Criteria; Water/Sewer

Primary Credit Analyst:

Scott D Garrigan, Chicago (1) 312-233-7014; scott_garrigan@standardandpoors.com

Secondary Contact:

Theodore A Chapman, Dallas (1) 214-871-1401; theodore_chapman@standardandpoors.com

Table Of Contents

Rationale

Outlook

General Credit Factors

Bond Provisions

Related Criteria And Research

Massachusetts Water Resources Authority; Joint Criteria; Water/Sewer

Credit Profile		
US\$62.83 mil multi-modal subordinate gen rev rfdg bnds ser 2012 E due 08/01/2031		
<i>Long Term Rating</i>	AA/Stable	New
US\$60.3 mil multi-modal subordinate gen rev rfdg bnds ser 2012 F due 08/01/2031		
<i>Long Term Rating</i>	AA/Stable	New
Massachusetts Wtr Resources Auth gen rev bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' rating and stable outlook to Massachusetts Water Resources Authority's (MWRA) series 2012E and 2012F refunding direct purchase bonds, purchased through two direct purchase agreements with Citibank N.A. and RBC Municipal Products Inc.

MWRA is also issuing its series 2012G refunding direct purchase bonds, purchased through a direct purchase agreement with Wells Fargo Municipal Capital Strategies LLC. The authority has not requested a rating on the these bonds, but we have considered the impact the bond provisions could have on our ratings.

The security on the bonds being purchased by the three counterparties is a subordinate-lien net revenue pledge. 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.

The 'AA' rating and stable outlook on the series 2012 refunding bonds is the same existing rating as MWRA's other subordinate-lien debt. We based the ratings on our opinion of the authority's ability to make payments under the agreements when due.

We have also affirmed the following ratings:

- The 'AA+' long-term rating and Standard & Poor's underlying rating (SPUR) on various series of MWRA's senior-lien debt,
- The 'AA' long-term rating and SPUR on various series of MWRA's subordinate-lien debt,
- The 'AAA' long-term rating on various series of subordinate-lien debt that is jointly secured by MWRA and a letter of credit provider, and
- The 'A-1+' and 'A-1' short-term ratings on various series of subordinate-lien debt whereby we based the ratings on the short-term rating on the counterparty providing liquidity support.

The outlook on the bonds is stable, except for when joint criteria has been applied to the issue's long-term rating, in which case we do not assign an outlook.

The ratings reflect our opinion of the authority's:

- Large and diverse service base that serves the Boston metropolitan area;
- Rate-setting autonomy combined with an historical 100% collection rate, rates and charges considered general obligations of the served communities, and a state aid intercept mechanism;
- A revenue stream that is largely dependent on Boston Water and Sewer Commission (revenue bonds rated AA+/Stable), which adds fiscal stability;
- Historical senior-lien coverage that has hovered at about 2x, not including rate stabilization transfers, since 2006;
- A swap portfolio we view as low risk due to the counterparty diversification and the wide gap between MWRA's existing bond rating and the 'BBB+' trigger that would cause an additional credit event;
- Capital improvement program (CIP) we consider manageable based on the system's size; and
- Bond provisions we consider adequate, following modifications to the general bond resolution, including a senior-lien debt service coverage (DSC) ratio of 1.2x.

A senior-lien net revenue pledge secures the senior-lien bonds, and a subordinate-lien net revenue pledge secures the subordinate-lien bonds.

We have rated the bonds being purchased pursuant to direct purchase agreements with Citibank and RBC 'AA'. Under all three agreements, the refunding bonds to be purchased will initially bear interest at SIFMA plus a spread (between 0.55% and 70% depending on the agreement). In the event an unsuccessful remarketing occurs, there is a term-out period (either three or five years, again depending on the agreement) for any unremarketed bonds still outstanding. The term-out period starts at least six months after the date of any unsuccessful remarketing, which, in our view, provides an adequate period to achieve market access and refund the unremarketed bonds, if the authority deems it financially necessary to do this in order to avoid large debt service cost increases.

