

FITCH RATES NEW YORK CITY MUNI WATER FINANCE AUTHORITY'S \$435MM REVS 'AA+'

Fitch Ratings-New York-29 November 2012: Fitch Ratings has assigned an 'AA+' rating to the following water and sewer system second general resolution (SGR) revenue bonds for the New York City Municipal Water Finance Authority (NYW):

--Approximately \$435 million, fiscal 2013 series BB.

The fiscal 2013 series BB bonds are scheduled for negotiated sale on December 4. Proceeds will provide funds for the authority's ongoing capital program and retire outstanding commercial paper notes.

In addition, Fitch has affirmed NYW's outstanding bonds as follows:

--\$8.2 billion first general resolution (FGR) revenue bonds at 'AA+';

--\$20.1 billion SGR revenue bonds at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The SGR bonds are special obligations of NYW, payable solely from and secured by a subordinate lien on gross revenues of NYW. FGR bonds are secured by a first lien on gross revenues of NYW. The bonds currently being issued will not have a debt service reserve fund.

KEY RATING DRIVERS

SOUND LEGAL PROTECTIONS: NYW's primary credit strength is its legal structure, including its status as a bankruptcy-remote issuer, providing substantial protection to bondholders from potential operating risks associated with the utility system and New York City (the city).

REGIONAL PROVIDER OF AN ESSENTIAL SERVICE: The combined system provides an essential service to a large and diverse service area and benefits from an abundant, high-quality water supply exempt from expensive filtration requirements and transmission costs.

WELL-MANAGED CAPITAL PROGRAM: Sophisticated capital planning efforts have helped achieve compliance with large, costly, mandated regulatory projects aiding the timely implementation of the large capital improvement plan (CIP).

INDEPENDENT RATE-SETTING AUTHORITY: Strong financial management and a proven ability to independently raise rates are reflected in consistently solid financial results, despite some volatility in demand.

HIGHLY LEVERAGED SYSTEM: Debt levels are high as a result of having to comply with environmental mandates and maintain a large urban system and its aging assets. Sizeable debt plans programmed into the current capital plan will keep debt levels elevated for the long term.

IMPROVED COLLECTIONS: Below-average collection rates persist, although the implementation of payment incentives and strong enforcement mechanisms have yielded positive results in recent years.

WHAT COULD TRIGGER A RATING ACTION

MAINTENANCE OF SUFFICIENT RATES: Failure to achieve rate hikes sufficient to ensure adequate financial margins and maintain current debt service coverage levels on senior and

subordinate lien obligations would be viewed negatively.

DEBT LEVELS EXCEEDING PROJECTIONS: Escalation of debt levels beyond what is currently included in the five-year financial forecast.

CREDIT PROFILE

SOUND LEGAL PROTECTIONS

Fitch believes NYW bondholders benefit from strong legal protections that include:

- Revenues collected in a lock box structure and controlled by the trustee and used to pay debt service of FGR and SGR bonds before operations and maintenance (O&M);
- The bankruptcy-remote, statutorily defined nature of the issuer;
- Ownership of system revenues by the bankruptcy-remote New York Water Board, which sets rates without city council approval;
- Legal covenants that require adjustment of water and sewer rates sufficient to provide at least 1.15 times (x) coverage of FGR bond annual debt service and 1.0x coverage on SGR bonds and operating expenses.

These layers of protection serve to shield bondholders significantly from the operational risks of the city's massive water and sewer enterprise as well as other city government operations. NYW SGR bondholders benefit from similar legal protections afforded FGR bondholders. SGR bondholders' claim on gross revenues is subordinate only to FGR debt service deposits, NYW administrative costs, and FGR debt service reserve fund (DSRF) requirements.

Following such deposits, revenues flow from the subordinated indebtedness fund of the FGR revenue fund directly to the SGR revenue fund to pay SGR debt service deposits. Only after monthly required deposits under the SGR are satisfied and held by NYW's trustee are funds released from the lock box to pay operations and maintenance.

STRONG FINANCIAL AND DEBT MANAGEMENT

NYW's strong financial management and conservative budgeting continue to yield solid operating results, despite sizable growth in debt service obligations and volatility in consumption. Historically below-average collection rates have shown noticeable improvement with the ongoing use of a payment incentive program for delinquent customers, a reduction in the threshold applicable to accounts eligible for termination of service, and the reauthorization by city council to conduct a lien sale program for property owners independent of the existence of property tax liens.

