

**Rating Action: Moody's upgrades New York Muni Water second resolution bonds to Aa1; outlook stable**

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Global Credit Research - 12 Nov 2015

**Action affects \$25.5 billion of rated second resolution debt; Aa1 ratings on \$4 billion of first resolution bonds and VMIG 1, VMIG 3 and P-1 ratings assigned to VRDBs and commercial paper affirmed**

New York, November 12, 2015 --

Moody's Rating

Issue: Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2016 Series BB, Subseries BB-1; Rating: Aa1; Sale Amount: \$317,000,000; Expected Sale Date: 11-19-2015; Rating Description: Revenue: Government Enterprise

Issue: Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2016 Series BB, Subseries BB-2; Rating: Aa1; Sale Amount: \$23,000,000; Expected Sale Date: 11-19-2015; Rating Description: Revenue: Government Enterprise

Opinion

Moody's Investors Service has upgraded the New York City Municipal Water Finance Authority's second general resolution water and sewer revenue bonds to Aa1 from Aa2, and affirmed the Aa1 ratings assigned to \$4 billion of outstanding first resolution bonds. We have also affirmed the VMIG 1, VMIG 3 and P-1 short-term ratings assigned to the authority's variable rate demand bonds, bank liquidity-supported commercial paper, and extendible municipal commercial paper. Additionally, we have assigned Aa1 ratings to the authority's \$317 million Water and Sewer System Second General Resolution Revenue Bonds, Fiscal 2016 Series BB, Subseries BB-1 and \$23 million Subseries BB-2, scheduled to price the week of November 16.

SUMMARY RATING RATIONALE

Affirmation of the Aa1 first resolution rating and the upgrade to Aa1 of the second resolution bonds reflect a strong legal structure that provides significant bondholder protections including a gross lien on system revenues; independent rate setting and a long history of setting rates as needed; and bankruptcy-remoteness that insulates bondholders from potential fiscal strain of the City of New York (Aa2 stable). The strength of that structure, overall strong management of the system and its capital needs, and completion of the bulk of large mandated capital projects has led to increasingly strong debt service coverage for both liens in recent years. Coverage is expected to narrow during the next five years but remain at levels that support Aa1 ratings. The strong legal structure and fact that 87% of outstanding debt was issued through the second resolution narrows the rating differential between the two. While the first resolution has a senior claim to the system revenues and benefits from a strong flow of funds, the rating is constrained by the open lien and ongoing need for sizeable capital reinvestment in a system of the size and age as New York's.

Affirmation of the short-term rating assigned to the authority's adjustable rate debt with bank liquidity support reflect the authority's long-term ratings, the ratings of its bank counterparties, and our assessment of the terms of the applicable bank facilities. Affirmation of the P-1 ratings on the authority's extendible commercial paper reflects its strong market access and its healthy liquidity position.

OUTLOOK

The outlook for the New York City Municipal Water Finance Authority is stable. A strong legal structure and conservative budgeting are expected to continue to provide healthy debt service coverage during the next five years. While mandated projects are a smaller portion of the capital plan than in recent years, like water and sewer systems throughout the nation, regulatory mandates could also drive future capital costs upwards. New York City's water and sewer system also has significant renewal and replacement needs that will continue to drive capital spending.

## WHAT COULD MAKE THE RATINGS GO UP

- Stronger limitations on leveraging the pledged revenues

## WHAT COULD MAKE THE RATINGS GO DOWN

- Weaker debt service coverage or financial ratios
- Failure to continue to set rates at levels needed to afford the system's capital program, large debt load and the water and sewer system's significant operating costs that result in weakened financial ratios or debt service coverage
- New state or federal regulations that require especially large capital expenditures or that create uncontrollable costs for the authority

## OBLIGOR PROFILE

See section below.

## LEGAL SECURITY

The first resolution bonds are secured by a first lien on gross revenues of the water and sewer system, and the second resolution bonds are secured by a subordinate claim on the gross revenues. Additional security provisions provide strong legal protections beyond those found in most municipal water and sewer revenue bonds. These include insulation from potential New York City fiscal stress, independent rate-setting, and (for first resolution bonds only) covenanted reserves, in addition to traditional revenue bond covenants. Neither the New York City Water Board (which sets rates) nor the authority has the ability to file for bankruptcy. A lease agreement between the board and the city establishes the board's ownership of system revenues, while a financing agreement between the board and the authority pledges those revenues first to bondholders, further protecting them from potential weakness in the city's financial position. Additionally, bond counsel has opined that system revenues could not be combined with New York City should the city file for bankruptcy protection. The lease with the city limits the annual rental payment to the greater of principal and interest on city general obligation debt issued for water and sewer purposes due in the fiscal year of the payment, or 15% of principal and interest due on the authority's bonds in that fiscal year. Importantly, the lease requires the city to operate and maintain the water and sewer system to its consulting engineer's recommendation regardless of whether or not it receives the board's rental payment.

The first resolution rate covenant requires net revenues to equal 115% of first resolution debt service, plus 100% of the sum of second resolution debt service, operating and maintenance expenses, and the city lease payment. First resolution bonds also benefit from a cash-funded debt service reserve equal to maximum annual debt service. First resolution issuance is subject to an additional bonds test that requires net revenues to equal 115% of maximum annual senior debt service for the next succeeding five years and 100% of second resolution debt service and operating and maintenance expenditures.

The second resolution rate covenant requires that net revenues on a cash basis be sum sufficient to cover combined debt service, operations and maintenance expenses and city lease payments. There is no debt service reserve on the second resolution bonds. The second resolution additional bonds test requires revenues to equal 110% of aggregate debt service for both first and second resolution bonds in either of the prior two fiscal years.

The authority pledges the gross system revenues to repayment of its debt obligations; revenues flow to the city (which operates the system through its Department of Environmental Protection) for operations and maintenance expenses only after debt service is funded monthly on a one-fifth of interest, one-eleventh of principal basis. In the event that revenues are insufficient to cover monthly debt service requirements, bondholders have the right to claim all revenues of the system until debt service obligations are met. The strength of this gross revenue pledge and the system's legal protections are key considerations in the ratings.

## USE OF PROCEEDS

Proceeds of the bonds will be used to take out maturing commercial paper and to refund outstanding bonds for savings.

## RATING METHODOLOGY

The principal methodology used in these ratings was US Municipal Utility Revenue Debt published in December 2014. The additional methodology used in the short term ratings was Variable Rate Instruments Supported by Conditional Liquidity Facilities published March 2015. Please see the Credit Policy page on [www.moody's.com](http://www.moody's.com) for a copy of these methodologies.

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