FitchRatings

Fitch Rates Erie County Water Authority, NY's Rev Rfdg Bonds 'AA+'; Outlook Stable

Fitch Ratings-New York-09 September 2016: Fitch Ratings has assigned a 'AA+' rating to the following revenue bonds issued by the Erie County Water Authority, NY (the authority):

--$32.1 million water system revenue refunding bonds, series 2016.

The bonds are scheduled to price via negotiation Sept. 15. The bonds will refund outstanding parity bonds for level interest cost savings and pay costs of issuance.

In addition, Fitch affirms the following ratings:

--$45.8 million water system revenue bonds, series 2007 and 2008 at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The current offering as well as outstanding water system revenue bonds and all clean water fund obligations of the authority are secured on parity by a first lien on net revenues of the authority. The series 2016 bonds will not carry a debt service reserve fund. However, revenue bonds currently outstanding are secured by fully funded debt service reserve funds.

KEY RATING DRIVERS
STRONG FINANCIAL METRICS: Strong operating margins consistently generate all-in debt service coverage that exceeds Fitch's median ratio, providing ample free cash flow to current fund capital needs. Liquidity is considered below average for the rating category but healthy relative to the system's operating profile and capital needs.

AMPLE OPERATING FLEXIBILITY: The authority's affordable user charges and ability to set rates independent of outside regulation provide operating flexibility. The levy of a fixed charge aimed at funding infrastructure repair and renewal needs provides solid cost recovery.

FAVORABLE DEBT PROFILE: Debt levels are exceptionally low and expected to continue improving given the authority's plan to fund capital needs on a pay-go basis for the next several years.

STABLE REGIONAL WATER PROVIDER: The ECWA provides water treatment and distribution to a sizeable and economically stable service territory primarily on a retail basis. The customer base and related water sales are highly diverse, and revenue collection has continued at close to 100%.

MANAGEABLE CAPITAL PROGRAM: Capital needs are manageable and are not burdened by costly regulatory requirements or growth pressures.

ABUNDANT CAPACITY: Available water supply and existing treatment capacity are sufficient to meet customer demand for the foreseeable future.

RATING SENSITIVITIES

FORECAST RESULTS REALIZED: The Erie County Water Authority's ability to achieve its forecast results, which include continued strengthening in debt service coverage and a sustained trend of deleveraging, would enhance its risk profile and could ultimately result in positive rating action.

CREDIT PROFILE
The authority provides water treatment and distribution service to a highly diverse and largely stable customer base. The service area includes much of the western portion of the county with the exception of the city of Buffalo, which maintains its own water treatment and distribution system. A small number of the 35 municipalities served by the authority are also located in parts of Chautauqua, Cattaraugus, and western Genesee counties.

Residential users account for nearly 95% of the customer base and roughly 52% of total utility revenues. Customers are served on either a direct basis or through lease managed or bulk sale agreements. Lease managed agreements require the authority to convey water to municipally owned distribution systems and operate and maintain the system's assets.

Bulk sale agreements limit the authority's role to that of a wholesale water provider with municipalities billed directly by the authority. Customers served on a bulk sale basis accounted for just 5.2% of total revenue in fiscal 2015. The authority's 10 largest users are composed mostly of bulk sale customers and accounted for a modest 6.8% of gross revenue in fiscal 2015.

Water supply is drawn from the Niagara River and Lake Erie and is estimated to be sufficient for the foreseeable future. Two treatment facilities provide a combined 156 million gallons daily (mgd) of available treatment capacity, more than twice the average daily demand. The system is reportedly in compliance with all EPA regulations and water quality standards.

STRONG OPERATING PERFORMANCE

The authority's financial profile remains strong, supported by ample rate flexibility, largely affordable capital needs and modest debt obligations. All-in debt service coverage (DSC) consistently meets or exceeds Fitch's rating category median, averaging 2.20x over the prior five fiscal years.

Liquidity has been low historically in comparison to Fitch's median for the rating category but with about 230 days cash on hand and improved cost recovery, the authority's reserves provide a solid cushion relative to the system's overall financial and capital needs. Management prudently targets a healthy minimum reserve balance equal to 20% of gross revenues after the payment of debt service and annual capital needs, which it comfortably exceeds by a wide margin.

Financial projections through fiscal 2020 appear achievable in Fitch's view. Annual debt service coverage is forecast to strengthen annually, growing from about 2.0x in fiscal 2016 to more than 7.0x in 2020 as yearly debt service obligations begin to lessen. The forecast reasonably assumes flat water sales, no additional increases in the metered rate, further escalation in the infrastructure investment charge and the full effect of the current bond refunding on annual debt service obligations.

DELEVERAGING TO CONTINUE

Capital needs of the system are manageable and should continue to be funded on a pay-as-you-go basis. Projected spending through fiscal 2020 is estimated at $97.8 million, primarily for routine repair and replacement projects aimed at keeping the system in good repair.

Exceptionally low debt levels remain a key credit strength. Management's prudent practice of funding capital needs principally on a pay-as-you-go basis continues to result in leverage metrics that meet or exceed Fitch's 'AAA' rating category medians. Outstanding debt as a percentage of net system assets declined to just 16% in fiscal 2015 while total debt on a per capita basis dropped to nearly $100. Annual debt service costs are also low at 17% of gross revenues.

Projected pay-out of total debt outstanding remains fairly level through 2018 when a sizeable drop-off in annual debt service occurs in 2019. The decline, coupled with already low debt levels, will provide the authority with significant flexibility and capacity to absorb additional debt if needed. No immediate plans for additional debt currently exist, although authority officials anticipate issuing debt in the 2019-2020 timeframe.

AFFORDABLE RATES

The authority's affordable rates and ability to increase user charges independent of outside regulation or approval provide management with ample flexibility. Residential rate payers, assuming monthly consumption of 10,000 gallons, currently pay about $38 per month, equal to roughly 0.9% of the county's median household income.

The current cost structure consists of a flat metered rate per 1,000 gallons of usage plus a fixed infrastructure investment charge of $19.65 levied on a quarterly basis. The infrastructure investment charge was first implemented in fiscal 2011 in an effort to decouple a portion of the rate structure from customer demand as fixed costs continued to rise and declining sales persisted. The fixed charge now generates about 15% of total revenue and provides a more predictable source of income.

The authority's metered rate was held constant from fiscal 2011 to 2013 followed by modest increases of 1.4%, 1.7% and 3.9% in each of the last three fiscal years, respectively. The infrastructure charge was also increased in each of those years, demonstrating the authority's ability and willingness to raise needed revenue.

The percentage of revenue generated from the fixed charge should continue to grow based on the authority's financial forecast, which shows the charge amount ultimately increasing to nearly $19.5 million compared to $10.4 million in fiscal 2015.

STABLE SERVICE AREA
The service area's exclusion of the city of Buffalo limits the authority's exposure to a service territory that exhibits noticeably weaker income levels and typically higher unemployment. Wealth and economic indicators for the balance of Erie County are generally more favorable, with median household and per capita income levels on par with national figures and a low June 2016 unemployment rate of 4.4%. Consequently, accounts receivable have remained low and annual write-offs continue to approximate less than 1% of annual income.

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Applicable Criteria

Revenue-Supported Rating Criteria (pub. 16 Jun 2014) (https://www.fitchratings.com/site/re/750012)
U.S. Water and Sewer Revenue Bond Rating Criteria (pub. 03 Sep 2015) (https://www.fitchratings.com/site/re/869223)

Additional Disclosures
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