

DEPARTMENT OF BUDGET AND FISCAL SERVICES

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CITY AND COUNTY OF HONOLULU

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May 12, 2025

The Honorable Tommy Waters
Chair and Presiding Officer
and Members
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawaii 96813

Dear Chair Waters and Councilmembers:

SUBJECT: Bill 60 (24), CD1 Relating to the Sewers, Drainage and Cesspools

With regard to Bill 60 (24), CD1 related to the Sewers, Drainage and Cesspools, approving a rate schedule for a minimum of 5 years (per the original rate increase schedule starting at 9% as proposed by the Department of Environmental Services (ENV), or following a rate increase schedule starting at 6% as also proposed by ENV) is of paramount importance considering the 'time value' of money.

After many meetings with bond counsel and the City's financial advisors, we believe it would be fiscally irresponsible for the City to not execute the ENV proposed schedules of sewer charge increases. As advised, we believe an increase starting at 4% or 5% for one year would be unacceptable to the City's rating agencies and bond investor community, potentially resulting in the Sewer Fund's default of bond covenants in FY26.

In the interest of full transparency, we feel compelled to share relevant information with both City Council and the public. Attached, please find information previously provided to City Council (Attachments 1 and 2) highlighting our concerns related to the sewer fees, and new publicly available information on credit rating downgrades (Attachment 3):

Attachment 1: Communication D-0339(25), Page 3, Provision for Sewer Activities, BFS' response to a Councilmember's proposed amendments to Bill 22 (25), CD2;

Attachment 2: Communication D-0158(25), Responses to Questions Regarding Bill 60 (2024) relating to proposed increase in sewer fees – Question 6 specifically. As recently documented, the City's Bank of America Securities, Inc. public finance investment banking team shared examples of municipal water and sewer credits where failure to

The Honorable Tommy Waters
Chair and Presiding Officer
and Members
May 12, 2025
Page 2

timely adopt adequate rate increases was a contributing factor to credit rating downgrades. There are examples of S&P's rating actions on water and sewer credit ratings that were downgraded or assigned negative outlooks due to weakening financial performance combined with delayed or inadequate rate adjustments. In addition, failure to adopt timely rate adjustments to meet increases in costs associated with regulatory mandates and facility renewal and replacement contributed to the downgrades. In some cases, the downgrades occurred even as rate increases were being adopted but were too late to avoid weakened financial positions – i.e., lower debt service coverage and reduced cash balances; and

Attachment 3: Examples of rating agencies' credit reports of public utilities who have not complied with their rate covenant promises. We can provide additional examples of credit downgrades associated with a failure to comply with Sewer Fund revenue bond covenants.

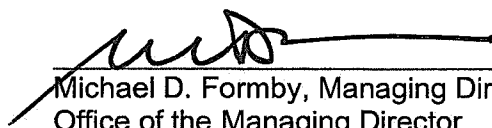
Again, we appreciate your continued assistance and support. If you have any questions concerning this matter, please call me at (808) 768-3901.

Sincerely,


Andrew T. Kawano
Director

Attachments

APPROVED:


Michael D. Formby, Managing Director
Office of the Managing Director

ATTACHMENT 1

DEPARTMENT: BUDGET AND FISCAL SERVICES

May 2, 2025

Page 3

the unexpected events impacting public safety). Due to the timing of these adjustments, the first quarter may appear to have savings; however, the next quarter would reflect a shortage in which funds from the first quarter would need to be transferred to the second quarter to cover the shortfall. Additionally, it would create a significant administrative burden to collect the information being requested under (2)i-iii from each Department on a monthly or even quarterly basis.

