

S&P Global
Ratings

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Narragansett Bay Commission, Rhode Island; Joint Criteria; Water/Sewer

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Table Of Contents

Rationale

Outlook

2008A Structural Analysis

Related Criteria And Research

Narragansett Bay Commission, Rhode Island; Joint Criteria; Water/Sewer

Credit Profile

Narragansett Bay Comm		
<i>Long Term Rating</i>	AAA/A-1+	Affirmed
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AA-' underlying rating on Narragansett Bay Commission (NBC), R.I.'s outstanding wastewater system revenue bonds, based on our view of NBC's very strong enterprise and financial risk profiles. The outlook is stable.

We also affirmed our 'AAA/A-1+' rating on the commission's series 2008A wastewater system revenue refunding bonds.

The 'AAA' long-term component of the 2008A rating is based on the joint support provided by NBC and TD Bank N.A. (AA-/Stable/A-1+) in the form of a letter of credit (LOC) at a low correlation level between the two supporting parties, and reflects our opinion of the likelihood that bondholders will receive interest and principal payments when due if they do not exercise the put option. The 'A-1+' short-term component of the rating is based on the short-term issuer credit rating (ICR) on TD Bank and reflects our opinion of the likelihood that bondholders will receive interest and principal payments if they do exercise the put option.

Today's rating action follows the substitution of the LOC previously provided by U.S. Bank N.A. (AA-/Stable/A-1+) with a new LOC from TD Bank. The LOC fully supports all bond payment obligations when the bonds are in the weekly interest mode (covered mode). Therefore, our rating applies only during the covered mode. If the bonds are converted to any other interest rate mode, we may withdraw our rating (See the "Structural Analysis" section below for more information). The LOC is scheduled to expire on July 7, 2021, unless terminated beforehand or extended pursuant to its terms.

The enterprise risk profile for the underlying rating reflects our view of the system's:

- Service area participation in the broad and diverse Providence-Warwick metropolitan statistical area (MSA);
- Rates that we generally view as affordable when benchmarking against Providence County's median household effective buying income (MHHEBI) and poverty rates; and
- Strong operational management practices and policies.

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

- Financial metrics that include debt service coverage (DSC) of at least 1.25x and a days' cash equivalent of around 130-150 days' cash; and
- Good-to-strong financial management practices and policies.

Our underlying rating also reflects our view that the credit profile benefits from the following:

- A long history of credit-supportive rate decisions by the Rhode Island Public Utilities Commission (PUC), an independent state-level body. NBC management indicates that it communicates with the PUC on a regular basis and also informs it of planned rate increases for future fiscal years. We would expect the commission to continue its regular communications with the PUC to seek timely rate approvals.
- A large service base that extends beyond the city of Providence into much of the surrounding MSA.

Debt service on NBC's bonds are payable from the revenues of the commission, which are on parity with Rhode Island Infrastructure Bank (RIIB) loans. We consider the pledge a net revenue pledge since monthly deposits for operating and maintenance expenses are made prior to debt service. Other bond provisions include the following:

- A covenant to set rates that generate an amount that represents at least 125% of annual debt service on the parity revenue bonds and 135% on RIIB loans;
- An additional bonds test requiring estimated net revenues for the three years following the issuance of bonds to be at least 1.25x the debt service requirement for revenue bonds and 1.35x the debt service requirement for (RIIB) loans; and
- A debt service reserve requirement that is flexible for each series of revenue bonds, but is generally set pursuant to the trust indenture at the lesser of 10% of par, 125% average annual debt service, maximum annual debt service (MADS), or the maximum permitted by federal tax law without requiring yield restriction.

NBC was established in 1980 and owns and operates two wastewater treatment facilities that serve 10 communities of approximately 360,000 residents and 8,000 businesses in northeastern Rhode Island, primarily Providence and Pawtucket. The commission does not have any taxing authority; its revenues derive from user charges.

The commission operates two treatment plants, which treat roughly 70% of the state's sewerage and serve more than one-third of its population. Field's Point has a dry-weather capacity of 65 million gallons per day (mgd) and a wet-weather capacity of 200 mgd. Bucklin Point is the second-largest wastewater treatment facility in Rhode Island, and its wet-weather treatment capacity was recently upgraded to 116 mgd. Systemwide average daily flow of 64 mgd is well below capacity.

The commission's 10 leading customers consist primarily of colleges, universities, hospitals, and cities, and this list has remained stable in recent years. These top 10 represent just 8.6% of operating revenues in fiscal 2016, which we consider a diverse customer base.

The commission's capital improvement plan is large, at \$354 million over the six years from 2017 through 2022. The majority of this amount--\$270 million or 86%--is for phase III of the combined sewer overflow (CSO) projects. The largest amounts of capital spending occurs in 2021 and 2022 as NBC fully transitions to phase III of its CSO plan.

About 60% of the commission's outstanding debt (as of June 30, 2015) is low-interest state revolving fund debt. About 10% (\$56 million) of the commission's \$589 million of debt and RIIB outstanding loans on June 30, 2015 is variable-rate debt. The commission is not engaged in any interest-rate swaps.

