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Ratings

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Summary:

New Orleans
New Orleans Sewerage and Water Board; Water/Sewer

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Credit Profile		
US$215.0 mil taxable sewerage svc rev rfdg bnds ser 2021 due 06/01/2045		
Long Term Rating	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' rating to the city of New Orleans' $215 million taxable series 2021 sewerage service revenue refunding bonds, issued for the Sewerage and Water Board of New Orleans (SWBNO). The outlook is stable.

Debt outstanding includes the $10.25 million series 2020A bonds (not rated) placed directly with JPMorgan Chase Bank N.A., considered parity debt under SWBNO's general bond resolution. The sewerage system also supports about $40 million in loans--some of which were assumed from SWBNO's water and drainage systems--related to debt service assistance provided by the state of Louisiana in the years immediately after hurricanes Katrina and Rita; in 2019 the state amended the terms, permitting loan principal to be deferred through 2031.

The 2021 bonds are secured by a first-lien pledge on SWBNO's sanitary sewer system, and will be used to refund callable maturities of the sewer division's series 2014 and 2015 sewer bonds. SWBNO's allocation of an interlocal agreement of "fair share" non-operating revenues are considered grant revenues under the master resolution and available as part of pledged revenues, although excluded from the additional bonds test.

Additional liquidity is provided by a common debt service reserve, funded at the lesser of maximum annual debt service, 125% of average annual debt service, or 10% of the par amount. The rate covenant established by SWBNO's 2014 master resolution requires annual debt service coverage (DSC) to be at least 1.25x on the senior lien and 1.1x for all debt.

Credit overview

The rating is based on our opinion of the system's general creditworthiness, including what we view as strong enterprise and financial risk profiles.

The enterprise risk profile reflects our view of New Orleans':

- Economic fundamentals that have lagged the nation's recovery from the pandemic-related recession because of the city's outsize tourist and visitor employment sector;
- Decision about the future of rates and charges beyond 2021, and how to keep any adjustments affordable; and
- Regional leadership's strategic commitment to resilience planning not just to rebuild existing SWBNO infrastructure

but to do so in a manner that coincides with similar physical and social infrastructure programs undertaken by the general government.

The financial risk profile reflects our view of the system's:

- Financial performance that has been remarkably stable despite the consent decree, natural disasters, the 2008 and COVID-19 recessions, a sharp population decline, and--in 2020--severely diminished nonoperating revenue;
- Liquidity that has remained reasonably strong, even as it has been the source for interfund loans from time to time; and
- Financial management practices and policies that we deem good.

The stable outlook reflects our expectation even as the sewer system is in the midst of a very capital-intensive period, with potential additional investments likely necessary even after the consent decree requirements are completed, that management seems committed to a long-term vision regarding both a well-defined capital improvement plan (CIP) and how to pay for it while still balancing affordability sensitivities. S&P Global Ratings' focus is on SWBNO's long-term financial forecast, which we expect to be publicly available later in 2021. The sewer division--and in fact also the water and drainage systems--have substantial rehabilitation and renewal needs that will only be possible to address should the requisite financial resources align themselves.

Environmental, social, and governance factors

SWBNO is a partner, along with the city, local higher education institutions, the federal government, and a number of private sector participants, in the Resilient NOLA master planning effort to identify and collaboratively implement resilient physical and social infrastructure. The plan comprehensively aims to include renewals and replacements of SWBNO's aging drainage, water distribution, and sewer collection systems. SWBNO's CIP specifically includes more than $600 million in planned investments over the next 10 years to modernize its electric equipment; some of its infrastructure is too old to effectively interconnect with Entergy New Orleans, leaving SWBNO to self-generate power to satisfy some of its total electric load. We view these goals as positive for all three SWBNO divisions, with the potential to increase reliability, reduce its carbon footprint by way of less use of old and inefficient generating assets, and measurably lower certain of its operating costs. More importantly, the Resilient NOLA plan contains both adaptation and mitigation efforts, specifically for wetlands restoration, addressing subsidence, and investing in infrastructure more efficiently, such as mutual efforts by SWBNO and the city public works department's "joint infrastructure recovery request."

The social infrastructure plan includes implementing programs to improve workforce participation, public health, and household financial independence, as well as expanding access to affordable housing. The plan also notes that improved mass transit and transportation infrastructure would, in the workgroup's view, be critical to connect labor force participants with employment opportunities. Although overall economic development and other socioeconomic measures typically take many years, we note that these could be positive for credit quality as well, given that our criteria assess within economic fundamentals such metrics or trends as population, income indicators, and poverty rate, as well as the rate of growth of the local economy relative to that of the U.S. Measurable improvements in one or more of these could help improve the enterprise profile.

