FITCH RATES ERIE COUNTY WATER AUTHORITY, NY'S WATER REVS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-28 June 2018: Fitch Ratings has assigned a 'AA+' to the following Erie County Water Authority, NY (the authority) bonds:

--$18.98 million water revenue bonds, series 2018.

The series 2018 bonds are scheduled for negotiated sale the week of July 23. Proceeds will finance improvements to the system and pay issuance costs.

In addition, Fitch has affirmed the 'AA+' rating on the following bonds:

--Approximately $43 million, series 2008 and 2016.

The Rating Outlook is Stable.

SECURITY

The bonds are payable by a first lien on the net revenues of the authority's water system (the system).

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.

CREDIT PROFILE

REGIONAL WATER PROVIDER

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 pay-go's 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 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. 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.

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. Additional debt financing is likely within the five-year forecast period to support capital spending, which should be manageable. 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.

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%.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Water and Sewer Rating Criteria (pub. 30 Nov 2017)
https://www.fitchratings.com/site/re/10010508