Erie County Water Authority, New York

New Issue Report

Ratings

New Issue

Water System Revenue Bonds, Series 2018	AA+

Outstanding Debt

Water System Revenue Bonds	AA+

Rating Outlook

Stable

Analysts

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New Issue Details

Sale Information: $18,980,000 Water System Revenue Bonds, Series 2018, expected to sell the week of July 23 via negotiated sale.

Security: A first lien on the net revenues of the Erie County Water Authority (ECWA, or the authority).

Purpose: To fund improvements to the system and pay issuance costs.

Final Maturity: Dec. 1, 2048.

Key Rating Drivers

Consistently Sound Financial Results: Financial performance continues to yield strong operating margins and sound debt service coverage (DSC). Liquidity is below average for the rating category but healthy relative to the system's operating profile and capital program.

Stable Service Territory: The authority provides water treatment and distribution to a stable service territory that includes a highly diverse customer base with sound economic and wealth indicators. The authority is a regional water provider and provides primarily direct retail service and limited wholesale service (6.5% revenues) to multiple communities.

Favorable Debt Profile: Debt levels are exceptionally low. Leverage should remain low even with planned additional debt issuance. Unfunded other post-employment benefit (OPEB) obligations are slightly elevated but annual costs are manageable.

Manageable Capital Program: Capital needs appear moderate and are not burdened by costly regulatory requirements or growth pressures.

Abundant Capacity: Available water supply and treatment capacity are sufficient to meet demand for the foreseeable future.

Rating Sensitivities

Sizeable Long-Term Obligation: The Erie County Water Authority's unfunded obligation related to other post-employment benefits (OPEB) is sizeable and continues to grow. Fitch views recent reforms enacted to reduce the liability as positive; however, rating stability is predicated on the authority's ability to sustain solid financial outcomes and an otherwise low fixed cost profile while ensuring adequate OPEB funding levels.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	6/28/18
AA+	Affirmed	Stable	9/9/16
AA+	Affirmed	Stable	1/29/16
AA+	Affirmed	Stable	6/6/14
AA+	Affirmed	Stable	6/13/12
AA+	Affirmed	Stable	6/28/10
AA+	Revision	Stable	4/30/10
AA	Upgrade	Stable	6/6/08
AA-	Assigned	Stable	8/24/07

Credit Profile

Regional Water Authority

The authority provides water treatment and distribution service to a highly diverse and largely stable customer base. The authority serves 11 communities and municipalities via direct service, 14 through lease managed agreements, and 16 as bulk customers. The service area includes much of the eastern portion of Erie County (general obligation bonds rated A+/Stable) with the exception of the city of Buffalo, which maintains its own water treatment and distribution system.

A small number of the aforementioned communities served are also located in parts of Chautauqua, Cattaraugus, and western Genesee and Wyoming counties. Regional customer growth has been modest, averaging about 1% annually over the past five years.

Sound Financial Profile

The authority's financial profile has been consistently strong, supported by ample rate flexibility, affordable capital needs and manageable debt obligations. Total DSC has remained favorable but has fluctuated somewhat in recent years due to sales reductions consistent with wet weather patterns. Fiscal 2017 DSC was a healthy 2.5x (excluding connection fees), and management forecasts coverage levels in fiscals 2018 and beyond to exceed 2.2x, including assumed modest rate increases.

Liquidity has historically been low compared to Fitch's median for the rating category, but Fitch believes that the authority's average reserves of over 200 days cash on hand in recent years provide a sound cushion relative to the system's overall risk profile. Management prudently targets a healthy minimum reserve balance that approximates 20% of gross revenues. Total reserves are consistently higher than management's stated target. Fitch expects financial metrics to remain strong over the next several years based on the authority's most recent financial forecast.

Low Debt, Moderate Fixed Cost Burden

Exceptionally low debt levels are a credit strength. Management's prudent practice of funding capital needs principally on a pay-go basis continues to result in leverage metrics that meet or exceed Fitch's 'AA' rating category medians. Debt to funds available for debt service (debt/FADS) was 1.7x in fiscal 2017 as compared to the 'AA' median of 5.5x. Even with the series 2018 bonds and possible additional debt issuance to finance capital needs, debt/FADS is expected to remain below 3.0x. Total annual debt service costs are also low at only 15% of gross revenues (versus the 'AA' median of 21%).