The management and governance structure of SWBNO, which includes the Board of Liquidation that effectively acts as trustee for the city's and SWBNO's debt, has generally been supportive of credit quality. In addition to the Resilient NOLA strategic plan and the 2013-2020 preapproved rate adjustments, leadership has generally seen the 2005 hurricanes as an opportunity to work toward addressing a massive backlog of deferred maintenance. In 2019, the city and other partners adopted a Resilient New Orleans 2050 plan to identify the city's existing strengths, as well as what it needs to do to adapt to climate change and socioeconomic and demographic changes over the next 30 years. Given the sheer scope of needs, we would expect that enacting this would most likely take a decade or more and still be subject to maintenance of ongoing financial capacity and willingness, but it has the potential to eventually be a best-in-class example of overall resilience and adaptation.

Stable Outlook

Downside scenario

If, as S&P Global Economics projects, credit conditions for all governments and their related utilities face headwinds in 2021 such as elevated unemployment because of an uneven and slow recovery, this could increase the likelihood of unfavorable variances to budget. The biggest risk to the rating would be if all-in DSC, as we calculate it, were to re-set at a level that approximates the rate covenant of 1.1x (for all liens). We could also lower the rating if there appears to be a pattern of deferred maintenance, as indicated by the board addressing only capital needs that the system can afford, not those which it truly needs to do. Barring outright and ongoing subsidization, we do not view the sewer system's credit fundamentals to be constrained by the other SWBNO systems' thinner financial performance or periodic need for interfund loans, as this is more broadly indicative to us of the sheer magnitude of capital needs of all of SWBNO's three systems.

Upside scenario

Although we don't expect to raise the rating within our two-year outlook horizon, we would look to long-term capital and financial plans to help inform our forward-looking view as to whether the currently strong financial profile is sustainable through and beyond the consent decree-driven projects given our expectation that additional debt is likely.

Credit Opinion

Enterprise risk

SWBNO provides drinking water, sanitary sewer service, and drainage infrastructure to almost 400,000 people in the city, which is still below the pre-storm population estimate of 455,000. The repopulation of the city has remained very slow, but steady. The pre-Katrina number of accounts once exceeded 140,000, before falling as low as 100,000; SWBNO has approximately 135,100 active accounts, an increase of 1.3% per year from 2016 to 2020. The resurgence has been led not just by the return of longtime residents but by growth in a number of different employment sectors. Leisure and hospitality related to tourism, maritime, and upstream energy continue to underpin the economy. Still, much of Louisiana, including the New Orleans metropolitan statistical area (MSA), has added new technology sector jobs. DXC Technology, a digital media company, opened a digital transformation center in 2019, and expects to hire 2,000 employees in the next several years as the economy continues to rebound. In addition, technology companies such as iMerit, Fortive, and DreamLeague Gaming have come to the city in recent years. According to IHS Markit, the professional services sector has also grown and now accounts for 14.5% of total employment, almost equal to the very hard-hit leisure and hospitality sector (15.8%). The added diversity and growing importance of such sectors could be a significant opportunity for an MSA for which median household effective buying income (MHHEBI) is still only 71% that of the U.S. As of November 2020, the unemployment rate for the MSA was still an elevated 10.1%. The water system is not overly dependent upon any of its principal customers for annual operating revenues.

In conjunction with the series 2020 bonds, SWBNO completed a financial feasibility study as well as a consulting engineer's report, both of which pointed to the need to address future capital budget needs as well as operating budget challenges such as personnel vacancies caused by retirements and a mismatch between staff needs and the available labor pool, all of which are not unique to New Orleans. These reports 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 achieve a third modification to the original consent decree to get much of the timeline extended by seven years, to 2025. SWBNO was able to close out those projects that still had to be completed by 2018; thus far, management has demonstrated the ability to oversee such a large, multifaceted capital plan.