Enterprise and financial risk profile details

We benchmark our analysis of market position, which is an input to the enterprise risk profile, to both MHHEBI and the county poverty rate. MHHEBI for Providence County is 93% of the national average. Although monthly-equivalent

water and sewer rates are \$46.48 for 800 cubic feet of usage, which is our standard benchmark for monthly consumption, when considering that the county's poverty rate is close to 20%, our view of the market position is somewhat more negative compared to a situation where a utility has both lower nominal rates combined with a lower poverty rate. Our methodology measures affordability for not only the median household, but also takes into account sensitivity to rate affordability based on the county poverty rate. But as mentioned above, our rating reflects our understanding that the service base extends well beyond the city of Providence, which would likely lead to greater rate affordability metrics if the entire service base was considered.

Rate increases for both general rate base increases as well as compliance rate increases to comply with debt covenants both require PUC approval. The most recent rate increase of 1.5% will be effective July 1, 2016; the additional revenues will be used to support additional debt service costs. The commission reports that the average residential rate for its customers is still competitive with other residential systems in the state.

All of the other components of the very strong enterprise risk score reflect the broad and diverse economic base, as well as operational management policies that indicate to us the existence of generally strong internal governance and controls and asset management policies.

The strong financial risk score reflects DSC being no less than about 1.25x and unrestricted liquidity ranging between about 130-150 days' cash equivalent. The commission's financial performance remains strong, in our opinion. For audited years 2009-2015, net revenues covered debt service by at least 1.25x; for the fiscal year ended June 30, 2015, coverage was 1.4x. Also, unrestricted cash has not dropped below a level representing 134 days' operating expenses since 2009, and it was at 157 days in 2015 (equivalent to \$16.0 million). For fiscal 2016, management does not anticipate major deviations from these trends.

Also supporting the financial risk profile is the "strong" financial management assessment, indicating that, in our view, financial practices are strong, well embedded, and likely sustainable. Examples include the existence of long-term capital planning, formal investment and debt policies, and monthly review of budget performance by the commission.

Outlook

The stable outlook on the underlying rating reflects our expectation that the strong financial performance, given a good history of credit-supportive rate decisions by the PUC, will continue. The outlook on the 2008A bonds is not meaningful.

Downside scenario

If, for some reason, future rates do not generate sufficient revenues to help maintain this strong financial performance, we could lower the underlying rating.

Upside scenario

Conversely, if the strong performance continues, combined with a steady reduction in debt needs, we could raise the underlying rating. However, given that these debt and capital reductions have a time horizon that extends beyond the two-year outlook, we believe the likelihood for upward rating movement is higher after this two-year period.

2008A Structural Analysis

When evaluating the bonds, S&P Global considers various risk factors, as described below.

LOC coverage for the covered modes

The LOC covers 60 days of interest accruals at the maximum interest rate described below, plus the entire bond principal amount. We believe the LOC coverage is sufficient to pay interest and principal while the bonds are in the covered mode, even assuming maximum interest rate accruals.

Interest rate mode changes

In addition to the covered mode, the transaction documents provide that the bonds may be converted to the daily, fixed, long-term, and short-term interest rate modes (uncovered modes). While the bonds are in these uncovered modes, except for bonds in the daily mode, a put option is not available. Furthermore, we believe the LOC provides enough interest coverage to account for the additional days of interest that would accrue between interest payment dates during the weekly interest rate mode, accounting for the 10-day interest reinstatement period and any duration that may elapse before the bonds are subject to mandatory tender, should an event of default occur under the reimbursement agreement. However, we do not believe there is any conversion-related risk of a put option loss or an interest shortfall to covered mode bondholders because the bonds are subject to a mandatory purchase at par plus accrued interest before the rate mode can be changed.

Ratings sensitivity

In view of the bond structure, changes to our rating on the bonds in the covered modes can result from, among other things, changes to our rating on the obligor and the LOC provider or amendments to the transaction's terms. We will maintain a jointly correlated rating on the bonds as long as they are in the covered mode and the LOC has not expired or otherwise terminated. If either of these conditions changes, we will likely revise our rating on the bonds.

Other call provisions

During the covered modes, bonds are subject to mandatory and optional redemptions. In all cases, the redemption price will at least equal par plus accrued interest, and the repayments are backed by both the obligor and the LOC provider.

Related Criteria And Research

Related Criteria

- USPF Criteria: Rating Methodology And Assumptions For U.S. Municipal Waterworks And Sanitary Sewer Utility Revenue Bonds, Jan. 19, 2016
- General Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015
- General Criteria: Methodology And Assumptions For Rating Jointly Supported Financial Obligations, May 23, 2016
- 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

Ratings Detail (As Of July 6, 2016)

Narragansett Bay Comm wastewtr sys rev bnds

Long Term Rating

AA-/Stable

Affirmed

Narragansett Bay Comm (MBIA)

Unenhanced Rating

AA-(SPUR)/Stable

Affirmed

Narragansett Bay Comm wstwtr

Unenhanced Rating

AA-(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

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