PROVISION FOR SEWER ACTIVITIES**Councilmember: Waters**

<u>Amount</u>	<u>Fund</u>	<u>Description</u>
\$16,882,517	GN	Transfer General Fund salary savings to Sewer Fund

Department's Comments and Concerns:

The City's bond counsel, John Wang, a partner with Orrick, Herrington & Sutcliffe, testified at the Budget Committee meeting on April 29, 2025, that funding from the General Fund does not legally qualify to meet the requirements of the rate covenant for the wastewater bonds. The rate covenant requires that sewer rates are set at sufficient levels to pay for operations and maintenance (O&M) costs, debt service and required reserves. The use of the General Fund to pay for sewer costs could have the following impacts:

- Lower the bond rating on wastewater revenue bonds, which would increase borrowing costs
- Result in default on the rate covenant because sewer rates are not raised sufficiently to cover the required sewer system costs
- Expose the City to legal risks if bond holders pursue legal remedies that may include making all outstanding wastewater revenue bonds due and payable

TRANSFER TO SOLID WASTE SPECIAL FUND FOR SOLID WASTE SUBSIDY**Councilmember: Cordero**

<u>Amount</u>	<u>Fund</u>	<u>Description</u>
\$(8,000,000)	GN	Reduce funding for current expenses

Department's Comments and Concerns:

The transfer to the Solid Waste Special Fund for Solid Waste Subsidy is needed to balance the Solid Waste Special Fund. (See also ENV's response)

ATTACHMENT 2

e. Has the City evaluated or applied for any funding or grants from the private or non-profit sector?

Response: ENV has not.

6. What ability does the City have to fund the Sand Island WWTP upgrades through existing City departmental budgets?

Response: The following answer is provided by the Department of Budget and Fiscal Services (BFS):

Reluctance to support ENV's proposed sewer increases based on professional and in-depth cost and engineering studies to comply with the 2010 Consent Decree entered into by the City, the United States Environmental Protection Agency, Department of Health and several non-governmental organizations in settlement of lawsuits relating to the City's wastewater system would very likely result in a downgrade to the sewer fund's credit ratings, increasing borrowing costs, and consequently further increasing costs to meet Consent Decree requirements.

Our investment bankers, Bank of America ("BoFA"), noted that there are numerous examples of municipal water and sewer credits where failure to timely adopt adequate rate increases was a contributing factor to credit rating downgrades. BoFA further noted that in some cases the downgrades occurred even as rate increases were being adopted but were too late to avoid weakened financial performance – lower debt service coverage and reduced cash balances. The following are some relevant examples:

Baltimore City Wastewater – A+ to A, March 13, 2024 – "The lowered ratings reflect our view of the wastewater utility's deteriorating financial performance, including the depletion of its rate stabilization funds with no plans for replenishment, as well as continued operational risks associated with its aged underlying infrastructure the costs to meet these added operational requirements have been significant and the City has not adopted a rate package to recover those costs, relying instead on its rate stabilization fund."

Sonoma County Water Agency – AAA to AA+, July 22, 2024 – decline in coverage largely attributable to drought-related drop in water sales – S&P notes "recent rate increases that were insufficient to maintain historically extremely strong all-in coverage metrics" but adopted rates increases projected at 8 – 10% annually should stabilize financial metrics.

Columbus OH Sewerage System – AA+ to AA with negative outlook, September 29, 2021 – "Historically, management intentionally set rates to achieve sum sufficiency or just above it, with the assumption that the full CIP would be debt funded, primarily with low-cost state loans. While we understand that this funding approach allowed the system to implement nominally small rate increases which have preserved the rate affordability in the service area, it has also resulted in very thin operating margins."

Albuquerque-Bernalillo County Water Utility Authority – AA+ to AA+ negative outlook – negative outlook reflects uncertainty about future rate increases and the related effect on both cash and coverage, given the postponement of rate increases in the past."

The Honorable Tommy Waters
Chair and Presiding Officer
and Members
March 5, 2025
Page 14

Charleston Sanitation Board, WV – AA- to A, November 9, 2022, – “downgrade reflects uncertainty regarding the need for additional rate increases to fund Capital Projects related to the City's long-term control plan (LTCP)....we consider CSB's overall financial ratios healthy for now, the uncertainty regarding how and when additional projects will be funded is the primary factor in the downgrade.”