To help support the consent decree and overall backlog of renewals and replacements, New Orleans leadership in 2012 preapproved annual across-the-board rate adjustments for both water and sewer by 10% per year, the last of which went into effect Jan. 1, 2020. This puts the average single-family residential sewer bill at about $77, or a relatively high 2% of MHHEBI using S&P Global Ratings' universal assumption of 6,000 gallons of service. When combined with the water bill of $56, the typical residential bill of more than $130 is closer to 4.2% of MHHEBI; actual average consumption, however, is much lower. Still, in our view, this could limit future headroom given the 26% poverty rate for Orleans Parish. Even a 2019 qualified independent consultant report triggered by the water system's DSC deviation noted that, "With the 10% rate increases and customer demographics that include substantial number of customers below 200% of the poverty line, affordability is a growing issue for the board." SWBNO has for years had means-based and other customer-assistance programs in place. For COVID-19-related health and safety reasons, SWBNO's moratorium on shutoffs and disconnections is still in place.

Based on our operational management assessment, we view SWBNO to be a '3' on a scale of 1-6, with '1' being the strongest. An assessment of good, in our opinion, implies that overall alignment between the system's operational characteristics and its management is sufficient but not comprehensive. Although we note, for example, that management continues to make progress toward the terms of the third modification of consent decree and has hit all major milestones thus far, substantial collection-system improvements still remain to address before the ultimate deadline of October 2025. SWBNO has had some turnover among upper management in recent years, attributable to both retirements and some higher-profile operating failures of the drainage system. We do not view the turnover to be impactful to credit quality unless it were, in our opinion, to create difficulty in maintaining public confidence and support for the system's financial needs.

Financial risk

The overall financial performance of the sanitary sewer system has, generally, been consistent and good, even if less strong over the past several years as debt service requirements have ratcheted up. SWBNO received an independent opinion that certain expenses in fiscal 2018 were deemed extraordinary and nonrecurring--almost $10 million for the sewer system--boosting all-in DSC for that year to 1.4x. The expected bounce-back in fiscal 2019 was evidenced by DSC of 2.8x. Because of the moratorium on shutoffs and disconnections, SWBNO disclosed a total of about $6 million in fiscal 2020 of uncollected accounts of at least 60 days. All-in DSC is S&P Global Ratings adjusted DSC metric that takes into account all long-term financial obligations of the utility system regardless of lien or accounting treatment. The sanitary sewer system does not make a payment in lieu of taxes to the general fund nor does it have any off-balance-sheet debt but does still carry about $36.5 million in debt service assistance fund loans payable to the state, stemming from the 2005 hurricanes.

The drainage system, which receives funding for both operations and capital improvements from the ongoing levy of a limited tax, had some high-profile operational failures in 2017 and even into 2018. To accelerate repairs and improvements, the drainage system depleted much of its available reserves, eventually having to execute interfund borrowing agreements with other SWBNO systems. The fair-share agreement provided an immediate influx of $51.45 million to the city and to SWBNO. The fiscal 2020 budget originally assumed about $12 million in ongoing cash inflows from this nonoperating revenue, although because of the pandemic actual revenues were a fraction of that; the fiscal 2021 budget did not assume any meaningful rebound. The intended use of the fair-share revenues is earmarked to help provide ongoing money for the drainage system to repay the interfund loans over three years, and also to provide additional much-needed capital dollars for the drainage system. We view a path for the drainage system's self-sufficiency as related, but not necessarily material to the credit quality of the water or sewer systems. For fiscal 2020, SWBNO management is estimating that the sewer system ended with $46.8 million in available reserves, or equivalent to 171 days of operating expenses.

The larger challenge for the long term will be the continued renewal of the collection system. SWBNO continues to make excellent progress toward addressing the consent decree; about 80% of the total program costs are already complete or committed; about $109 million of additional projects remain. The five-year sewer CIP through 2025 lists $432 million in projects, as well as an almost equal number for infrastructure common to all three utilities, such as a power system that needs to be almost completely modernized. We anticipate that management will consider all financing options as part of the overall sources of funds toward the CIP--including consideration of a Water Infrastructure Finance and Innovation Act loan--but that at least some additional debt is likely. The SWBNO also has about a $97 million unfunded pension liability based on the most recently completed actuarial valuation, with an overall funded position of 71%.

Based on our financial management assessment (FMA), we view SWBNO to be a '3' on a scale of 1-6, with '1' being the strongest. An FMA of good indicates that the finance department, in our opinion, maintains adequate policies in most, but not all key areas. While we note, for example, that the management team has what we view as excellent continuing disclosure, an updated financial forecast was not available for this rating review, deferring in part to the completion of next year's rate study. SWBNO has a covenant to maintain reserves equivalent to at least 180 days of operating expenses, and monitoring of year-to-date intra-year financial performance occurs monthly, and is posted to the Board of Liquidation's website. SWBNO also has an internal policy to repay interfund borrowings between utility divisions over three years.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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