FitchRatings

# FITCH RATES MASSACHUSETTS WATER RESOURCES AUTHORITY REVS 'AA+'; OUTLOOK STABLE

Fitch Ratings-Austin-19 April 2017: Fitch Ratings has assigned a 'AA+' rating to the following Massachusetts Water Resources Authority, Massachusetts (MWRA) bonds:

--Approximately $69 million general revenue bonds, 2017 series B;
--Approximately $282 million general revenue refunding bonds, 2017 series C (Green Bonds).

The bonds are scheduled to sell via negotiation as early as the week of May 3. Proceeds will be used to fund a portion of the authority's capital program, refund a portion of the authority's outstanding bonds for interest savings without extension of maturity, and pay costs of issuance.

In addition, Fitch has affirmed the following MWRA ratings:

--$3.2 billion (pre-refunding) general revenue bonds at 'AA+';
--$895 million subordinate general revenue bonds at 'AA'.

The Rating Outlook is Stable.

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.

KEY RATING DRIVERS

REGIONAL PROVIDER OF ESSENTIAL SERVICE: MWRA provides essential wholesale water and wastewater services to a large and diverse service area that encompasses 61 communities located primarily in eastern Massachusetts, including the city of Boston. The service area benefits from strong economic underpinnings.

STRONG PAYMENT PROTECTIONS AND COLLECTIONS: 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. MWRA has achieved strong collection rates of 100% since its inception.

ABILITY TO SET RATES INDEPENDENTLY: The authority maintains independent rate-setting ability, 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 ultimately stabilize over time.

CHANGE IN CAPITAL FOCUS: The authority's capital improvement program (CIP) has transitioned from costly court-mandated projects to ongoing rehabilitation and water system redundancy.

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 DEBT: Rising capital costs that lead to escalating debt levels and in particular, lower debt service coverage, could result in downward rating pressure on the authority's bonds.

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 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 (Issuer Default Rating 'AAA'/Stable Outlook), 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 Outlook. The service area generally is economically diverse, and wealth levels tend to be 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 BWSC), provide significant operating flexibility and are important credit considerations.

HIGH RATES LIMIT FLEXIBILITY

MWRA's high rates are an ongoing credit concern as flexibility continues to diminish. Average combined charges within MWRA, based on the authority's advisory board's most recent rate survey for fiscal 2016, were just over $1,500 per year (based on 120 hundred cubic feet of water usage). This total is 2% of median household income (MHI), which is Fitch's affordability threshold. 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 five years through fiscal 2016 the authority raised rates on average a moderate 3.4% annually, and just 3.34% in fiscal 2017.

MWRA's long-term rate forecast also continues to trend below prior estimates. Rates originally projected to climb by as much as 5.2% annually by 2021 are now estimated to increase by 3.8% through fiscal 2022. Actual rate 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 2023 debt service carrying costs begin to drop off, which should allow the authority to limit future rate increases.

STABLE FINANCIAL PERFORMANCE

The authority's financial operations have remained very stable despite escalating debt service. Historical DSC on senior lien obligations has averaged a strong 1.9x over the three years through audited fiscal 2016 (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 same period. Liquidity, while still solid, dipped slightly to 243 days cash on hand in fiscal 2016, less than the 300 days it has averaged since 2011.

Management forecasts point to continued stable operations based on the authority's conservative budgeting practices. DSC is expected to remain near historical norms and generate surpluses that the authority will use to defease more debt. 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

The projected base-line spending cap for capital projects spanning fiscal years 2014-2018 is now estimated at $661 million (down from $711 million in fiscal 2016) and includes a significant shift in funding priorities from regulatory compliance projects to renewal and replacement (R&R) of system assets and water redundancy. Estimated spending for asset protection and water redundancy is now almost 80% of the CIP, compared to 46% in the fiscal 2009-2013 capital cycle. Conversely, costs related to the ongoing court-mandated combined sewer overflow (CSO) control plan will drop to around 10% of capital spending versus 38% over the last five years.

The authority's CIP remains sizeable 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 CSO master plan in recent years. In December 2015 courts declared MWRA's long-term CSO Control Plan to be substantially complete.

Expected capital spending beyond fiscal 2018 totals $3 billion, with about $1.4 billion dedicated to new tunnels to provide water redundancy. While the fiscal 2019-2023 CIP has yet to be formally adopted by the board, anticipated annual capital costs total $246 million. This represents a material increase in annual capital costs compared to the 2014-2018 CIP, which averaged $150 million annually. 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 debt levels have been and will remain high for the foreseeable future due to past 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, 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 for at least several years beyond fiscal 2018. Even with the planned capital spending, this trend should help to improve the authority's debt profile over time and position the authority to handle the additional debt associated with the R&R and redundancy projects.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumenis.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/site/re/750012
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 30 Nov 2016)
https://www.fitchratings.com/site/re/890402