S&P Global
Ratings

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Summary:

New York City Municipal Water Finance Authority, New York; Water/Sewer

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*(**Editor's Note:** On Feb. 25, 2022, we assigned the incorrect rating to the series 2022EE water and sewer system second general resolution revenue bonds. We have withdrawn the incorrect rating and assigned the correct rating of 'AA+' to the bonds.)*

Credit Profile		
US$772.0 mil wtr and swr sys second gen res rev bnds ser 2022EE due 06/15/2045		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to New York City Municipal Water Finance Authority's (New York Water) anticipated $772 million series 2022EE water and sewer system second general resolution revenue bonds.

The outlook is stable.

The 'AA+' long-term rating reflects our view of the general creditworthiness of New York Water. We rate the first general resolution (senior) issues 'AAA'. We maintain a one-notch difference between the first and second general resolution bonds based primarily on the active utilization of both, even if most of the outstanding debt is second in priority. New York Water has approximately $790 million in first general resolution bonds and $30.9 billion in second general resolution bonds outstanding. New York Water plans to use the series 2022EE bond proceeds to refund certain outstanding second resolution bonds.

The second resolution bonds do not benefit from a debt service reserve fund. However, by practice, New York Water has utilized carry forward cash balances to fund debt service well in advance of payment dates, which functions as a de facto set-aside. All bondholders benefit from a gross revenue pledge and a statutory, perfected lien. Current law does not authorize New York Water or the board to declare bankruptcy. While S&P Global Ratings does not rate to recovery, the presence of a statutorily perfected lien and limitations around bankruptcy are viewed as positive structural provisions. Security provisions offset all-in net revenue coverage that is lower than its similarly rated peers.

Although the rating on New York Water's first general resolution bonds is currently above that of the U.S., New York Water has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all the entity's revenues. This, coupled with operating expense flexibility, precludes exposure to federal revenues and allows us to rate the system above that of the U.S.

Credit overview

Key credit factors, in addition to the structural provisions described above, include our view of the following:

- A broad and diverse economic and customer base that has no comparably sized peers. The pandemic has significantly affected the city--with unemployment that has declined but is still elevated and twice the national level;

- Affordable rates, with no rate increase in 2021 and a minimal rate adjustment adopted for 2022. Rate increases are expected to be manageable and below 6% per year through 2026 but that is based on a forecast that is somewhat dated. Rate setting is flexible, with the ability to increase rates within 30 days, which we view favorably;
- Delinquencies that continue to be above average, reflecting the stubborn nature of the recovery as well as the decision not to sell liens in fiscal years 2020 through 2022, which reduces remedies available to compel payment;
- Adequate financial capacity with continued softness related to the pandemic as well as the impact of foregone lien sales due to prioritization of the billing system implementation, which suggests liens will not resume until 2023, at the earliest, which could influence collections, based on past experience;
- Seasoned and effective management team and board that we believe have a strong sense of fiduciary duty as well as operational and financial acumen. Our confidence in management supports our credit view despite the substantial complexities New York Water faces during the outlook period, including a sizable capital plan, implementation of a new billing system, unsettled labor negotiations, uncertainties related to selling liens and navigating increasing climate change pressures, all in a currently challenging economic environment;
- Significant capital plan, with an increase of approximately $413 million for fiscal years 2022 through 2031. This is driven by funding increases to upgrade wastewater treatment, vehicle investment, and maintenance of a watershed; and
- Extremely strong liquidity position, both nominally and on a days' cash basis, which is critical to financial flexibility and the credit strength. The ability to maintain significant cash balances directly influences debt service coverage given the carry forward of balances on an annual basis, which reduces debt service and improves coverage. This practice also allows for a more level rate structure, although if the use of rolling cash balances results in a postponement of rate increases, we would view that as indicative of potential structural issues, which could pressure credit quality.

The stable outlook on the long-term ratings reflects our belief that New York Water will retain the financial capacity to weather the effects of the COVID-19 pandemic as well as other system challenges.

Environmental, social, and governance

New York Water is faced with numerous ongoing environmental, social, and governance (ESG) factors that affect our analysis. We believe the system has outsized environmental risks, given the regulatory and climate resilience efforts that will be required to maintain its infrastructure at adequate levels. We believe governance efforts are sophisticated, which supports addressing long-term risks associated with asset adequacy.

Extreme weather events, such as Hurricane Ida and 2012's Superstorm Sandy, are becoming more common and ongoing sea level rise will present system challenges. Emergency preparedness has improved. Climate resilience has taken on more urgency and is expected to require significant additional funding. New York Water has several planning initiatives, including resiliency planning, climate change modeling, and annual reporting to measure progress.

Most recently, the city released a report on "The New Normal", which addresses risk mitigation related to extreme storms. This report outlines efforts to reduce emissions, harden infrastructure to protect shoreline communities most vulnerable to storms, and initiatives to create a continuous line of protection against rising sea levels and storms. Specific to the utility, the report addresses the substantial need to rehabilitate and replace sewer pipes that were designed a century ago and are expected to be inadequate for current climate considerations. This is expected to require a $100-billion investment, with federal funding expected. The report highlights long- and short-term upgrades needed as well as innovative drainage solutions.

We believe management's approach to climate resiliency and sustainability is sound and there is strong collaboration with the city. Given the age of the system and the climate risks of the region, the capital plan addresses infrastructure projects that result in a more resilient system and was increased to incorporate some of the projects associated with the recent report.

An independent consulting engineer's opinion, updated annually, indicates that the system's condition is generally adequate, its most favorable characterization. An updated report will be available April 2022. Although replacing underground infrastructure will remain a focus--including reducing high water losses and addressing regulatory requirements related to the combined sewer system--the water supply's quality and quantity are extremely favorable. The management and governance structure--with separate entities for operations, governance, and finance--has also allowed for critical and apolitical decision-making with an eye toward both financial integrity and maintaining operations at a high level.

Median household effective buying income varies widely from borough to borough. Given the variance, the city's Department of Environmental Protection has a bill pay assistance program for low-income, senior, and disabled customers that we view as at least as robust as those of comparable peer cities in achieving social goals.

For more information, please see the analysis published Jan. 25, 2022, on RatingsDirect.

Stable Outlook

Downside scenario

While we believe that New York Water's budgeting practices are generally conservative and credit-supportive at the current rating, misalignment between revenues and revenue requirements that leads to financial performance that is consistently weaker than historical trends could pressure the rating. This includes any potential revenue declines associated with the pandemic or the lack of water lien sales and the potential change that could have on user behavior, which could be difficult to correct. We believe management has the capacity and willingness to adjust rates to offset such changes, as evidenced by the board having a very long history of adjusting rates, usually annually, as needed. However, we will monitor the system for additional rate increases or any indication of reduced flexibility in rate setting.

Upside scenario

Consistent with the application of our "Assigning Issue Credit Ratings Of Operating Entities", criteria (published May 20, 2015, on RatingsDirect), we do not consider there to be upward rating potential on the second general resolution debt, unless the senior lien is closed and the amount of senior-lien obligations remains minimal relative to total debt outstanding.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020