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Summary:
New York City Municipal Water Finance Authority; Water/Sewer

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Credit Profile		
US$100.0 mil wtr & swr sys rev bnds adj rate fiscal 2012 ser B2 due 06/15/2045		
Long Term Rating	AAA/A-1+/Stable	New
US$100.0 mil wtr & swr sys rev bnds adj rate fiscal 2012 ser B1 due 06/15/2045		
Long Term Rating	AAA/A-1/Stable	New
US$75.0 mil wtr & swr sys rev bnds adj rate fiscal 2012 ser B3 due 06/15/2045		
Long Term Rating	AAA/A-1+/Stable	New
US$50.0 mil wtr & swr sys rev bnds adj rate fiscal 2012 ser B4 due 06/15/2045		
Long Term Rating	AAA/A-1+/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AAA/A-1', 'AAA/A-1+', 'AAA/A-1+', and 'AAA/A-1+' ratings to New York City Municipal Water Finance Authority's (NYCMWFA) general resolution water and sewer system revenue bonds fiscal 2012 series B subseries 1, 2, 3 and 4, respectively. The outlook is stable.

The 'A-1' short-term component of the rating on subseries 1 is based on a standby bond purchase agreement (SBPA) provided by U.S. Bank N.A. The 'A-1+' short-term component of the rating on subseries 2, 3, and 4 is based on SBPAs provided by California Public Employees Retirement System, State Street Bank and Trust Co., and The Northern Trust Co., respectively. The SBPAs provide for the principal of, and a maximum of 35 days' interest on unremarketed tendered bonds. The initial SBPAs, which are scheduled to expire on March 27, 2015, provide coverage only for the bonds during the daily or weekly modes. The SBPA providers' obligation to purchase unremarketed tendered bonds shall be terminated without notice to certificate holders upon the occurrence of various events in the SBPA that include, but are not limited to, the obligor's rating dropping below 'BBB-'. While in the daily and weekly mode, the bonds are subject to optional tender when holders provide appropriate notice. The bonds are also subject to mandatory tenders, mandatory sinking fund redemption and optional redemption as fully detailed in the trust agreement.

The 'AAA' long-term component of the rating reflects our opinion of the following credit strengths of NYCMWFA:

- The bondholder protections provided by the issuer's legal and structural features, including a gross pledge of revenues that results in true separation from the utility's operating function when combined with the New York City Water Board's ability to raise rates (a true-up mechanism) and the segregation of funds;
- The system's fundamental credit strengths, characterized by a large and diverse customer base, very good financial profile, and strong management; and
- The capacity and demonstrated willingness to adjust rates when necessary, especially in the face of a sizable capital improvement plan (CIP) of $13.2 billion in forecasted capital commitments through fiscal year 2021.

The bonds are being used to convert $325 million in outstanding commercial paper (CP) notes to long-term debt. NYCMWFA currently has about $8.8 billion of first general resolution debt and $19 billion of second resolution debt. A first lien pledge on the system's gross revenues secures the first resolution debt. A debt service reserve provides additional liquidity to the first resolution debt. The second resolution bonds are subordinate and do not benefit from a debt service reserve.

Long-term financial planning, both for the operating budget and the capital program, remains a strength of the system, in our opinion. This continues to allow management to fund and complete major projects and mandates while maintaining the system, as well as generally maintaining favorable variance to budget. For example, through February 2012, management is reporting a 1.7% year-over-year increase in operating revenues even with a 2.6% decline in consumption. The planned capital expenditures during fiscals 2012-2021 are distributed between water supply and transmission (18%), water distribution (27%), and water pollution control (35%). Sewer expansion and replacement account for the remaining 15% of the CIP. Officials typically initially fund capital improvements through the $800 million CP program before using long-term debt to retire the notes.

For fiscal 2011, management saw a net surplus of $376.8 million on a cash basis, as consumption moved in line with forecasted expectations. Management has also made aggressive efforts to contain costs and pursue operational and debt savings whenever possible. As such, for fiscal 2011, debt service coverage (DSC) on senior and combined senior and subordinate debt is 5.8x and 2.7x, respectively, which is in line with recent historical performance. The authority projects combined senior and subordinate DSC, on a gross basis, to remain steady at what we consider a still healthy 2.32x by 2016. In our opinion, liquidity remains a strength as well. Between the designated operations and maintenance reserve of one-sixth of projected operating expenses, and surplus system revenues, fiscal 2011 cash on hand of about $578 million equates to nearly five months' of expenses.

