

Massachusetts Water Resources Authority; Joint Criteria; Water/Sewer

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Credit Profile		
US\$150. mil gen rev & gen rev rfdg bnds 2011 ser B&C due 08/01/2041		
Long Term Rating	AA+/Stable	New
Massachusetts Wtr Resources Auth gen rev bnds		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' long-term rating to Massachusetts Water Resources Authority's (MWRA's) series 2011B and 2011C revenue and refunding bonds. We also affirmed the following ratings:

- The 'AA+' long-term rating and Standard & Poor's underlying rating (SPUR) on various series of MWRA's senior-lien debt,
- The 'AA' long-term rating and SPUR on various series of MWRA's subordinate-lien debt,
- The 'AAA' long-term rating on various series of subordinate-lien debt that is jointly secured by MWRA and a letter of credit provider, and
- The 'A-1+' and 'A-1' short-term ratings on various series of subordinate-lien debt where the ratings are based on the short-term rating of the counterparty providing liquidity support.

The outlook on the series 2011B and 2011C bonds is stable. Except for when joint criteria has been applied to the issue's long-term rating, in which case the outlook is not meaningful, the outlook on MWRA's other series of bonds is also stable.

The ratings reflect our opinion of the authority's:

- Large and diverse service base that serves the Boston metropolitan area;
- Rate-setting autonomy combined with a historical 100% collection rate, rates and charges considered general obligations of the served communities, and a state aid intercept mechanism;
- A revenue stream that is largely dependent on Boston Water and Sewer Commission (revenue bonds rated AA+/Stable), which adds fiscal stability;
- Historical senior-lien coverage that has hovered at about 2.0x, not including rate stabilization transfers, since 2006.
- Capital improvement program (CIP) we consider manageable given the size of the system; and
- Bond provisions considered adequate, following modifications to the general bond resolution, including a senior-lien debt service coverage (DSC) ratio of 1.2x;

A senior-lien net revenue pledge secures the senior-lien bonds, and a subordinate-lien net revenue pledge secures the subordinate-lien bonds. The authority pledges all revenues--defined as all income, revenues, receipts, and other funds derived by the authority from its ownership and operation--of the systems, combined with any existing rights to

receive the same in the future, other than certain grant receipts and other funds--as security for the bonds. As such, the authority has represented and warranted that the trustee has a first priority-perfected security interest in the revenues. Bond counsel has advised that the pledge is perfected automatically under the authority's 1984 enabling legislation.

MWRA will use the series 2011B bonds for capital projects and to retire commercial paper (CP) and the series 2011C bonds to refund outstanding debt.

MWRA is a regional, wholesale, water and sewer services provider for slightly more than 40% of Massachusetts' population (or, about 2.8 million), including Boston and its metropolitan area. The authority has statutory authority to serve 61 communities. Boston Water and Sewer Commission comprises about 30% of the authority's overall rates and charges revenue, which, in our view, lends stability to the rating on MWRA's bonds, given Boston Water and Sewer Commission's bond rating of AA+/Stable.

MWRA's operations are primarily funded with rates and charges received from communities within the service area. These are assessed to the local governments on an annual basis and payable to MWRA monthly. Assessments are essentially based on proportional flow or use and can be changed as needed through board approval. Assessments are a general obligation of each local body and are also subject to a state aid intercept mechanism (for those communities that receive local aid). In recent years, combined rates have risen anywhere from 1% to 7% annually, which is consistent with projected annual rate increases through 2016. Management reports that average water and sewer utility bills for a household using 7,500 gallons per month are about \$105.

Financial operations have remained at least adequate, in our view. At the end of fiscal 2010 (June 30), net revenues provided a strong 2.1x coverage on the senior-lien bonds and a more adequate 1.2x coverage on the combined senior- and junior-lien bonds. Net revenues have been calculated to include rates, charges, and interest earnings but exclude transfers from the rate stabilization fund; in addition, net revenues have been increased by noncash other postemployment benefit (OPEB) expenses and subordinated payments in lieu of taxes and payments to the commonwealth. In addition, at fiscal year-end 2010, the authority's unrestricted cash and investments were \$92.9 million, or a strong 130 days' operating expenses.

These levels of coverage and unrestricted cash have been consistent with previous years, and management has indicated that, over the next several years, these financial metrics will not deviate significantly from these historical trends.

Debt service is the largest component of the budget, accounting for about 60% of audited operating expenses; while these figures are elevated, in our opinion, wholesale systems tend to have relatively high debt levels compared to retail systems. For the variable rate portion of its portfolio, MWRA has been budgeting for 3.25% average interest cost, which is well above the actual rate of less than 1%, as indicated by management.

Other reserves include \$41.8 million in a rate stabilization fund and \$32.9 million in a bond redemption fund, along with additional amounts in the community obligation and revenue enhancement funds, which management could draw on if a community fails to pay on time. Management projects to draw the bond redemption fund down through 2015 as it defeases additional debt and the rate stabilization fund down through 2019 for general rate stabilization.

Massachusetts Water Resources Authority has completed most of the major projects in its CIP, including the Deer

Island harbor wastewater treatment plant, the MetroWest water supply tunnel, and the John J. Carroll water treatment plant. The CIP for \$641.9 million of projects for 2011-2013 is large but represents a significant reduction from capital spending in the late 1990s. Forecasting further out, the authority has recently completed a master plan for the repair and replacement of existing infrastructure and enhanced water system redundancy. The plan identified \$3.1 billion in system needs over the next 40 years.

