

# RatingsDirect®

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## Boston Water & Sewer Commission; Water/Sewer

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### Table Of Contents

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Rating Action

Stable Two-Year Outlook

Credit Opinion

Enterprise Risk

Financial Risk

# Boston Water & Sewer Commission; Water/Sewer

## Credit Profile

US\$95.05 mil gen rev and rfdg bnds (federally taxable) ser 2020A due 11/01/2037		
<i>Long Term Rating</i>	AAA/Stable	New
US\$64.025 mil gen rev and rfdg bnds ser 2020B due 11/01/2050		
<i>Long Term Rating</i>	AAA/Stable	New
Boston Wtr & Swr Comm WTRSWR		
<i>Long Term Rating</i>	AAA/Stable	Upgraded

## Rating Action

S&P Global Ratings raised its rating on the Boston Water & Sewer Commission's (BWSC) senior-lien debt by one notch to 'AAA'. At the same time, S&P Global Ratings assigned its 'AAA' long-term rating to BWSC's series 2020A taxable general revenue and refunding bonds, as well as to its series 2020B general revenue and refunding bonds. The outlook is stable.

The upgrade is based on our opinion that BWSC's overall creditworthiness is consistent with our highest rating, even if all-in debt service coverage (DSC) is low for the rating category. DSC has, however, steadily improved as both BWSC and its wholesale treatment provider have moved beyond some of the most capital- and debt-intensive periods in their respective histories, given the extremely strong and comprehensive nature of the management team. We view BWSC as having some of the best-in-class enterprise risk management and resilience planning among municipal water and sewer utilities.

BWSC will have an estimated \$587 million in revenue bonds outstanding after the series 2020 transactions, and about \$31.2 million in various loan programs through the Massachusetts Water Resources Authority (MWRA).

We understand that BWSC will use the proceeds of the series 2020A bonds to advance refund certain maturities of its series 2012A and 2016B revenue bonds for savings purposes. The series 2020B bonds will be used primarily to fund new projects.

## Credit overview

Factors that support our view of BWSC's general creditworthiness include:

- The economic fundamentals of the Boston-Cambridge-Newton metropolitan statistical area (MSA), which remains among the strongest-performing economies on the East Coast;
- Operational and financial management assessments we view as strong; and
- Extremely strong liquidity when considering total available reserves.

## Environmental, Social and Governance Factors

BWSC's management team has for years incorporated risk and resilience planning, long before it became a requirement as part of the America's Water Infrastructure Act of 2018. In addition to already planning for sea level rise

by implementing protections for critical assets, BWSC was an early adopter of green infrastructure in large urban cities, including as part of its overall corrective action plan to address a 2012 stormwater-focused consent decree. Work on that program is still ongoing and is expected to be for some time, with a focus on more aggressive preventive maintenance; sewer line replacements; in some cases separating the sanitary sewer system infrastructure from the combined sewer-stormwater lines; and establishing best management practices in excess of the requirements of the consent decree. Despite the non-discretionary nature of the consent decree consuming much of BWSC's capital plan--and likely to continue to create headwinds for stronger DSC--we view management's comprehensive approach to its risk management, resilience, and joint efforts with the city and other regional partners as uniquely supportive of our highest rating.

The stable outlook reflects our view that the system's other credit strengths will continue to more than offset financial metrics that are strong and extremely consistent, but perhaps on the outer band compared with those of 'AAA' rated peers.

## **Stable Two-Year Outlook**

### **Downside scenario**

Any downside risk would be driven mainly by the erosion of financial capacity. Factors that could contribute to that include not fully passing through MWRA's assessments, an escalation of other fixed costs such as debt service, or what we would consider an over-reliance on the rate stabilization reserve in lieu of aligning operating revenues with total revenue requirements. We have observed that BWSC has historically and consistently outperformed its financial forecast; our 'AAA' rating assumes this favorable variance trend will continue. Although MWRA assessments are subordinate to BWSC's debt service, we treat it as if it were *pari passu* with all other direct operating expenses in our adjusted DSC calculation, so that we can assess if ongoing operating revenues are sufficient to address all operating expenses, debt service, and other fixed costs.

## **Credit Opinion**

## **Enterprise Risk**

BWSC provides water distribution, wastewater collection, and stormwater services to approximately 90,000 Boston retail customers, almost all of which are metered. The commission purchases its water from the MWRA, and relies on the authority's facilities for sewage treatment. Because of the large number of tax-exempt and not-for-profit entities in its customer base, and because the city is the largest economy in New England, the system does not overly depend on any principal customer for operating revenue. Core industries in health care, higher education, financial services, technology, and tourism give the city a multifaceted economy that withstood the recession unscathed. Boston is also one of the stronger-performing housing markets in the S&P/Case-Shiller Home Price Index. The city's December 2019 unemployment rate was 2.6%, which was lower than commonwealth and national levels. Income indicators are strong, in our view, with median household effective buying income for the MSA in line with the national level.

