FitchRatings

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Fitch Rates New York City Muni Water Finance Authority's Revs 'AA+'; Outlook Stable

Fitch Ratings - New York - 18 Sep 2024: Fitch Ratings has assigned a 'AA+' rating to the following New York City Municipal Water Finance Authority (NYW or the authority) water and sewer system second general resolution (SGR) revenue bonds fiscal 2025 series AA consisting of the following:

--Approximately $600.0 million fiscal 2025 subseries AA-1;

--Approximately $300.0 million fiscal 2025 subseries AA-2.

The fiscal 2025 series AA bonds are scheduled to sell the week of Sept. 23 through negotiation. Proceeds of the bonds will be used to pay costs of system improvements, refund and/or purchase through tender certain outstanding bonds, and pay costs of issuance.

Fitch has also affirmed the following ratings:

--Approximately $405.7 million first general resolution (FGR) revenue bonds and various related bank bonds at 'AA+' (pre-refunding);

--Approximately $26.3 billion SGR revenue bonds and various related bank bonds at 'AA+' (pre-refunding);

--$400 million authorized extendable municipal CP (EMCP) notes, series seven and eight at 'F1+'.

The Rating Outlook is Stable.

The 'AA+' rating on the FGR and SGR bonds reflects the combined credit quality of the authority and the New York City Water Board (the water board), as well as the authority's role as the issuer of revenue bonds on behalf and in support of the expansive New York City (the city) water and sewer system (the system). The financial profile is very strong and assessed at 'aa' in the context of historically very low leverage, measured as net adjusted debt to adjusted funds available for debt service (FADS) on a gross revenue basis.

Bondholders are afforded strong protections through a statutory framework providing a gross lien on pledged water and sewer revenues, along with Fitch's expectation of the remoteness of either the authority or water board filing for bankruptcy protection or being included in a city bankruptcy proceeding if one were to ever occur. The credit profile is further supported by the very strong revenue defensibility and operating risk profile, both assessed at 'aa'.

Leverage was in the mid-7.0x range through fiscal 2020 (FYE June 30). The adverse impact of the pandemic on the service area and resulting weaker collections drove leverage to 8.3x in fiscal 2021. In addition, the system's previously projected rate increase was not adopted that year in light of widespread economic strain, further reducing revenue-generating capacity.

In fiscal 2022, leverage improved to 8.0x, reflecting an increase in revenues driven by the 2.76% rate increase combined with a higher rate of consumption, slowing rate of delinquencies and the suspension of the rental payment to the city (discussed in more detail below). Fiscal 2023 results showed continued improvement, with leverage declining to 7.3x, driven by better than projected revenue, including the impact of an amnesty program in place for fiscal 2023.

The authority's projections reflect consolidated operations of the authority, board and system operations performed by the city's Department of Environmental Protection (DEP). These projections reflect estimated fiscal 2024 results, for which rates were adjusted 4.42%. Financial projections for fiscal years 2025 through 2028 reflect the enacted 8.5% rated increase for fiscal 2025, and anticipated rate increases of 8.5% in each of fiscal years 2026 through 2028.

These revenue increases mitigate the impact of the resumption of the rental payment in fiscal 2024 (approximately 50% of the amount the city could have requested) and fiscal years 2025 through fiscal 2028, which assume the maximum rental payment amount.

Based on these assumptions, leverage is anticipated to rise from fiscal 2023 levels but trend downward thereafter, falling to 7.6x in Fitch's Analytical Stress Test (FAST) rating case by fiscal 2028. Fitch anticipates a continued trend of declining leverage; failure to maintain this trend would likely have negative rating implications.

Fitch does not differentiate between the FGR and SGR liens as they are both afforded strong support from gross revenue pledge and benefit from the subordination of O&M payments. Since 2020, the authority has historically prefunded in excess of $1.0 billion of debt service, further reducing risk to subordinate lien bondholders.