The water board has a long history of adjusting rates as necessary, some of which have been relatively large. Rate increases for 2010 and 2011 were 12.9%; management implemented a less-than-projected 7.5% increase for fiscal 2012, and it has planned for 9.3% increases in fiscals 2013 and 2014 and 6% in 2015. Once finalized, the fiscal 2013 rate increase will likely be lower than the original forecast given conservative budgeting assumptions; the rate increase is expected to be approved by May 2012. The CIP remains the key driver behind the continued rate adjustments. However, despite the large size and the mandate-heavy nature of the capital program, key projects all remain within budget and on time. Key projects include installing auto-read meters to over 90% of the system, meeting key milestones toward treatment and overflow-remediation projects, and maintaining good relationships with various environmental regulators.

The events during the summer of 2011 are, in our opinion, merely indicative of the challenges of operating a very large, mature urban system. In July 2011, a fire at a wastewater treatment plant caused some pumping and power failures that eventually led to accidental discharges of untreated wastewater into the Hudson River. While possible consequences, if any, from state and federal regulators are not yet known beyond a state notice of violation, the system is self-insured and absorbed the approximately $46 million cost of repairs and clean up of. Fewer material impacts, however, were felt by Hurricane Irene in August 2011, as key dams retained their structural integrity and spill control abilities despite all-time record reservoir levels. The system otherwise saw much fewer-than-feared operational interruptions, and eligible costs likely will be mostly reimbursed by the Federal Emergency Management Agency.

Regardless, the authority's capital and borrowing needs remain significant. In February 2012, the city released its most recent update to its capital plan; by the first five years through fiscal 2016, planned capital commitments average about $1.6 billion per year, funded mainly with debt (including bonds already sold). Management plans to continue to use its existing CP programs and additional revenue bonds to fund the bulk of identified projects, although annual borrowings are projected to decline each year across the forecast.

The ratings also reflect our view of the pledged revenue stream and management's ability to adjust rates in a timely manner and without state regulation to provide adequate revenue sources to cover debt service and ongoing operating and capital expenditures. Water and sewer rates are affordable and, in general, lower -- on both an actual and a percentage-of-income basis -- than comparable urban systems. The abundant, low-cost water supply and delivery system is a major, unique advantage that has helped management maintain its rate-raising capacity over time despite the large capital program.

The rate covenant provides 1.15x maximum annual debt service (MADS) coverage on the first resolution bonds, but just 1x MADS coverage on all subordinate debt. In addition, while the first resolution debt has an additional bonds test (ABT) of 1.15x MADS and 1x operating expenditures, the second resolution debt's ABT is a lower 1.1x MADS and 1x operating expenditures.

The authority is including its federal Build America Bond subsidy as revenue for both rate-setting and ABT purposes. Because no debt service reserve fund exists for second resolution debt and the rate-setting requirement is 1x, any delays in payment receipt could potentially pressure coverage and liquidity. Management's practice of budgeting conservatively for debt service and including large amounts of pay-as-you-go capital in its budget, coupled with historical net debt service coverage well above 1x, help mitigate this concern, in our opinion. Furthermore, the city rental payment is subordinate to the second resolution bonds, providing additional liquidity at the date of debt service; the rental payment was about $200 million in fiscal 2011.

The system serves about 836,000 accounts primarily in New York's five boroughs. In addition, the authority provides water and sewer services to about one million customers in Westchester, Putnam, Orange, and Ulster Counties. About 91% of the system is residential, with commercial and industrial users accounting for the balance.

Outlook

The stable outlook reflects our expectation that the system's financial profile will remain commensurate with the rating over the two-year outlook horizon. The large CIP reflects the current regulatory environment and a large system that serves roughly 9 million people. We believe the strong management, including long-term planning and transparency regarding potential future rate adjustments, will continue to allow management to fund identified needs despite the expectation of rising operating costs and significant amounts of additional debt.

Related Criteria And Research

USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

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