



RATING ACTION COMMENTARY

Fitch Affirms Metropolitan Water Reclamation District, IL GO Bonds at 'AAA'; Outlook Stable

Wed 23 Sep, 2020 - 3:09 PM ET

Fitch Ratings - New York - 23 Sep 2020: Fitch Ratings has affirmed Metropolitan Water Reclamation District 's (the District) 'AAA' Issuer Default Rating (IDR) and the 'AAA' rating on the following bonds:

--\$711.0 million unlimited tax bonds;

--\$1.1 billion limited tax bonds.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AAA' IDR and bond ratings reflect the District's very strong revenue defensibility and very low operating risks, particularly the District's ability to access the resource base of the favorable service area through its ad valorem taxing authority; the District does not collect a retail user charge. While the District's financial profile is assessed at 'a' given a net leverage

ratio, measured as net adjusted debt to adjusted funds available for debt service (FADS), approaching 12.8x in fiscal 2019, the additional enhancement to revenues afforded by the taxing authority supports the higher rating. The operating risk assessment incorporates the very low operating cost burden and life cycle ratio.

Fitch also assessed the District's leverage profile in the context of the service area's (Cook County) resource base. From this vantage, the District's long-term obligations approximate 1.4% of total personal income. When combined with the District's ability to levy taxes to pay debt service and operations, this expanded view of leverage further supports the District's overall rating.

Coronavirus Considerations

The outbreak of coronavirus and related containment measures worldwide creates an uncertain global environment for the water and sewer sector. The District is continuing to monitor the situation; it projects that revenue declines related to large user charges and personal property tax replacement will be mitigated by ongoing cost reduction measures. Fitch's ratings are forward-looking in nature. Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks as appropriate.

CREDIT PROFILE

The District is an independent unit of government focused on wastewater treatment, stormwater management and flood control, and related environmental sustainability. It encompasses over 90% of the land area and virtually all of the equalized assessed valuation (EAV) of Cook County (IDR of A+). The District provides wastewater treatment services to a population of 5.2 million people located in the city of Chicago and 129 suburban municipalities. The city of Chicago comprises just over 50% of the district's population and approximately 55% of the EAV.

The District collects wastewater from municipalities in its service area, conveys it to wastewater reclamation plants, provides full secondary treatment, and discharges clean water to local waterways. The District is also responsible for stormwater management for all of Cook County, including areas outside the District's boundaries for wastewater services. The District's total treatment capacity exceeds 2.0 billion gallons per day (BGD) and it treated an average of 1.47 BGD in fiscal 2019.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Revenue Defensibility Supported by Stable Revenues and Favorable Service Area

The District's favorable service area is broad and diverse, and includes the vast majority of Cook County. Ad valorem taxes are the District's primary source of revenue, insulating it from volatility associated with volumetric changes. While operating levies are generally limited by statute, the District retains strong revenue raising flexibility when viewed against the relative stability of this revenue source.

Operating Risks 'aa'

Very Low operating Cost Burden; Significant Capital Investment Supports a Low Life Cycle Ratio

The District's operating cost burden is very low, less than \$940 per million gallons treated, and reflects the significant economies of scale of District operations as well as its focused operating mandate. The life cycle ratio is just 4% and should remain low as the District continues to implement its still large, though moderating capital improvement program (CIP).

Financial Profile 'a'

Strong Financial Profile is Supported by the Ability to Access a Broad Resource Base

The District's leverage ratio reflects an historically significant and largely debt funded CIP. The District's revenue structure enables it capture the broad resource base of the favorable service area.

ASYMMETRIC ADDITIVE RISK CONSIDERATIONS

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--N/A given the 'AAA' rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Long-term liability burden as measured in the context of the resource base that no longer supports an enhancement to the financial profile;

--Downward revision in the revenue defensibility assessment, reflecting sustained economic contraction in the service area.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

SECURITY

The bonds are direct and general obligations of the District, the payment for which the full faith and credit of the District are pledged. The unlimited tax bonds are payable from ad valorem taxes levied upon all taxable property within the District without limitation as to rate or amount. The limited tax bonds are payable from ad valorem taxes levied upon taxable property within the District without limitation as to rate, but the amount of the taxes that may be extended to pay them is limited as provided by law.

In addition to the full faith and credit security provisions of all bonds, the 2014 series B and 2016 series E bonds are also payable from stormwater management tax receipts. The District is required to deposit into the debt service fund on or before the last business day of February of each year stormwater management tax receipts to pay debt service payments through the following Dec. 1. This funding must occur before the District may abate the direct annual tax levy also securing 2014 series B and 2016 series E bonds.

REVENUE DEFENSIBILITY

The District's revenue defensibility incorporates the favorable service area, which includes the majority of Cook County. Cook County median family income is marginally above national levels, as the wealthier suburban area offsets the urban core. The unemployment rate was 3.8% in 2019, in line with that of the nation (3.7%) and just below that of the state (4.0%).