All the direct purchase agreements expire either three (RBC and Citibank) or five years (Wells Fargo) from the bond purchase date, while the purchased refunding bonds mature by 2023 (series 2012G) or 2031 (series 2012F and E). A mandatory tender provision exists in all the supplemental indentures for any bonds outstanding on the agreement expiration date. It is our understanding that the timing of these agreement expirations is part of MWRA's larger variable rate and counterparty management strategy. Management has ongoing experience in renewing and extending liquidity and credit agreements, and through October 2017, expiring credit, liquidity, or direct purchase agreements at any one time represents no more than 30% of the notional value of MWRA's total variable rate portfolio. We expect the authority to continue managing the expiration of its various liquidity, credit, and direct purchase agreements in order to avoid liquidity calls due to agreement expiration, as it has in the past.

Occurrences of various events of default also could lead to acceleration of outstanding bonds. While a payment default on the related refunding bonds, parity bonds, or other MWRA debt could cause an immediate or seven-day acceleration under all the purchase agreements, we view this acceleration risk as credit risk already incorporated into our long-term credit rating. However, acceleration caused by a covenant default (which includes various reporting and other requirements pursuant to the purchase agreements or related transaction documents), only occurs after an uncured period of 180 days. We believe that if acceleration occurs due to a covenant default, this 180-day period would be adequate for MWRA to achieve market access and refund the bonds subject to acceleration, or achieve some other resolution to avoid acceleration.

If MWRA's credit rating falls below 'A-', the Citibank agreement allows for immediate acceleration, while the other two agreements allow for a 180-day cure period. Our criteria allow for the assumption that the authority could gain market access in less than 180 days due to the 'AA' rating on parity subordinate-lien bonds.

One additional event of default of note arises due to an acceleration of other parity bonds because an event of default occurs in a related hedge, credit, or liquidity agreement. All swap documents have a 'BBB+' rating trigger as an additional credit event for the counterparties. At this time, we see this as remote due to the current 'AA' rating on subordinate-lien bonds. The authority has also adopted a debt derivative policy and has incorporated this into its general debt policy. In addition, management has reported that it actively manages and reviews its swap agreements. Due to the low degree of swap termination risk, we did include the swaps' value-at-risk as a contingent liability for the authority, or incorporate this acceleration as a contingent liability related to the direct purchase agreements.

Outlook

The stable outlook reflects Standard & Poor's view of the authority's financial position as well as management's demonstrated willingness to increase rates. We expect that the authority will continue to maintain financial metrics consistent with historical trends and will also continue to benefit from the diversity of the underlying economic base.

If the authority is not able to maintain this stability in its financial position by not implementing consistent rate increases or if the local units begin to experience difficulty in paying their annual assessments, we could consider a lower rating. However, based on management's demonstrated willingness to implement rate increases and the wide and diverse nature of the economic base, we do not believe these potential risks will affect creditworthiness within the two-year outlook horizon.

General Credit Factors

MWRA is a regional, wholesale, water and sewer services provider for slightly more than 40% of Massachusetts' population (or, about 2.8 million), including Boston and its metropolitan area. The authority has statutory authority to serve 61 communities. Boston Water & Sewer Commission comprises about 30% of the authority's overall rates and charges revenue, which, in our view, lends stability to the rating on MWRA's bonds, given the AA+/Stable bond rating on Boston Water & Sewer Commission.

MWRA's operations are primarily funded with rates and charges received from communities within the service area. These are assessed to the local governments on an annual basis and payable to MWRA monthly. Assessments are essentially based on proportional flow or use and can be changed as needed through board approval. Assessments are a general obligation of each local body and are also subject to a state aid intercept mechanism (for those communities that receive local aid). In recent years, combined rates have risen anywhere from 1% to 7% annually, which is consistent with projected annual rate increases through 2018. Management reports that average water and sewer utility bills for a household using 7,500 gallons per month are about \$113.

Financial operations have remained at least adequate, in our view. At the end of fiscal 2012 (June 30), net revenues

provided a strong 2.9x coverage on the senior-lien bonds and a good 1.3x coverage on the combined senior- and junior-lien bonds. When including fixed-charge obligations (which includes capital leases and commonwealth obligations paid to the Massachusetts Water Pollution Abatement Trust), net revenues still provided a good 1.3x coverage. Net revenues have been calculated to include rates, charges, and interest earnings but exclude transfers from the rate stabilization fund; net revenues also have been increased by noncash other postemployment benefit (OPEB) expenses and subordinated commonwealth payments. In addition, at fiscal year-end 2012, the authority's unrestricted current cash and investments were \$90.1 million, or a strong 126 days' operating expenses.

These levels of coverage and unrestricted cash have been consistent with previous years, and management has indicated that, over the next several years, these financial metrics will not deviate significantly from these historical trends.

