FitchRatings

FITCH RATES NEW YORK CITY MUNI WATER FINANCE AUTHORITY'S $480MM REVS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-21 March 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):

--Approximately $480 million water and sewer system SGR revenue bonds, fiscal 2014 series DD.

The fiscal 2014 series DD bonds are scheduled for negotiated sale the week of March 24. Proceeds will be used to retire outstanding first general resolution (FGR) bonds and pay issuance costs.

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

--$7.3 billion FGR revenue bonds at 'AA+';
--$17.5 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. Note principal is also secured by moneys and investments in the FGR subordinated indebtedness fund, and, ultimately, the authority pledges the sale of first resolution bonds or SGR bonds to the payment of principal on the notes. The original maturity on the 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, 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 cash 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 and preserves rate flexibility. Nevertheless, Fitch continues to view the 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.

Results through the first eight months of the current fiscal year are positive, with year-to-date revenues reportedly up by almost 6% compared to the adopted budget. Consumption, while down by nearly 1% to date, is about in line with budgeted expectations. The authority adopted a modest 5.6% rate increase for fiscal 2014 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, 3% yearly increases in salary and wage adjustments, and a 1.5% decline in consumption in fiscals 2014 and 2015 followed by a 2% drop in fiscals 2016 and 2017. As a result, all-in DSC from net revenues is projected to remain at a satisfactory level of no less than 1.7x through the current planning period.

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 CIP for fiscal years 2014-2023 includes an estimated $13 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 2018 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 the projected escalation included in the current forecast will likely 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 3, 2013);
--'U.S. Water and Sewer Revenue Bond Rating Criteria' (July 31, 2013);
--'2014 Water and Sewer Medians' (Dec. 12, 2013);
--'2014 Outlook: Water and Sewer Sector' (Dec. 12, 2013).

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=709499
U.S. Water and Sewer Revenue Bond Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715275
2014 Water and Sewer Medians
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2014 Outlook: Water and Sewer Sector
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=724357