The District does not levy a retail utility charge, instead funding debt service and the majority of its operating costs through ad valorem taxes. It also imposes incremental charges for large users, and receives Personal Property Replacement Taxes; which together accounted for 22% of fiscal 2019 General Corporate Fund revenues. Based on the District's total tax rate in fiscal 2019, the monthly charge is affordable for approximately 90% of the District's service area (assuming 6,500 gallons treated per month per user).

Although the District's ability to raise ad valorem taxes is limited for certain operations, it retains meaningful revenue raising flexibility in the context of the relative stability of this revenue, which largely insulates the District from revenue fluctuations related to changes in treated volumes. The District is not limited in its ability to levy taxes for debt service.

OPERATING RISKS

The District's operating risk is assessed at 'aa', reflective of both a very low operating cost burden and life cycle ratio, which is supported by ongoing capital investment. The District's service area is large, but its operational focus limits the likelihood of unexpected or significant cost increases driven by changes in the District's mandate or operational requirements.

Operating costs were less than less than \$940 per million gallons (MG) treated in fiscal 2019. Operating costs per MG reflect the approximately 1.5 billion gallons per day treated and nature of the District's operations. Operating costs are expected to grow in generally line with inflation. The District levies a separate tax for retirement costs that is separate from and in addition to other levies, which limits the impact on funding for operations.

The District continues to have a significant unfunded pension liability, which approximated \$1.6 billion in fiscal 2019 (as calculated by Fitch). However, annual costs (approximately \$142 million in fiscal 2019) are manageable in the context of overall District operations and considering the separate levy. The District has made contributions to the pension fund in excess of those actuarially required since fiscal 2014, including \$20 million fiscal 2020.

The District's other post-employment benefits (OPEB) Trust Fund is projected to be fully funded by fiscal 2026, providing the District with additional financial flexibility. Once fully funded, it will eliminate the need for \$5 million annual advance funding and the Trust Fund is projected to be able to support approximately \$10 million in claims annually.

The forward-looking CIP continues to decline as key projects related to water reclamation facilities and the District's Tunnel and Reservoir Plan are completed. The current five-year CIP approximates \$892 million through 2024 and is focused on stormwater (35% of the total) and facilities replacement (26% of the total). The District anticipates issuing \$470 million of debt to fund the CIP; remaining funds will come from current revenue and accumulated funds, including the stormwater levy.

FINANCIAL PROFILE

The District's financial profile is strong and reflects a net leverage ratio that was just below 12.8x in fiscal 2019. Leverage has declined from 15.2x in fiscal 2015 and is projected to further decline as the District's CIP continues to moderate, along with associated borrowing.

The District's coverage of full obligations (COFO) has approximated 1.1x since 2015. COFO should remain stable through fiscal 2024 given current projections for revenue and

anticipated borrowing plans. The District's liquidity is neutral to the rating, with cash on hand in excess of 250 days as measured by Fitch.

The District's bonds are secured by a pledge of ad valorem taxes, providing access to a broader economic base than user charges generally afford. To capture the benefit of this taxing capacity, Fitch additionally analyzed the District's long-term liability burden in the context of the resource base. As compared to the service area's personal income, the long-term liability burden is approximately 7.8%, including debt of overlapping governmental entities. When considering only the District's long-term obligations, including its unfunded pension liability, the burden is 1.4% of personal income. This low burden, and the ability to levy taxes as necessary to pay debt service, lend support to the District's rating despite its leverage ratio and financial profile assessment, which are less of a consideration in the final rating.

Fitch Analytical Stress Test (FAST)

The FAST considers the potential trend of key ratios in a base case and a stress case. The stress case is designed to impose capital costs 10% above expected levels and evaluate potential variability in projected key ratios. The FAST base case and stress case include issuer provided information. Under both the FAST base case and stress case, leverage is expected to decline through the forward period.

Overall revenue and expenditure projections are based recent growth rates, the CIP as outlined in the District's fiscal 2020 budget and approximately \$470 million of debt through 2024. Under this scenario, net leverage declines through the forward period to 11.6x in the base case and 11.7x in the stress case in 2024, and remains supportive of the financial profile assessment.

Fitch applied a stress to reflect potential economic contraction related to the coronavirus pandemic. Given the historically strong property tax collection rates, this scenario did not materially influence view of the rating.

SOURCES OF INFORMATION

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Metropolitan Water Reclamation District of Greater Chicago (IL) [Sewer]	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
● Metropolitan Water Reclamation District of Greater Chicago (IL) /General Obligation - Limited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

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APPLICABLE CRITERIA

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub. 03 Apr 2020\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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Metropolitan Water Reclamation District of Greater Chicago (IL)

EU Endorsed

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