Other reserves include \$40 million in a rate stabilization fund and \$33 million in a bond redemption fund as of June 30, 2012, along with additional amounts in the community obligation and revenue enhancement fund (totaling \$20 million as of June 30, 2012), which management could draw on if a community fails to pay on time. Management projects to draw the bond redemption fund down through 2021 as it defeases additional debt and the rate stabilization fund down through 2019 for general rate stabilization.

Debt service is the largest component of the budget, accounting for about 60% of audited operating expenses; while these figures are elevated, in our opinion, wholesale systems tend to have relatively high debt levels compared with retail systems and we consider them less of a credit risk. For the variable rate portion of its portfolio, MWRA has been budgeting for 3.25% average interest cost, which is well above the actual rate of less than 1%, as indicated by management.

Unhedged variable-rate debt represents about 10% of the authority's portfolio (or, \$551 million). Another 11% is hedged through various swap agreements. Total notional value of its swaps is \$664 million, their fair value is negative \$183 million (with respect to MWRA), and all swaps are floating-to-fixed rate. Counterparties include Barclays Bank PLC (A+/Negative); Wells Fargo Bank N.A. (AA-/Negative); Citigroup Financial Products, with a credit support guarantee from Citigroup Inc. (A-/Negative); Morgan Stanley Capital Services, with a credit support guarantee from Morgan Stanley (A-/Negative); and Goldman Sachs Capital Markets L.P., with a guarantee from Goldman Sachs Group (A-/Negative). All documents list a 'BBB+' rating trigger as an additional credit event for the counterparties. There is an additional credit event if the authority's rating goes down to 'BBB+', which we consider remote due to the 'AA' subordinate-lien credit rating. The authority has also adopted a debt derivative policy and has incorporated this into its general debt policy. In addition, management has reported that it actively manages and reviews its swap agreements. 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.

Given MWRA's large swap and variable rate portfolio, if termination triggers are implemented on the swaps or failed remarketings on any variable-rate bonds occur, these could also lead, in our view, to fiscal stress. However, it is our understanding that most of the additional interest costs in the case of a failed remarketing would only occur after 90 days; we believe this provides the authority a sufficient amount of time to examine its financial options. Regarding the swaps, an additional termination event occurs if the rating on the counterparties or MWRA drops to 'BBB+' or lower.

We view a drop of MWRA's bond rating to this level as remote, and if any counterparty rating should drop to this level, a collateral posting or replacement counterparty would need to be furnished.

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 CIP for fiscal 2013 is \$156 million. For the 2014-2018 period, management's current projections indicate \$1.1 billion of capital needs (including a \$65 million contingency).

Bond Provisions

The authority's recent senior-lien bonds, including the series 2012 refunding bonds being issued in conjunction with the direct purchase agreements, have been sold pursuant to proposed modifications to the authority's general bond resolution. Management expects these changes to be enacted by about 2016 since some of the proposals require two-thirds approval of senior-lien bondholders. Under the modified bond 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, in our view, for a wholesale entity; the rate covenant for subordinate-lien bonds would be 1.1x under the modified provisions. The modifications to the general resolution would also free up roughly \$112 million of reserves. Management expects that it would use the released amounts primarily to redeem bonds.

A summary of 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 would be expanded to include more permitted investments, including securities repurchase agreements. Investments in the debt service reserve funds would no longer be limited to 15 years.
- The purpose of the renewal and replacement reserve fund would 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 could be covered by a line of credit, such as a CP program, rather than having to be funded with cash and investments.

Related Criteria And Research

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

Ratings Detail (As Of November 15, 2012)

Ratings Detail (As Of November 15, 2012) (cont.)

Massachusetts Wtr Resources Auth multi-modal subord		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds ser 2008B		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008A-1		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008 ser A-2 dtd 05/29/2008 rmktd. dtd 05/09/2011 due 08/01/2037		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008 ser A-3 dtd 05/29/2008 rmktd. dtd 05/09/2011 due 08/01/2037		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008 ser C-2 dtd 11/29/2008 due 11/01/2026 rmktd. dtd 05/07/2011		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord ser C-1		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AAA/A-1+	Affirmed
Massachusetts Wtr Resources Auth gen rev		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth gen rev bnds		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth multi modal sub gen rev rfdg bnds		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AA/NR	Affirmed

Many issues are enhanced by bond insurance.

Copyright © 2012 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.