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Summary:

New Orleans
Sewerage & Water Board of New Orleans; Water/Sewer

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Credit Profile		
US$100.0 mil swg svc rev bnds (New Orleans Swg & Wtr Brd) ser 2015		
Long Term Rating	A/Stable	New
New Orleans, Louisiana		
New Orleans Swg & Wtr Brd, Louisiana		
New Orleans (New Orleans Swg & Wtr Brd) WTRSWR		
Long Term Rating	A/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'A' long-term rating to New Orleans' 2015 sewerage service revenue bonds, issued for the Sewerage & Water Board of New Orleans (SWBNO). At the same time, we affirmed our 'A' long-term rating and underlying rating (SPUR) on the sewer system's parity revenue bonds outstanding.

The rating continues to be based on our opinion of the system's general creditworthiness, including its:

- Preapproved across-the-board rate increases of 10% each year through Jan. 1, 2020, which we believe will preserve good financial capacity even with additional borrowings that will fund much of the sewer system's capital projects, and even if the rate increases might eventually cause affordability concerns given the city's income indicators;
- Ongoing economic and population recovery, which are helping SWBNO spread its fixed costs over more customers and further the natural economies of scale that benefit large systems; and
- Financial performance that has been remarkably stable despite regulatory mandates, natural disasters, the recession, and declines in the number of metered accounts.

A consent decree-driven capital improvement program (CIP) and below-average but improving income indicators are factors that currently restrict a higher rating.

The water system took much longer than the sewer system to achieve structural cash flow balance, even at times predicated on the FEMA (Federal Emergency Management Agency) or other reimbursements for help. Fiscal 2013 debt service coverage (DSC) for the water system was, by Standard & Poor's calculations, just over 1.3x, the first time in years that cash from operations provided coverage above sufficiency levels without the benefit of extraordinary nonoperating revenues. Conversely, the sewer system has consistently seen DSC of 1.5x or better without any reliance on cash infusions. With 24 months of capitalized interest on the series 2014 bonds (but none for the series 2015 bonds), the rate increases should not only allow the sewer system to sustain its solid margins but also build reserves even further, including its designated funds. Part of the policies and targeted metrics established by SWBNO include setting rates to achieve at least 1.5x annual DSC on senior-lien debt. Even with a small amount of post-Katrina Gulf

Opportunity Zone ("GOZone") subordinate-lien bonds still outstanding, it is our opinion that total DSC, not just the senior lien, is likely to remain above 1.5x throughout the forecast period.

System liquidity has been, in our opinion, thin at times but improving and currently solid. We expect continued improvement, because cash reserves are an explicit focus in management's financial plan. Following the 2005 hurricanes, the sewer system had a stronger available cash balance than the water system. As such, the water system began heavy inter-fund borrowing, which significantly constrained cash flow and working capital balances of the sewer system; by fiscal 2013, the water system had substantially repaid the sewer system those borrowings. For fiscal 2014, the sewer system's cash balances of almost $22 million were equivalent to more than five months of operating expenses, not even including designated but available reserves that the system continues to build. A part of management's financial policies established in concert with the 2014 general resolution calls for an operating reserve of at least 90 days of operating expenses, and overall liquidity equal to at least 180 days. The flow of funds is closed, precluding any transfers to the general government save for some legacy post-storm reimbursements to the public works system that are scheduled to be repaid within a few years. The SWBNO also has a long history of fully funding its annual required pension fund contribution, thus avoiding some of the more difficult budgetary situations facing the city's general government, especially its uniformed public safety workers.

Much of the improvement in coverage is due to a rebound in customer accounts. Where the pre-Katrina number of accounts was once in excess of 140,000 before falling to as low as 100,000, that has rebounded to about 128,000 currently. New Orleans' pre-storm population estimate was about 455,000, many of whom were lifelong residents who did not follow the steady exodus to the suburbs and elsewhere since the U.S. Census peak of 627,000 in 1960. Pre-Katrina, the city had about 10.1 million visitors and tourists, over 40,000 businesses, and about $3 billion in construction activity. Post-Katrina, New Orleans saw over 100,000 residential units damaged or destroyed, a sharp drop-off (but quick rebound) in tourism, and difficult choices by the general government to reduce staffing as its revenues ebbed. In recent years, the city has seen its:

- Taxable assessed value (AV) increase and later surpass pre-Katrina levels;
- Population steadily return to almost 85% of the pre-storm levels, as the 2014 estimated population was 384,320, and the city has ranked among the fastest-growing cities in the U.S. since 2010;
- Tourism sector recover, as measured by airport, hotel, and convention activity; and
- Sales tax revenues grow strongly, spurred in part by recovery of existing commercial activity as well as new additions to the retail base.

The sewer system is not dependent on any of its principal customers for operating revenues even with the entry of some major new employers after the recession, led by a very large medical campus downtown, several large high-tech ventures, and growth in the energy sector, although the latter two have leveled off sharply since 2014.

Despite the rebound, median household effective buying income (MHHEBI) for the metropolitan area is $29,239, or 70% of the U.S. The unemployment rate of 6.1% as of September 2015 is in line with the state's, but above the nation's, reflecting the volatility in oil and gas exploration and production, as well as the technology sector volatility. Although MHHEBI has been improving along with the recovery, an increasingly important credit factor is ensuring that cash from operations is not impeded by residents' ability to pay.

