Fitch Rates New York City Muni Water Finance Authority's $425MM Revs 'AA+'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-New York-05 September 2014: Fitch Ratings has assigned an 'AA+' rating to the following water and sewer system second general resolution (SGR) revenue bonds for the New York City Municipal Water Finance Authority (NYW, or the authority):

--Approximately $200 million water and sewer system SGR revenue bonds, fiscal 2015 series CC;
--Approximately $225 million water and sewer system SGR revenue bonds, fiscal 2015 series DD.

The fiscal 2015 series CC bonds are scheduled for competitive sale on Sept. 10, while the fiscal 2015 series DD bonds are scheduled for negotiated sale on September 16. Proceeds of the series CC bonds will be used to retire a portion of outstanding commercial paper notes, fund costs related to NYW's ongoing capital program and pay costs of issuance. Proceeds of the series DD bonds will refund a portion of NYW's outstanding first general resolution FGR) bonds for cost savings and pay the costs of issuance.

In addition, Fitch has affirmed NYW's outstanding bonds as follows:

--$6.6 billion FGR revenue bonds at 'AA+';
--$18.3 billion SGR revenue bonds at 'AA+';
--$200 million extendable municipal commercial paper notes, series seven at 'F1+';
--$200 million extendable municipal commercial paper notes, series eight at 'F1+'.

The Rating Outlook is Stable.

SECURITY

The SGR bonds are special obligations of NYW, payable solely from and secured by a subordinate lien on gross revenues of NYW's combined system. FGR bonds are secured by a first lien on gross revenues of NYW. The bonds currently being issued will not have a debt service reserve fund (DSRF).

Note interest is secured by moneys and investments in the FGR subordinated indebtedness fund, on parity with outstanding SGR bonds. Principal of the commercial paper notes is secured solely by the proceeds of bonds issued to repay the commercial paper notes. The original maturity on the extendable notes is 1-90 days. However, NYW has the option to extend the maturity of any note by an additional 180 days, and redeem notes at any time during the extension period.

KEY RATING DRIVERS

SOUND LEGAL PROTECTIONS: NYW's primary credit strength is its legal structure, including its status as a bankruptcy-remote issuer, providing substantial protection to bondholders from potential operating risks associated with the combined utility system (the system) and New York City (the city).

REGIONAL PROVIDER OF AN ESSENTIAL SERVICE: The system provides an essential service to an exceptionally large, diverse and economically important service area. The system benefits from an abundant, high-quality water supply exempt from expensive filtration requirements and transmission costs.

INDEPENDENT RATE-SETTING AUTHORITY: Strong financial management and a proven ability and willingness to independently raise rates are reflected in consistently solid financial results, despite the continued volatility in consumption.

WELL-MANAGED CAPITAL PROGRAM: Sophisticated capital planning efforts have helped achieve compliance with large and costly mandated regulatory projects and ensured the system's total assets are adequately maintained.

HIGHLY LEVERAGED SYSTEM: Debt levels are high as a result of having to comply historically with environmental mandates and maintain a large urban system and its aging assets. Declining but still sizeable debt issuances programmed into the current capital plan will keep debt levels elevated for the long term.
IMPROVED COLLECTIONS: Below-average current collection rates persist, although payment incentives and strong enforcement mechanisms have yielded positive results in recent years.

RATING SENSITIVITIES

MAINTENANCE OF SUFFICIENT RATES: Failure to achieve rate hikes sufficient to ensure comparable financial margins and maintain current debt service coverage (DSC) levels on senior and subordinate lien obligations would be viewed negatively.

RISING DEBT LEVELS: The continued escalation in the system's debt levels remains an increasing concern that could ultimately pressure the rating. Increases in leverage beyond what is currently forecast would likely place added pressure on the authority's current rating.

CREDIT PROFILE

SOUND LEGAL PROTECTIONS

Fitch believes NYW bondholders benefit from strong legal protections that include:
--Revenues collected in a lock box structure controlled by the trustee and used to pay debt service of FGR and SGR bonds before operations and maintenance (O&M) expenses;
--The bankruptcy-remote, statutorily defined nature of the authority;
--Ownership of system revenues by the bankruptcy-remote New York Water Board, which sets rates independently without city council approval.

These layers of legal protection serve to significantly shield FGR and SGR bondholders from the operational risks of the city's massive water and sewer enterprise as well as other city government operations. Consequently, Fitch does not make a rating distinction. SGR bondholders' claim on gross revenues is subordinate only to FGR debt service deposits, NYW administrative costs, and FGR DSRF requirements.

