

# RatingsDirect®

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## Summary:

# Massachusetts Water Resources Authority; Joint Criteria; Water/Sewer

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## Table Of Contents

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Massachusetts Water Resources Authority; Joint Criteria; Water/Sewer

### Credit Profile

US\$285.01 mil gen rev rfdg bnds ser 2013 A due 08/01/2038

*Long Term Rating*

AA+/Stable

New

## Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating to Massachusetts Water Resources Authority's (MWRA) series 2013A general revenue refunding bonds.

We 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 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 where the ratings are based 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 the outlook is not meaningful.

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 a historical 100% collection rate, rates and charges considered general obligations (GOs) of the served communities, and a state aid intercept mechanism;
- Revenue stream that largely depends 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 given 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 given the size of the system; 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. 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.

MWRA will use the series 2013A bonds to refund various portions of its outstanding debt for interest cost savings.

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 and 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' rating on Boston Water and Sewer Commission's bonds.

MWRA's operations are primarily funded with rates and charges received from communities within the service area. These are assessed to the local governments annually 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 GO of each local body and are also subject to a state aid intercept mechanism (for those communities that receive local aid). Since 2009, rates have risen from 1% to 4% annually, and management projects that annual rate increases through 2017 could be as much as 8.9%. Management reports that average water and sewer utility bills for a household using 7,500 gallons per month are currently 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 2.3x coverage on the senior-lien bonds and a more adequate 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 just under 1.3x coverage. Net revenues have been calculated to include rates, charges, and interest earnings but exclude transfers in from the rate stabilization fund; in addition, net revenues have been increased by noncash other postemployment benefit (OPEB) expenses and subordinated payments in lieu of taxes and 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 at June 30, 2012, along with additional amounts in the community obligation and revenue enhancement fund (totaling \$21 million at 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 to retail systems and present less of a credit concern to us. 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.

After the issue of the 2013A bonds, unhedged variable-rate debt will represent about 9% of the authority's portfolio (or, \$484 million). Another 10% is hedged through various swap agreements. The total notional value of its swaps is \$658 million, their fair value is negative \$174 million (with respect to MWRA), and all swaps are floating-to-fixed. 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 see as remote due to its strong 'AA+' credit profile. 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 to fiscal stress, in our view. 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 counterparties' rating or MWRA's bond rating drops to 'BBB+' or lower. We view a drop of the rating on MWRA's bonds to this level as remote, and if any counterparty rating should do so, a collateral posting or replacement counterparty would need to be furnished.

MWRA 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 2013 is \$156.3 million, and for 2014-2018, management's current projections indicate \$732 million of capital needs (including a \$49 million contingency). While large, this represents a significant reduction from capital spending in the late 1990s.

### **Bond provisions**

The authority's recent senior-lien bonds, including the series 2013A bonds, 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 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, 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 commercial paper program, rather than having to be funded with cash and investments.

## 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 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 lower our rating on the bonds. However, given management's demonstrated willingness to implement rate increases and the wide and diverse nature of the economic base, we do not believe, at this time, that creditworthiness will be pressured in these ways within the two-year outlook horizon.

## 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: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007

### Ratings Detail (As Of February 15, 2013)

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	Downgraded
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 rmkt. dtd 05/09/2011 due 08/01/2037		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed

**Ratings Detail (As Of February 15, 2013) (cont.)**

Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008 ser A-3 dtd 05/29/2008 rmkt. dtd 05/09/2011 due 08/01/2037

*Long Term Rating* 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 rmkt. dtd 05/07/2011

*Long Term Rating* AA/A-1/Stable Affirmed

Massachusetts Wtr Resources Auth multi-modal subord ser C-1

*Long Term Rating* AA/A-1/Stable Affirmed

Massachusetts Wtr Resources Auth multi-modal subordinate gen rev rfdg bnds ser 2012 E due 08/01/2031

*Long Term Rating* AA/Stable Affirmed

Massachusetts Wtr Resources Auth multi-modal subordinate gen rev rfdg bnds ser 2012 F due 08/01/2031

*Long Term Rating* AA/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

*Long Term Rating* AAA/A-1+ 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

**Massachusetts Wtr Resources Auth multi modal sub gen rev rfdg bnds**

*Unenhanced Rating* AA(SPUR)/Stable Affirmed

*Long Term Rating* AA/NR Affirmed

Many issues are enhanced by bond insurance.

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