The authority's long-term unfunded OPEB liability remains sizeable at $66.9 million (as of Jan. 1, 2016) and continues to grow as the authority uses pay-go funding for the actual annual OPEB costs to retirees versus the actuarial required contribution (ARC). In fiscal 2017, the authority's actual payments OPEB contributions totaled $1.96 million, or 26% of the $7.6 million ARC.

Overall, the authority's annual OPEB pay-go costs account for a nominal proportion of total revenues, and when combined with fully funded pension ARC payments, consumed a reasonable 5.9% of the authority's budget in fiscal 2017. By comparison, fully funding the ARCs for both OPEB and the pension would total a still affordable 13.5% of fiscal 2017 revenues. As a result of reforms enacted in 2011 by the authority to raise the retiree eligibility age, as well as

Related Research

2018 Water and Sewer Medians (December 2017)

Fitch 2018 Outlook: Water and Sewer Sector (December 2017)

Related Criteria

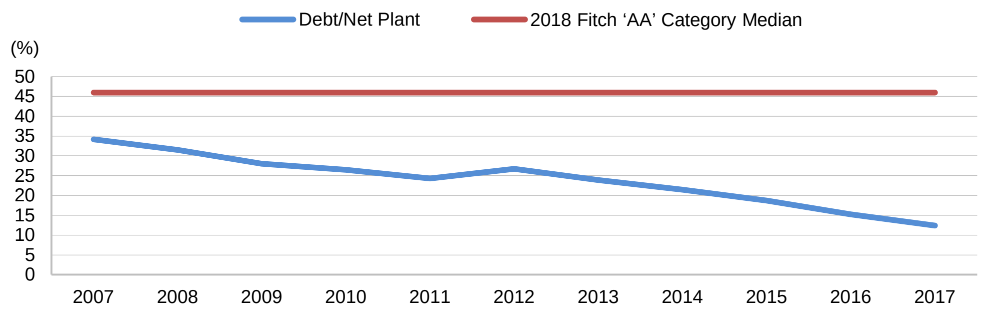
Rating Criteria for Public-Sector, Revenue-Supported Debt (February 2018)

U.S. Water and Sewer Rating Criteria (November 2017) by requiring a 15% employee contribution toward the plan's premium, the authority expects its growing OPEB obligation to be limited going forward.

Manageable Capital Program

The system's capital needs are manageable and should continue to be mostly funded on a pay-go basis. However, additional debt financing is likely within the five-year forecast period to support capital spending, which should be manageable. The authority is able to take advantage of a significant decline in annual debt service starting in fiscal 2019 to issue the series 2018 bonds to fund the expanded CIP while maintaining affordable debt levels.

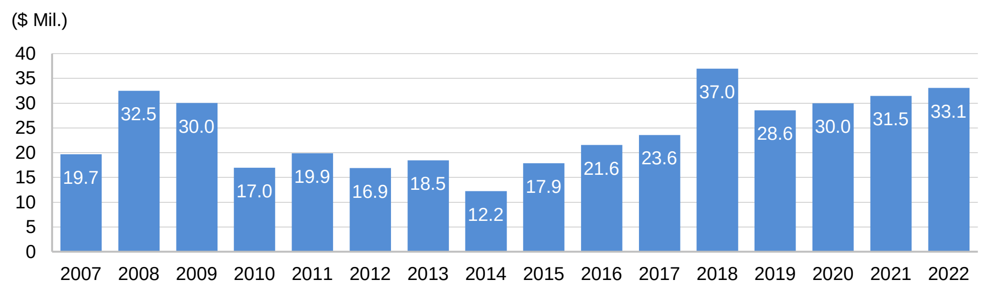
Low System Debt Levels Lend Issuance Capacity



Source: Fitch Solutions, ECWA audited historical balance sheet statements.