Following such deposits, revenues flow from the subordinated indebtedness fund of the FGR revenue fund directly to the SGR revenue fund to pay SGR debt service deposits. Only after monthly required deposits under the SGR are satisfied and held by NYW's trustee are funds released from the lock box to pay O&M expenses.

STRONG FINANCIAL AND DEBT MANAGEMENT

NYW's strong financial management and conservative budgeting continue to yield sound financial metrics, despite ongoing volatility in consumption over the last several years and sizable growth in debt service obligations. FGR and SGR DSC from net operating revenues improved for the third consecutive year in fiscal 2013, increasing to 6.7x and 2.4x, respectively. Reflecting the gross lien on system revenues, DSC grew to 10.3x and 3.6x, respectively. The authority's favorable operating results were driven in part by the adoption of a 7% rate increase and a return to positive growth in consumption compared to a 1.5% decline in demand incorporated in the 2013 adopted budget.

Liquidity has also steadily grown in recent years to a more acceptable level. Unrestricted cash and investments together with O&M reserves increased to nearly 250 days of cash on hand in fiscal 2013, more than three times the amount on hand at the close of fiscal 2010. NYW's prudent practice of carrying forward and applying any operating surplus generated in the prior year to the payment of debt service in the coming fiscal year prevents the build-up of more robust cash balances but preserves rate flexibility. Fitch continues to view this strategy favorably. The net surplus generated in fiscal 2013 (measured on a cash basis) totaled $750 million, up from the $498 million generated in fiscal 2012. Positively, the authority estimates that funds already held by the bond trustee as a result of surplus operations generated in fiscal year 2014 equaled about one-half of NYW's total fiscal 2015 debt service obligations.

Projected year-end results for fiscal 2014 are positive, with net revenues providing senior lien and all-in projected debt service coverage of 6.7x and 2.6x, respectively. Consumption, while down by nearly 1% for the year, was in line with budgeted expectations.

The authority adopted modest rates increases of 5.6% and 3.4% in fiscals 2014 and 2015, respectively, following several years of more sizeable increases, including double-digit rate hikes enacted in fiscals 2008 - 2011. Despite the escalation in rates, the average monthly residential bill remains relatively affordable in comparison to median household income levels for the service area.

PROJECTED FINANCIAL RESULTS REMAIN SATISFACTORY

Financial projections through fiscal 2018 are based on what Fitch believes to be reasonable assumptions. The forecast assumes the continuation of moderately sized rate hikes and incorporates sizeable annual debt offerings, a 1.5% decline in consumption in fiscal 2015, a 2% drop in fiscals 2016 and 2017 and an additional 1% decline in fiscal 2018. As a result, all-in DSC from net revenues is projected to remain at a strong level of no less than 2.3x through the current planning period and annual surpluses are forecast to remain well in excess of $800 million and will be applied to subsequent year's annual debt service obligations.

LEVERAGED SYSTEM

Similar to many large urban utility systems, NYW's capital needs are significant, principally the result of state and federally mandated projects. The capital program for fiscal years 2014 -2023 includes an estimated $13.4 billion in water and sewer projects, almost $1 billion less than the fiscal 2012-2021 capital program and down significantly from a peak of $19.5 billion projected for fiscal years 2008 - 2018.

Funding for capital projects will continue to come almost entirely from long-term debt issuance and an extensive commercial paper program. NYW's current forecast shows additional bond issues through fiscal 2019 totaling $6.6 billion, or an annual average of approximately $1.3 billion. Projected debt issuance, while sizable, is a marked decline from the amount of debt incurred over the previous five years.

Debt levels are high and escalation beyond what is currently forecast could pressure NYW's rating over the medium term. Debt to net plant now stands at about 100%, and, measured on a per capita basis, leverage approximates slightly more than $3,000. By comparison, Fitch's 'AA' category median ratios for debt to net plant and debt per capita are 49% and $492, respectively. Fitch believes the demonstrated commitment to raising rates as well as management's conservative budgeting will be key to preserving operating margins and meeting the continued growth in debt service costs included in NYW's financial forecast.

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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 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' (December 2013);
--'2014 Outlook: Water and Sewer Sector' (December 2013).

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
2014 Water and Sewer Medians
2014 Outlook: Water and Sewer Sector

Additional Disclosure
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