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Ratings

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Summary:

New York City Municipal Water Finance Authority; Water/Sewer

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Table Of Contents

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Credit Profile		
US$1500.0 mil wtr and swr sys 2nd general resolution rev bnds ser 2023 DD due 06/30/2047		
Long Term Rating	AA+/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA+' rating to New York City Municipal Water Finance Authority's anticipated $1.2 billion 2023 series DD water and sewer system second general resolution revenue bonds, issued on behalf of New York Water.
- The outlook, where applicable, is stable.

Security

The long-term ratings reflect our view of the general creditworthiness of first general resolution bonds for New York Water. We maintain a one-notch difference between the first ('AAA') and second ('AA+') 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 plans to use the second-lien series DD bond proceeds to refund certain outstanding bonds.

The second resolution bonds do not benefit from a debt service reserve fund. However, by practice, New York Water has used 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 that of 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 the U.S.

Credit overview

The 'AA+' long-term rating reflects our view of New York Water's broad, diverse, and affluent service area as well as the sophisticated management team that supports its highly complex operating profile and capital plan. While all-in coverage is weaker than that of its peers at the current rating level, the security structure provides significant bond holder security and robust system liquidity, which provides operating flexibility and mitigates the potential financial pressure from event risk. New York Water faces several challenges related to the macroeconomic and policy landscape as well as to the age, size, and complexity of the system's underlying infrastructure. Recessionary headwinds are expected to bring affordability considerations to the forefront. With continued uncertainty related to the ability to sell liens, higher relative rates may be required to offset lower collections. The authority's ability to balance rate affordability and financial health will be an important credit consideration going forward. Water and sewer payments for the first seven months of fiscal year 2023 were 4% higher than budget (as of June 2022). However, accounts receivable remain elevated, with unpaid bills increasing by more than 7% year-over-year to more than $1 billion. The Department of Environmental Protection is offering an amnesty program for a late-charge portion of the accounts receivable amount. If rate-setting flexibility or enforcement becomes more challenged, it could pressure credit quality.

Furthermore, labor and supply chain obstacles are expected to remain material for both New York Water and the sector. Labor challenges may pose outsized credit risk for New York Water, given the magnitude of its unfilled vacancies. Prolonged unfilled vacancies can lead to overtime costs and potential compliance risk. In addition, New York Water's vacancies have led to capital plan execution difficulties, which may increase deferred maintenance risks, though major milestones have been met. We consider an entity's ability to hire and retain essential staff an important aspect in our operational effectiveness assessment. Management indicates that it is executing strategies to mitigate the influence of vacancies and the reduced allowable headcount. Further, labor contracts with DC 37 were recently tentatively settled. According to management, the projected operating and maintenance expenses assume an increase in each year for labor costs, inclusive of collective bargaining settlements, overtime, and other factors influencing compensation changes. The proposed settlement includes a one-time payment to employees, a retroactive increase in salaries and wages, and increases in each year through 2026. The proposed annual increases include four 3% wage increases and a 3.25% increase in the final year, retroactive to the first day of the contract. We view settlement favorably as it reduces uncertainty and does not exceed budgeted allowances.

The fiscal 2023 capital budget is $2.27 billion, a slight increase from the fiscal 2022 level. Legally mandated projects account for approximately a third of New York Water's capital and expense budget, well below past levels, a factor we view favorably as it provides greater capital execution flexibility. About 98% of the New York City Department of Environmental Protection strategic initiatives are on schedule, including several climate-related projects and critical maintenance. We consider its strong asset management an important credit consideration. Management continues to refine and improve its asset management program, including well-defined policies that provide a uniform methodology for a comprehensive evaluation of capital assets and a systematic approach to scheduling preventive maintenance and upgrades. This is a critical driver in our asset adequacy assessment, given the advanced age of New York Water's infrastructure and the potential risks for catastrophic failures. We consider management's asset planning extremely robust.

Environmental, social, and governance

Our rating on these issues is linked to the support provider. Environmental, social, and governance (ESG) factors that influence the rating on these supporting entities could also influence the rating on these securities. Our assessment of the creditworthiness of support providers incorporates any material ESG credit factors regardless of any self-designation, such as green or social, the issuer might apply. In our view, exposure to ESG factors in these transactions is limited to the factors related to support providers. (For further information on the ESG considerations relevant for bank ratings and underlying securities, refer to the U.S. and Canadian, EMEA, Asia-Pacific, and Latin

American bank ESG industry report cards and "Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors," published March 2, 2022, on RatingsDirect.)

Outlook

The stable outlook reflects our belief that New York Water will retain the financial capacity to weather the effects of a potential recession, inflation, and other system challenges.

Downside scenario

While we believe that New York Water's budgeting practices are generally conservative and credit-supportive at the current rating, a misalignment between revenue and revenue requirements leading to financial performance that is consistently weaker than historical trends could pressure the rating. This includes any potential revenue declines associated with reduced remedies available and the potential change that could have on user behavior, which could be difficult to correct. Further, we expect inflation, supply chain challenges, and labor difficulties to pressure expenditures, stressing financial performance. We believe management has the capacity and willingness to adjust rates to offset these issues, 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 rate-setting flexibility.

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.