In 2014, and updated for 2015, management completed several system studies, including a needs assessment study and financial feasibility evaluation. This provided third-party validation that the collection system continues to be major driver of the system's operational--and therefore financial--requirements. The system remains under a consent decree with date-certain timelines on most projects to address primarily sanitary and combined sewer overflows. Management has been successful in meeting all major milestones for projects already initiated, and in 2014 was able to modify the consent decree to get much of the timeline extended by seven years, to 2025. Certain projects must still be completed by March 31, 2018, but thus far management has demonstrated the ability to manage such a large, multifaceted capital plan. Significant amounts of federal cost-sharing will help lessen the near-term impact of debt funding, helping the overall financial risk profile retain ample financing flexibility, which we view as critical to maintaining the rating. However, management is not assuming any additional federal aid beyond that which has already been committed. Therefore, management intends to fund the planned capital commitments through fiscal 2020 alone of roughly $454 million in water and $421 million in sewer projects mainly with debt or internally generated revenues.

While substantial, the investments are expected to help reduce an extraordinarily large non-revenue water percentage, which has averaged over 70% of total pumped water. Not all of that is "lost" water that is unaccounted for; much of it is for line flushing and other public health purposes but is nevertheless deemed non-revenue water and is therefore associated with a foregone revenue opportunity. However, leak detection is an ongoing part of capital maintenance, and a comprehensive meter replacement program is also included in the near-term CIP. Increasing the billed water percentage has the effect of growing operating revenues without increasing rates, which--while not assumed by management in its forecast--we expect should also help boost the net revenues available for debt service. This is also relevant to the sewer system as the volumetric portion of the sewer bill is tied to water consumption.

The 2014 general resolution permits additional bonds with DSC of 1x maximum annual debt service (MADS) on the existing plus proposed parity debt, although a recent rate increase may be considered toward that requirement. We understand SWBNO will borrow an average of $55 million annually through the remainder of the decade, with plans for internally generated funds to contribute about $5 million per year for infrastructure reinvestment. Federal cost sharing could lessen future borrowings, but SWBNO management is not assuming additional money beyond that which has already been committed, and has therefore budgeted accordingly.

In 2012, the governing entities of the SWBNO (city council, the Board of Liquidation, and SWBNO's own board) came to a consensus agreement to support preapproved, across-the-board rate increases of 10% on each January 1 from 2013 through 2020. Currently, a monthly residential water and sewer bill is $84, or 3.4% of MHHEBI, using Standard & Poor's assumption of 6,000 gallons of service; actual average bills are much less given the area's typical rainfall patterns and lack of residential-driven peaking, including minimal outdoor watering. However, we apply this uniform assumption to all utilities for better rate comparability. We view the support for rate adjustments as favorable to credit quality. A change in SWBNO's structure, as well as the far-reaching efforts to gain support for the 2012 rate adjustments, helped depoliticize the discussion and should lend continuity toward financial consistency. The voter-approved board changes, which became effective in 2014, reduced the size of the board and created eight citizens among the total 11-member board (the city's mayor and two Board of Liquidation members fill out the membership), who now are limited to two four-year terms. The Board of Liquidation is continuing in its role as essentially acting as the debt service trustee.

The series 2015 and 2014 bonds, the only senior-lien debt outstanding, are secured by a first-lien pledge on the net revenues of SWBNO's sewer system. A reserve in the amount of maximum annual debt service (MADS) requirements, funded with bond proceeds, provides additional liquidity. We understand that bond proceeds will be used mainly to refund all existing senior-lien sewer debt, as well as providing some additional funds for new projects. The rate covenant established by the new 2014 general resolution requires SWBNO to maintain annual coverage of at least 1.25x on this lien and total DSC of at least 1.1x; balances in a rate stabilization fund are permitted to provide up to 0.25x of the senior-lien rate covenant's calculation. Although a rate stabilization reserve is a long-term goal for the sewer fund, there is no minimum required balance; any surplus net revenues not already allocated for pay-as-you-go funding may eventually flow to this designated reserve, but management currently has no specific plans to build or maintain any such balance. We understand bond proceeds will fund projects in the sewer system's capital improvement program.

Outlook

The stable outlook reflects our expectation that the sewer division is in the early stages of a very capital-intensive period, but given the pre-approved rate increases and the continued slow, steady revival of the metropolitan area economically and demographically, it is our view that the additional debt can be added without weakening the sewer division's financial risk profile.

Upside scenario

Although we don't expect upward rating movement within our two-year outlook horizon, should the system further add to and maintain reserves in line with management's preferred minimums, and manage the large capital plan on time and within budget, we could raise the rating again.

Downside scenario

Downside risk would be associated with the challenges of managing a large CIP to ensure critical projects stay within the budget and timeline, as well as making inroads into the needs of the system, whether driven by environmental regulators or not. Should the size or scope of the system improvements become larger than expected--to the point where leverage would increase and DSC and cash reserves would decrease, all in a manner that would delay, halt or even reverse the financial improvements--we could lower the rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Water And Sewer Ratings, June 25, 2007
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 20, 2015

Ratings Detail (As Of November 30, 2015)		
New Orleans swg		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
New Orleans, Louisiana		
New Orleans Swg & Wtr Brd, Louisiana		
New Orleans (New Orleans Swg & Wtr Brd) swg (BAM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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