The current five-year capital improvement plan (CIP) through 2022 totals $160.1 million and reflects a continued increase in capital spending plans consistent with the authority's push to address targeted areas that have been greatly impaired over the course of recent severe winters. Primary focus is on extensive repair and replacement projects aimed at keeping the system in good repair. Historically, capital expenditures have routinely exceeded the annual rate of depreciation, indicating the authority's commitment to maintaining system assets. Positively, capital spending remains wholly discretionary and is not dictated by regulatory or supply expansion requirements.

Historical and Planned Annual System Capital Expenditures



Source: ECWA historical audited cash flow statements (through fiscal 2017) and ECWA-provided five-year, fiscal 2018–2022 capital improvement program.

Excess Capacity Exists

The authority benefits from an ample water supply and significant excess treatment capacity. The system's 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 of available treatment capacity, more than two times the average daily demand. The system is reportedly in compliance with all regulations and water quality standards.

Stable Service Area

The service area's exclusion of the city of Buffalo limits the authority's exposure to a customer base that in general exhibits weaker income levels, higher unemployment and potentially lower utility collection rates. Consequently, accounts receivable have remained low and annual write-offs continue to approximate a nominal 1%. 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. Positively, the county as a whole is experiencing economic growth, with the countywide April 2018 unemployment rate declining to a strong 4.6%.

Financial Summary

($000, Audited Years Ended Dec. 31)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Balance Sheet										
Unrestricted Cash and Investments	23,100	24,228	28,723	24,356	24,462	—	—	—	—	—
Other Unrestricted Current Assets	15,393	16,805	16,373	19,030	19,201	—	—	—	—	—
Available Restricted Cash and Investments	550	550	550	550	—	—	—	—	—	—
Current Liabilities Payable from Unrestricted Assets	(17,980)	(18,367)	(17,675)	(21,578)	(20,915)	—	—	—	—	—
Net Working Capital	**21,063**	**23,216**	**27,971**	**22,359**	**22,747**	**—**	**—**	**—**	**—**	**—**
Net Fixed Assets	354,953	354,995	360,641	369,413	380,222	—	—	—	—	—
Net Long-Term Debt Outstanding	84,767	76,279	67,452	56,340	47,242	—	—	—	—	—
Operating Statement										
Operating Revenues	63,556	65,909	69,595	79,711	73,292	76,603	78,991	80,112	81,250	82,421
Non-Operating Revenues Available for Debt Service	403	357	355	360	434	—	—	—	—	—
Connection Fees	1,393	1,465	4,134	1,644	1,628	—	—	—	—	—
Total Revenues Available for Debt Service	**65,351**	**67,730**	**74,084**	**81,715**	**75,354**	**76,603**	**78,991**	**80,112**	**81,250**	**82,421**
Operating Expenditures (Excluding Depreciation)	42,229	45,457	44,941	46,788	46,808	52,462	57,916	59,471	56,703	58,223
Depreciation	12,154	12,355	12,495	12,713	12,824	—	—	—	—	—
Net Revenues Available for Debt Service	**23,122**	**22,274**	**29,143**	**34,927**	**28,547**	**24,141**	**21,076**	**20,641**	**24,547**	**24,198**
Total Debt Service (ADS)	11,731	11,642	11,645	10,253	10,727	10,591	6,052	5,160	5,161	5,488
Financial Statistics										
Total Debt Service Coverage (DSC) (x)	2.0	1.9	2.5	3.4	2.7	2.3	3.5	4.0	4.8	4.4
Total DSC (Excluding One-time Connection Fees) (x)	1.9	1.8	2.1	3.2	2.5	2.3	3.5	4.0	4.8	4.4
Days Cash on Hand	204	199	238	194	191	—	—	—	—	—
Days Working Capital	182	186	227	174	177	—	—	—	—	—
Debt/Net Plant (%)	24	21	19	15	12	—	—	—	—	—
Outstanding Long-Term Debt Per Customer ($)	511	454	400	333	278	—	—	—	—	—
Outstanding Long-Term Debt Per Capita ($)	154	138	122	102	85	—	—	—	—	—
Free Cash/Depreciation (%)	94	86	140	194	139	—	—	—	—	—

Note: Fitch may have reclassified certain financial statement items for analytical purposes.
Source: Erie County Water Authority and Fitch Solutions.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.