Fitch considers the lien sale program a strong enforcement mechanism given the recovery of approximately \$287 million in delinquent accounts from 2009 - 2011 as a result of actual or pending lien sales. Fitch views positively city council's recent vote to extend the lien sale program through Dec. 31, 2014.

For fiscal 2012 the board adopted a more moderate rate hike of 7.5% versus annual increases that averaged a sizeable 12% over the preceding five fiscal years. Fitch notes that despite the recent rate hikes, NYW's user charges remain relatively affordable compared to other large cities and in relation to income levels throughout the service area.

The fiscal 2012 adopted rate hike was somewhat offset by a larger than budgeted decline in consumption, although financial results continued to outperform budgeted expectations. Year-end debt service coverage from net operating revenues improved to 4.5x and 1.8x on FGR and SGR debt service (7.5x and 3.1x reflecting the gross lien), respectively, compared to 3.2x and 1.5x in fiscal 2011.

Liquidity has been relatively stable over the last five years, averaging nearly 125 days cash on hand. The authority's prudent practice of carrying forward and applying any surplus generated in the prior year to the payment of debt service diminishes the need to the build-up of more robust cash balances. The net surplus generated in fiscal 2012, measured on a cash basis, totaled \$498 million.

IMPACT OF THE RECENT HURRICANE IS BELIEVED TO BE MANAGEABLE

Through the first four months of the current fiscal year consumption is reportedly down by almost 1%% compared to the same period in the prior fiscal year. Despite the variance, year-to-date revenues are reportedly up slightly compared to the adopted budget. However, the year-to-date results do not incorporate the impact of Hurricane Sandy, which prompted the termination of service or delay of billing to an estimated 1.2% of NYW's customers.

To date officials estimate the storm related damage is approximately \$95 million, consisting of \$56 million of operating and maintenance expenses and about \$39 million in damage to system assets. The majority of costs incurred by the system are expected to ultimately be reimbursed with Federal Emergency Agency Funds. In the interim, management reports that the revenue impact will be minimal at close to 1% of budgeted revenues, which Fitch expects will be manageable given the authority's satisfactory liquidity and conservative budgeting.

PROJECTED FINANCIAL RESULTS REMAIN SATISFACTORY

Financial projections through fiscal 2016 show a continuation of more moderate annual rate hikes, including an already adopted 7% for fiscal 2013 followed by 7.9% in fiscals 2014 and 2015, 8.7% in fiscal 2016 and 7.5% in 2017. The financial forecast incorporates significant annual debt issuance and reasonable assumptions that include the aforementioned increases in user charges, 3% annual increases in salary and wage adjustments, and a 1.5% decline in consumption in fiscals 2013 and 2014 followed by a 2% drop in 2016. As a result, ADS coverage on all obligations from net revenues is projected to remain at a satisfactory level of about 1.3x through the forecast period.

SUBSTANTIAL LEVERAGE

Similar to most large urban utility systems, NYW's capital needs are significant, principally the result of state and federally mandated projects. The CIP for fiscal years 2013 - 2021 includes an estimated \$11.4 billion in water and sewer projects, down from a peak of \$19.4 billion projected in the fiscal years 2008 - 2017 CIP. The relatively smaller CIP is primarily a result of costly regulatory projects beginning to decline to about one-fourth of total capital spending versus an average of about 75% over the latter part of the prior decade. Capital funding is expected to come almost entirely from NYW's extensive commercial paper program and long-term debt issuance.

Historical funding of mandated projects and the overall capital program of the system required a substantial amount of debt issuance over the last several years, leaving the system highly leveraged as a result. Continued escalation in debt levels could pressure the rating over the longer term. Rate increases are approved by the independent board without approval by the city council. Fitch believes the board's demonstrated commitment to raising rates as well as management's conservative budgeting will be key to preserving operating margins and meeting the continued growth in debt service costs included in NYW's financial forecast.

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by Creditscope and HIS Global Insight.

Applicable Criteria and Related Research:

- 'Revenue-Supported Rating Criteria'(June 20, 2011);
- 'Water and Sewer Revenue Bond Rating Criteria'(Aug. 10, 2011);
- '2012 Water and Sewer Medians' (Dec. 8, 2011);
- '2012 Outlook: Water and Wastewater Sector' (Dec. 8, 2011).

Applicable Criteria and Related Research:

Revenue-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681015

U.S. Water and Sewer Revenue Bond Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684901

2012 Water and Sewer Medians

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=657111

2012 Outlook: Water and Sewer Sector

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=657110

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