Water and sewer charges account for about 95% of BWSC's total revenue. The commission has long been willing to adjust rates, most recently by 7.9% effective January 2020. The forecast calls for additional annual adjustments of 3.5% per year, which are less than previous forecasts and reflect the management team's inherently conservative assumptions. The MWRA assessment of \$244 million, by itself 61% of the BWSC budget, is passed through to the retail rate base, even if the timing within the fiscal year is slightly different from MWRA's. Officials anticipate that this assessment will continue to grow at a more incremental pace because regulatory-driven projects that had previously pushed MWRA rate increases are complete. The MWRA assessments are subordinate to debt service payments on the monthly flow of funds, even after MWRA state loans. For consistency in the calculation of common utility metrics such as DSC, we treat authority assessments as equal to all other direct operating expenses. Still, as the MWRA assessments have increased, so have BWSC's retail rates. Based on our universal assumption of 6,000 gallons of both water and sewer service, a monthly single-family residential bill is closing in on \$100, or about 2.6% of median household effective buying income.

Based on our operational management assessment (OMA), we view BWSC to be a '1' on a scale of '1' to '6', '1' being the strongest. This indicates our opinion of the strongest alignment of operations and organizational goals. The strong OMA includes the limited operational risk associated with the system's role as a distribution and collection customer of the MWRA. Both BWSC and MWRA have just recently moved beyond a capital-intensive period in which each completed a large scope of projects related to sanitary sewer environmental regulatory mandates, which pressured rates. BWSC has been a leader in keeping its nonrevenue water and water main breaks among the lowest in the country for any large city by using advanced metering infrastructure, regular water audits, and aggressive distribution line maintenance and replacements. It is still managing through a consent decree related to its stormwater system as its last remaining regulatory-driven challenge. Part of the corrective action plan includes a commitment to green infrastructure. The lessening of the mandate-driven projects as a portion of the total capital program has allowed management to further what we view as already extremely strong risk management practices. This includes proactive mitigation projects to address climate change and sea level rise, as well as extremely robust cybersecurity architecture and policies.

## **Financial Risk**

Although we view current financial capacity as measured by all-in DSC, as strong, it in our view remains an area of further opportunity. For example, in "U.S. Municipal Water And Sewer Utility Sector Is Stable As Median Ratios Show Improved Finances" (published Aug. 23, 2019), we noted that among New England utilities, the average all-in DSC over the past three years is 1.5x and nationally it is 1.7x, while for BWSC it is closer to a still strong 1.3x. All-in DSC is S&P Global Ratings' adjusted DSC metric that incorporates all debt and debt-like obligations regardless of lien or accounting treatment.

BWSC has a number of ongoing related rehabilitation and replacement projects, master plans, and additional best practices that management notes it would have likely pursued even if not compelled by regulators, and began corrective actions even while it awaited regulatory acceptance of the proposed remediation plan. In general, management reports a good working relationship with regulators, meeting all milestones and key dates as it had also

done before for the previous combined sanitary and storm sewer overflow remediation program. Led by MWRA, that program has been closed out after completion of 13 major projects and almost \$300 million in capital improvements.

BWSC's debt service schedule is such that it will decline over time in stair-step fashion. Total payments of about \$46 million per year now will be approaching \$30 million by decade's end. This will provide the commission good borrowing capacity, even if it is not currently needed as management anticipates no large new endeavors in the capital improvement plan (CIP). It will also likely mean continued consistency in financial results. Senior-lien DSC is regularly at or above 1.8x, with all-in coverage of 1.3x including all obligations such as the MWRA assessments and state loans. The MWRA has completed 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. BWSC has identified \$339 million in capital commitments through 2024, which in our view is modest relative to comparably sized systems with an active consent decree. This level of planned spend is also down significantly from capital spending in the late 1990s because the authority has also completed large environmental mandates. BWSC intends to finance \$197 million of the plan with either additional bonds or state loans.

Although BWSC typically reports unrestricted cash balances of \$5 million-\$10 million in a given year, total system liquidity is generally more robust, and consistently equivalent to three-six months of total operating expenses plus the MWRA assessment. The commission has a number of designated operating reserves that, while reported as restricted, are generally available for any lawful purpose. This includes a rate-stabilization reserve and a renewal and replacement reserve. At the beginning of fiscal 2020, the stabilization reserve was almost \$62 million, by itself about 70 days of operating expenses, and total cash (S&P Global Ratings-calculated) equaled about six months of operating expenses. Management's forecast does not assume any use of the stabilization fund through at least 2024.

Based on our financial management assessment (FMA), we view BWSC to be a '1' on a scale of 1-6, with '1' being the strongest. An FMA of strong indicates that practices are strong, well embedded, and likely sustainable. In our view, the utility maintains best practices deemed critical to supporting credit quality and these are well embedded in daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will continue and transcend changes in the operating environment or personnel. This includes pro forma financial projections with conservative assumptions that not only identify annual revenue requirements but also capital needs, funding sources, and potential rate adjustments. The management team also has robust policies for the maintenance of working capital, including a sizable budget-stabilization reserve.

The BWSC system has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the system's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues and allows us to rate BWSC above the rating of the U.S.

#### **Ratings Detail (As Of March 9, 2020)**

Boston Wtr & Swr Comm wtr/swr		
<i>Long Term Rating</i>	AAA/Stable	Upgraded
Boston Wtr & Swr Comm wtrswr		
<i>Long Term Rating</i>	AAA/Stable	Upgraded

**Ratings Detail (As Of March 9, 2020) (cont.)**

Boston Wtr & Swr Comm WTRSWR		
<i>Long Term Rating</i>	AAA/Stable	Upgraded

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