FitchRatings

FITCH RATES MA WATER RESOURCES AUTHORITY REVS 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-16 May 2014: Fitch Ratings assigns the following ratings to Massachusetts Water Resources Authority, Massachusetts' (MWRA, or the authority) bonds:

--$50 million multi-modal subordinated general revenue refunding bonds, 2014 series A at 'AA';
--$64.8 million multi-modal subordinated general revenue refunding bonds, 2014 series B at 'AA'.

The bonds are scheduled to be directly placed with Banc of America Preferred Funding Corp. on May 20. 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 billion subordinate general revenue bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY

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

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 stabilize over time.

DECLINE IN CAPITAL PROJECTS: The authority's capital improvement program (CIP) has transitioned 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 to increasing capital expenses and the corresponding funding through debt would likely weaken MWRA's credit profile.

DEBT SERVICE COVERAGE PRESSURE: A decline in debt service coverage (DSC), particularly total 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 over 40% of the population of the commonwealth) reside in the authority's service area. The largest of these is the city of Boston (general obligation bonds 'AAA', Stable Outlook), 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 Boston Water and Sewer Commission, 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 2014 the authority raised rates on average by a moderate 2.9% annually; fiscals 2013 and 2014 adjustments were 3.0% and 3.5%, respectively.

Rates are forecast to rise by an annual average of 4.8% through fiscal 2020 to keep pace with rising debt service. Actual adjustments may be less though as MWRA has prudently been applying surplus revenues to level off near-term escalations in debt service costs. Beyond fiscal 2021 debt service carrying costs begin to drop off which should afford the authority ample capacity to limit growth in adjustments in future years.

STABLE FINANCIAL PERFORMANCE

The authority's financial operations have remained very stable despite escalating debt service and a reliance on moderate rate hikes. Historical DSC on senior lien obligations has averaged a strong 1.9x over the five years through fiscal 2013 based on Fitch's calculation of DSC which includes certain accruals from the income statement. All-in DSC, which includes subordinate public debt and privately-placed state revolving fund loans, has been low but adequate at 1.1x over the last five fiscal years. Liquidity has been favorable and equaled 320 days cash for fiscal 2013.

Fiscal 2013 ended with a sizeable budgetary surplus that was prudently applied to the retirement of approximately $25 million of outstanding senior and subordinate lien bonds. Fiscal 2014 year-to-date results also show a positive variance and are expected to allow the authority to defease additional debt later this year that will reduce debt service in the fiscal 2015-2018 timeframe. MWRA's positive variances are driven by conservative budgeting estimates (particularly with regards to variable interest rate costs) and tight expenditure controls.

SUBSTANTIAL LEVERAGE TEMPERED BY IMPROVING CAPITAL CYCLE

Projected spending for capital projects spanning fiscal years 2014-2018 is estimated at $718 million and includes a significant shift in funding priorities from regulatory compliance projects to renewal and replacement (R&R) of system assets. Estimated spending for asset protection is now over 50% of the capital program compared to 31% in the fiscal 2009-2013 capital cycle. Conversely, costs related to the ongoing court-mandated combined sewer overflow (CSO) control plan will drop to just 7% of capital spending versus 38% over the prior five years.

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 100%, and annual debt service costs consume over one-half of gross annual revenues. Fitch expects this trend to continue for the intermediate term. Favorably though, more debt is expected to roll off through fiscal 2018 than will be issued. This positive variance of amortization to debt issuance is expected to continue beyond fiscal 2018, which should help to improve the authority's debt profile over time.

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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 2013;
--'U.S. Water and Sewer Revenue Bond Rating Criteria', July 2013;
--'2014 Water and Sewer Medians', dated Dec. 2013;
--'2014 Outlook: Water and Sewer Sector', dated Dec. 2013.

Applicable Criteria and Related Research:
2014 Outlook: Water and Sewer Sector
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724357
2014 Water and Sewer Medians
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724358
U.S. Water and Sewer Revenue Bond Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715275
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=709499