S&P Global Ratings

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Summary:

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

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Credit Profile		
US$200.0 mil taxable wtr rev rfdg bnds ser 2021 due 06/01/2045		
Long Term Rating	A-/Stable	New
New Orleans, Louisiana		
New Orleans Sewerage & Water Board, Louisiana		
New Orleans (New Orleans Swg & Wtr Brd) wtr (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
New Orleans (New Orleans Swg & Wtr Brd) WTRSWR		
Long Term Rating	A-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A-' rating to the city of New Orleans' $200 million taxable series 2021 water revenue refunding bonds, issued for the Sewerage and Water Board of New Orleans (SWBNO). At the same time, S&P Global Ratings affirmed its 'A-' rating on the system's approximately $189.9 million in water system senior-lien revenue bonds outstanding. The outlook is stable.

The 2021 bonds are secured by a first-lien pledge on SWBNO's waterworks system, and will be used to refund callable maturities of the water division's series 2014 and 2015 revenue 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:

- Long-term trend of adequate financial performance despite 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; and
- Financial management practices and policies that we deem good.

We have recognized that certain extraordinary expenses altered the income statement in recent years, which required the exercise of clauses of the 2014 general bond resolution that allows for adjustments to operating revenues regarding recently enacted rate adjustments to avoid a covenant violation. The accounting treatment for these, which was independently reviewed by SWBNO's external auditor, agrees with the utility's management team that these were attributable to nonrecurring weather events. S&P Global Ratings' focus is instead on SWBNO's long-term financial forecast, which we expect to be publicly available later in 2021. The water division--and in fact also the sewer and drainage systems--have substantial rehabilitation and renewal needs that will only be possible to address should the requisite financial resources align themselves. We anticipate those financial resources will include periodic additional borrowing, in addition to the remaining commitments from the Federal Emergency Management Agency (FEMA). An interlocal agreement to share visitor-related revenues will help SWBNO as well, although because of the pandemic that revenue stream has for now collapsed.

The stable outlook reflects our view that the management team seems to remain 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.

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.

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 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 2021 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, none of which are unique to just New Orleans. These reports provided third-party validation that the water distribution infrastructure continues to be major driver of the system's operational--and therefore financial--requirements.

To help support an overall backlog of renewals and replacements across all divisions, 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 water bill at almost $56, or 1.8% of MHHEBI using S&P Global Ratings' universal assumption of 6,000 gallons of service. When combined with the sewer bill of about $77, 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, driven by the pre-approved rate adjustments. 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. For example, water losses are extremely high. As part of addressing this, management will kick off the first phase of an advance metering infrastructure program later in 2021, with pipe replacements an ongoing, prioritized program in the capital plan. 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 water system has, generally, been sawtoothed, with deviations in DSC generally reflecting the city's exposure to weather-event risks. S&P Global Ratings notes that without the accounting adjustments that benefited the income statements for fiscal years 2018 and 2017, all-in DSC would have been less than 1.0x. 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 water sewer system does not make a payment in lieu of taxes to the general fund nor does it have any off-balance-sheet debt.

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. Management has estimated that the water division ended fiscal 2020 with about $22 million in available reserves, equivalent to 97 days of operating expenses. The feasibility report associated with the series 2021 bonds forecasts generally three to four months of cash on hand over the next five years, assuming 2% per year rate adjustments beginning in 2022.

The larger challenge for the long term will be the continued renewal of the distribution system; two-thirds of it pre-dates 1960. The five-year CIP through 2025 has a total of $548 million in water projects identified. That total does not include about the same amount 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. 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%.

The separately rated SWBNO sewerage system, in addition to its own revenue bonds, 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. However, we understand that the water division is not required to reimburse the sewer division for those loan repayments and we are therefore not adjusting our financial metrics for them.

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

Ratings Detail (As Of January 27, 2021)

Ratings Detail (As Of January 27, 2021) (cont.)		
New Orleans, Louisiana		
New Orleans Sewerage & Water Board, Louisiana		
New Orleans (New Orleans Swg & Wtr Brd) wtr (AGM) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
New Orleans (New Orleans Swg & Wtr Brd) wtr (BAM)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
New Orleans (New Orleans Swg & Wtr Brd) wtr (BAM) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
New Orleans (New Orleans Swg & Wtr Brd) wtr (MAC)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.