SECURITY

The SGR bonds are special obligations of NYW issued under the SGR and payable solely from and secured by a subordinate lien on gross revenues of NYW. Outstanding FGR bonds are payable solely from and secured by a first lien on gross revenues of NYW.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Strong Rate Flexibility, Favorable Service Area with Unique Economic Profile

The water board retains the legal authority to adjust rates as needed without external oversight. Revenue defensibility is further supported by the system's monopolistic provision of water and sewer services to its favorable service area. The service area is characterized by a stable customer base, median household income that approximates that of the nation and a weaker, but improving, unemployment rate relative to that of the nation.

Fitch also considers the city's unique economic profile as an international center for numerous industries and an anchor for the service area. Rates are considered affordable for approximately 80% of the service area population, using Fitch's standard monthly usage of 7,500 gallons for water and 6,000 gallons for sewer. Anticipated rate increases are not expected to materially impact affordability.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Significant Capital Investment

In fiscal 2023, the system's operating cost burden was considered very low at $3,497 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was a low 37% in fiscal 2023. Capex outpaced annual depreciation, with a five-year average of 182% for the five years ended fiscal 2023.

The system's capital improvement plan (CIP) for fiscal years 2024 through 2028 approximates $16.0 billion of system funds, while associated estimated actual spending is expected to be around $12.0 billion for the same period. Approximately 36% of the CIP for this period is related to water pollution control projects, including plant upgrades and reconstruction. Water distribution approximates 21% of the CIP, water supply and transmission approximate 21% and sewer programs approximate 18%. Estimated capital spending averages $2.4 billion annually during these five years, well in excess of historical depreciation, supporting a continued low life cycle ratio.

Financial Profile - 'aa'

Elevated Leverage Anticipated to Decline; Neutral Liquidity

The authority's leverage (on a gross lien basis) was 7.3x in fiscal 2023, declining from the peak of 8.3x in fiscal 2021. Fiscal 2023 results reflect increased liquidity available for debt service, collections that benefitted from the rate increase and an amnesty program that realized about $105 million. The liquidity profile is neutral to the assessment and reflects coverage of full obligations (COFO) of 1.6x and current cash on hand of 391 days, when incorporating carry forward revenues. (Carryforward revenues include available funds that are restricted at the fiscal year end.)

The FAST considers the potential trend of key ratios in a base case and stress case over a five-year period. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

In the base case, leverage is an estimated 8.1x in fiscal 2024, after which leverage trends downward through the five-year horizon, falling to 7.5x in fiscal 2028. In the stress case, which is also the rating case, leverage reaches 8.2x in fiscal 2024 and gradually declines to 7.6x by fiscal 2028. In consideration of the significant construction funds that would likely be available in each year, given the cyclical nature of issuing and spending the system demonstrates, leverage remains below 8.0x in the rating case after fiscal 2024.

Supported by robust rate adjustments, leverage expectations through the five-year period are improved from Fitch's prior review. However, a sustained pause in the declining leverage trend or a reversal of this trend is likely to pressure the rating. Fitch expects the liquidity profile to remain neutral to the assessment.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Interruption or reversal of the declining leverage trend through Fitch's rating case;

- Leverage sustained above 8.0x in Fitch's rating case;

- Sustained weakness in FADS stemming from a delay in rate-setting or an increase in expenses that weakens the liquidity position.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Leverage sustained below 5.0x in Fitch's rating case within the context of current revenue defensibility and operating risk assessments.

PROFILE

The authority was created as a public benefit corporation in 1984 to issue bonds, notes and other financing instruments to fund capital improvements to the city's system. Fitch considers the authority an issuer that benefits from a contractual framework in which revenues and costs are largely balanced. The water board leases the system from the city and is responsible for setting, levying and collecting customer rates and system revenues to transfer to the authority for bond repayment and to the city for O&M reimbursement.

In addition to reimbursement for O&M, the city is entitled to an annual rental payment which may not exceed 15% of annual debt service. In fiscal 2024, the city requested and received a payment of $145 million, approximately half the maximum amount. Projections for fiscal years 2025 through 2028 include the maximum rental payment allowed, ranging from $295.0 million in fiscal 2025 to $368.6 million in fiscal 2028.