Outlook

The stable outlook reflects Standard & Poor's view of the authority's financial position as well as management's demonstrated willingness to increase rates. We expect that the authority will continue to maintain financial metrics consistent with historical trends and will also continue to benefit from the diversity of the underlying economic base.

If the authority is not able to maintain this stability in its financial position by not implementing consistent rate increases or if the local units begin to experience difficulty in paying their annual assessments, the rating on the bonds could be lowered. However, given management's demonstrated willingness to implement rate increases and the wide and diverse nature of the economic base, we do not believe at this time that creditworthiness will be pressured in these ways within the two-year outlook horizon.

Given MWRA's large swap and variable rate portfolio, if termination triggers are implemented on the swaps or failed remarketings on any variable rate bonds occur, these could also lead, in our view, to fiscal stress. However, it is our understanding that additional interest costs in the case of a failed remarketing would only occur after 90 days; we believe this provides the authority a sufficient amount of time to examine its financial options. Regarding the swaps, an additional termination event occurs if the counterparties' rating or MWRA's bond rating drops below 'A-'. We view a drop of MWRA's bond rating to this level as remote, and if any counterparty rating should drop to this level, a collateral posting or replacement counterparty would need to be furnished.

Bond Provisions

The authority's recent senior-lien bonds, including the series 2011 bonds, have been sold pursuant to proposed modifications to the authority's general bond resolution. Management expects these changes to be enacted by about 2017 since some of the proposals require two-thirds approval of senior-lien bondholders. Under the modified legal provisions, the authority has agreed to set rates and charges so that net revenues are at least equal to 1.2x annual debt service, which is still high for a wholesale entity; the rate covenant for subordinate-lien bonds would be 1.1x under the modified provisions. The modifications to the general resolution would free up roughly \$140 million of reserves. Management expects that it would use the released amounts primarily to redeem bonds.

A summary of proposed changes to the general resolution include:

- The debt service reserve requirement for senior bonds would be reduced to 50% of maximum annual debt service on an aggregate basis from the current level of 100% of average annual debt service on a series basis.
- The community obligation and revenue enhancement fund would be eliminated, abolishing the supplemental coverage ratio requirement. The community obligation and revenue enhancement fund coverage requirement is currently 0.1x DSC, and the total DSC requirement is 1.3x when combined with the primary coverage requirement.
- The investments permitted for the debt service funds and debt service reserve funds would be expanded to include

more permitted investments, including securities repurchase agreements. Investments in the debt service reserve funds would no longer be limited to 15 years.

- The purpose of the renewal and replacement reserve fund would be defined more narrowly as a fund for emergency needs, the balance of which a consultant engineer determines. Any renewal and replacement reserve fund requirement in excess of \$10 million can be covered by a line of credit, such as a CP program, rather than having to be funded with cash and investments.

Debt Derivative Profile, '2': Low Credit Risk

Standard & Poor's has assigned Massachusetts Water Resources Authority a Debt Derivative Profile (DDP) overall score of '2' on a scale of '1'-'4', with '1' representing the lowest risk and '4' the highest risk.

The overall score of '2' reflects our view that the authority's swap portfolio is a low credit risk due to:

- A low degree of involuntary termination risk under the authority's swaps due to a wide ratings trigger spread,
- The strong economic viability of the swap portfolio over stressful economic cycles, and
- An adopted swap policy as part of the authority's larger debt management policy.

These strengths are offset by the more-narrow ratings trigger spread among three of the swap counterparties and their respective credit events.

The authority's interest rate swaps outstanding are all floating-to-fixed-rate agreements with a total notional value of \$757 million.

The authority replaced the swap agreements it had with two Lehman Bros. entities with new agreements with Barclays Bank PLC (AA-/Negative) and Wells Fargo Bank N.A. (AA/Negative). Under these swap agreements, the authority will pay a fixed rate and receive floating payments based on the Securities Industry and Financial Markets Assn. Index. The fixed rate ranges between 4.032% and 4.470% for the swaps effective from 2008 through 2030 and is 6.585% for a forward-starting swap effective from 2030 through 2037. In addition to these, the authority has floating-to-fixed-rate swap agreements outstanding with Citigroup Financial Products, with a credit support guarantee from Citigroup, Inc. (A/Negative); Morgan Stanley Capital Services, with a credit support guarantee from Morgan Stanley (A/Negative); and Goldman Sachs Capital Markets L.P., with a guarantee from Goldman Sachs Group (A/Negative).

All documents list a 'BBB+' rating trigger as an additional credit event for the counterparties. There is an additional credit event if the authority's rating goes down to 'BBB+', which is seen as remote due to its strong 'AA' credit profile. The authority has also adopted a debt derivative policy and has incorporated this into its general debt policy. In addition, management has reported that it actively manages and reviews its swap agreements. Of the authority's debt outstanding, roughly 10% is true variable-rate debt or CP. Due to the low degree of termination risk, we did not factor in the swaps' value-at-risk as a contingent liability for the authority.

Related Criteria And Research

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept.15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue

Bonds, Sept. 15, 2008

- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009

Ratings Detail (As Of April 28, 2011)		
Massachusetts Wtr Resources Auth multi-modal subord		
<i>Long Term Rating</i>	AA/NR/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/NR/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth multi-modal subord gen rev rfdg bnds 2008		
<i>Long Term Rating</i>	AA/A-1+/Stable	Affirmed
Massachusetts Wtr Resources Auth sub (MBIA) (National)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AAA/A-1+	Affirmed
Massachusetts Wtr Resources Auth gen rev		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth gen rev bnds		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Wtr Resources Auth multi modal sub gen rev rfdg bnds		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AA/NR	Affirmed

Many issues are enhanced by bond insurance.

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