FitchRatings

FITCH RATES NEW YORK CITY MUNI WATER FINANCE AUTHORITY'S $517MM REVS 'AA+'

Fitch Ratings-New York-06 March 2013: Fitch Ratings has assigned an 'AA+' rating to the following water and sewer system (the system) second general resolution (SGR) revenue bonds for the New York City Municipal Water Finance Authority (NYW):

--Approximately $517 million water and sewer system SGR revenue bonds, fiscal 2013 series DD.

The fiscal 2013 series DD bonds are scheduled for negotiated sale on March 11. Proceeds will be used to refund outstanding first general resolution (FGR) bonds for cost savings.

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

--$8.2 billion FGR revenue bonds at 'AA+';
--$20.7 billion SGR revenue bonds at 'AA+'.

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 water and sewer system (the 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.

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 system and New York City (the city).

REGIONAL PROVIDER OF AN ESSENTIAL SERVICE: The combined system provides an essential service to an exceptionally large and diverse service area and 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 successful implementation of the large capital improvement plan (CIP).

HIGHLY LEVERAGED SYSTEM: Leverage is high as a result of having to comply with environmental mandates and maintain a large urban system and its aging assets. Declining but still sizeable debt plans programmed into the current capital plan will keep debt levels elevated for the long term.

IMPROVED COLLECTIONS: Below-average 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 adequate financial margins and maintain current debt service coverage (DSC) levels on senior and subordinate lien obligations would be viewed negatively.

DEBT LEVELS EXCEEDING PROJECTIONS: Escalation of debt levels beyond what is currently included in the five-year financial forecast would place added pressure on the system's debt profile.

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 issuer;
--Ownership of system revenues by the bankruptcy-remote New York Water Board (the board), which sets rates without city council approval;
--Legal covenants that require adjustment of water and sewer rates sufficient to provide at least 1.15x coverage of FGR bond annual debt service and 1.0x coverage on SGR bonds and O&M expenses.

These layers of protection serve to significantly shield bondholders from the operational risks of the city's massive water and sewer enterprise as well as other city government operations. NYW SGR bondholders benefit from similar legal protections afforded FGR bondholders. SGR bondholders' claim on gross revenues is subordinate only to FGR debt service deposits, NYW administrative costs, and FGR debt service reserve fund (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 solid operating results, despite sizable growth in debt service obligations and volatility in consumption. Financial results continued to outperform budgeted expectations in fiscal 2012, despite a larger than forecast decline in consumption of about 2.3% that partially offset the adopted 7.5% rate hike. Consequently, year-end DSC from net operating revenues improved to 4.5x and 1.8x on FGR and SGR debt service (7.5x and 3.0x reflecting the gross lien), respectively, compared to 3.2x and 1.5x in fiscal 2011.

Liquidity has steadily grown in recent years to a more acceptable level. Unrestricted cash and investments together with O&M reserves have equaled a healthy average of 125 days cash on hand since 2008. 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, although Fitch continues to view the strategy favorably.

The net surplus generated in fiscal 2012, measured on a cash basis, totaled $498 million. Results through the first seven months of the current fiscal year are positive with year-to-date revenues reportedly up by almost 3% compared to the adopted budget, despite little change in consumption through the first seven months. Rates were increased in fiscals 2012 and 2013, albeit by a more moderate 7.5% and 7%, respectively, compared to a series of double-digit rate hikes enacted between fiscals 2008-2011. Despite the annual increases, the average monthly residential bill remains relatively affordable in comparison to the median household income level.

IMPACT OF THE RECENT HURRICANE BELIEVED TO BE MANAGEABLE
Fitch does not expect the damage caused by Hurricane Sandy to have a material impact on the financial operations or ongoing capital program of NYW. The delivery of safe drinking water was continued during and after the October 2012 hurricane, and despite needed bypasses and overflows at certain wastewater treatment plants, officials do not expect to incur any regulatory penalties. The assessment of system-wide damage is reportedly ongoing, but the latest cost estimate includes

approximately $51 million of O&M expenses and approximately $44 million of capital expenses, the vast majority of which will likely be reimbursable with Federal Emergency Management Agency funds.

PROJECTED FINANCIAL RESULTS REMAIN SATISFACTORY
Financial projections through fiscal 2017 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 about 1.6x through the current planning period.

LEVERAGED SYSTEM
Similar to most 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 $12.2 billion in water and sewer projects, approximately $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 2017 totaling $6.8 billion, or an annual average of approximately $1.36 billion. Projected debt issuance, while sizable, is a marked decline from the annual average of about $3.1 billion incurred over the previous five years, including a peak of $3 billion in fiscal 2011.

Debt levels are high and the projected escalation included in the current forecast may pressure NYW's rating over the medium term. Debt to net plant now exceeds 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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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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 12, 2012);
--'U.S. Water and Sewer Revenue Bond Rating Criteria' (Aug. 3, 2012);
--'2013 Water and Sewer Medians' (Dec. 5, 2012);
--'2013 Outlook: Water and Sewer' (Dec. 5, 2012).

Applicable Criteria and Related Research
Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681015
U.S. Water and Sewer Revenue Bond Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684901
2013 Water and Sewer Medians
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695756
2013 Outlook: Water and Sewer Sector
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695755