The authority has the power to require the water board to charge and collect sufficient rates to pay the costs of operating and financing the system, as well as to enforce that the city adequately operates and maintains the system. The authority may not file for bankruptcy without state legislative approval, and Fitch views the authority as bankruptcy-remote from the city. Fitch also views the water board as bankruptcy-remote from the city.

The system is the country's largest municipally owned water and sewer utility. It is operated by the DEP and provides retail water and sewer service to approximately 838,500 accounts and about 8.3 million residents within the city. It also provides wholesale service to approximately one million residents in communities north of the city. The service area includes over 300 square miles across the city's five boroughs (the Bronx, Brooklyn, Manhattan, Queens and Staten Island), as well as communities in Westchester, Putnam, Orange and Ulster counties.

The DEP performs day-to-day system O&M and is responsible for executing the system's multibillion-dollar capital program. Capital and maintenance needs are expected to remain significant over the long term, given the demand placed on system assets in an expansive urban setting.

The water system provides an average of approximately 1 billion gallons per day (bgd) from three upstate aqueducts that span as far as 125 miles north of the city. Demand has steadily declined over time due to water efficiency measures and has been a stable 75% of dependable yield from three city-owned upstate reservoir systems. The sewer system collects and treats an average of approximately 1.2 bgd of wastewater at 14 in-city wastewater treatment plants for virtually the entire city. Average annual flows approximate 70% of the 1.8 bgd design capacity.

Response to Updated U.S. Environmental Protection Agency (EPA) Regulations

The EPA's enhanced focus on lead and copper lines and per- and polyfluoroalkyl substance (PFAS) contaminants has led to the introduction of the Lead and Copper Rule Revisions (LCRR) and the proposed Lead and Copper Rule Improvements, along with specific testing requirements for PFAS chemicals.

DEP reports that it is in compliance with the currently applicable requirements of the Lead and Copper Rule. The LCCR contained new requirements for water systems, some of which DEP was already implementing, and some of which require new programs that have a compliance deadline of October 2024. DEP continues to analyze the impact of the LCRR on its operations, as well as the costs of any new programs required thereunder.

DEP monitors for PFAS compounds as required by the Fifth Unregulated Contaminant Monitoring Rule (UCMR5). Monitoring for UCMR5 commenced in the fourth quarter of calendar 2023. DEP is planning to conduct a PFAS assessment in the Kensico Reservoir watershed. In addition, sampling and monitoring of PFAS in wastewater influent, effluent and biosolids maybe required in the near future, and DEP is tracking and preparing for this potential future regulatory requirement.

Structural and Legal Protections

Fitch believes NYW bondholders benefit from strong legal protections that include the statutorily defined nature of the authority, bankruptcy remoteness and the gross pledge of system revenues. While these layers of legal protection do not completely shield bondholders from the operational risks of the city's massive water and sewer enterprise, they limit diversion of revenue to general city operations.

A large portion of annual debt service obligations is consistently funded well in advance of scheduled payment dates by the restricted revenue fund, which consists of both current year revenues and carryforward surplus cash. The authority carried forward about $1.7 billion into fiscal 2024, sufficient to prepay over 90% of fiscal 2024 total debt service of about $1.9 billion.

After monthly required deposits under the SGR are satisfied and held by NYW's trustee, funds will be released for other purposes, including the cash defeasance of additional debt, reimbursement to the city for O&M expenses and the rental payment (if any).

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by data from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
New York City Municipal Water Finance Authority (NY) [Water, Sewer]			

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues (2nd Lien)/2 LT	LT	AA+	Affirmed		AA+
• New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues/1 LT	LT	AA+	Affirmed		AA+
• New York City Municipal Water Finance Authority (NY) /Water & Sewer Revenues/1 ST	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub.29 Feb 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

New York City Municipal Water Finance Authority (NY)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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