Woonsocket, RI water revenue bonds – A- to BBB+, November 1, 2024, – “downgrade reflects reactive rate setting resulting in financial erosion at the water fund before a recent large rate hike, compounded by poor transparency characterized by delayed audits and budgeting, which we view as governance weaknesses in risk management and transparency. The negative outlook reflects our concern that near-term financial performance could weaken further if recently approved rate increases are insufficient to cover rising operating costs and sufficiently fund capital reinvestment in the system.”

Pearland TX Water and Sewer – A+ to A, negative outlook, May 28, 2024, – “recent and planned rate adjustments lag increasing operating and debt carrying costs. An improvement in FADS [ratio of net debt to funds available for debt service] and a reduction in leverage is heavily dependent on the City's planned annual rate adjustments that are expected to range from 8%-17% through 2028. However, adoption of these rates is still subject to City Council approval.”

North Fort Bend Water Authority, TX – A+ negative outlook to A stable outlook, July 26, 2024, – “the notable increase in purchased water costs expected in 2027 is not expected to be offset with a commensurate revenue increase as no rate adjustments are currently planned.

Lastly, BofA confirmed that the Council's inquiry about the City's ability to subsidize the sewer fund is a futile exercise. The credit agencies will view any such action as Council's and the sewer fund's inability to responsibly increase Sewer Fees to cover increasing operational costs to comply with the 2010 Consent Decree. There will be projected unintended consequences – beyond the sewer fund's credit rating downgrade, if Council allocates general fund resources to the sewer fund to reduce Sewer Fee Increases, the credit worthiness of the general fund could be impaired, further raising the costs of City operations.

Therefore, based on expert financial advice, it would be irresponsible for ENV or BFS to allocate any general fund resources to the sewer fund to reduce Sewer Fee Increases.

7. Has ENV discussed the rate increases with all the Oahu Neighborhood Boards?

Response: ENV Director and Deputy Director have either made presentations or are scheduled to make presentations on the proposed Sewer Fee Increase to all 33 Neighborhood Boards.

a. If not, why not?

Response: It took time to work with all the NB chairs to get on all their agendas; multiple contacts were required which stretched it out over 6 months.

b. Which Neighborhood Boards have you already met with?

ATTACHMENT 3

RatingsDirect®

Summary:

Baltimore Mayor & City Council, Maryland; Water/Sewer

Primary Credit Analyst:

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

Summary:

Baltimore Mayor & City Council, Maryland; Water/Sewer

Credit Profile

Baltimore Mayor & City Council wastewtr

Long Term Rating

A+/Stable

Downgraded

Baltimore Mayor & City Council wastewtr subord

Long Term Rating

A/Stable

Downgraded

Credit Highlights

- S&P Global Ratings lowered its rating to 'A+' from 'AA-' on the Baltimore Mayor and City Council, Md.'s outstanding senior-lien wastewater bonds.
- At the same time, S&P Global Ratings lowered its rating to 'A' from 'A+' on the city's outstanding subordinate-lien wastewater bonds.
- The outlook is stable.
- The lowered ratings reflect our view of the wastewater utility's deteriorating financial performance, including the depletion of its rate stabilization funds with no plans for replenishment, as well as continued operational risks associated with its aged underlying infrastructure.

Security

The subordinate-lien bonds are rated one notch lower than the senior-lien bonds because the wastewater system has senior-lien coverage that is higher than the subordinate lien, which we view as material.

Credit overview

The downgrade reflects the wastewater utility's deteriorating financial performance, including the depletion of its rate stabilization funds with no plans for replenishment, as well as the continued operational risks associated with its aged underlying infrastructure. The city has made progress in several areas, including labor and regulatory compliance, which supports the stable outlook. The interim public works director has been successful in creating a culture of compliance, which has been beneficial to the system's improved performance. That said, the costs to meet these added operational requirements, have been significant and the city has not adopted a rate package to recover those costs, relying instead on its rate stabilization fund.

The city recently settled ongoing litigation with the state environmental department regarding wastewater pollution discharge from the Back River and Patapsco wastewater treatment facilities, which we view favorably given the reduced fine and corrective action that has been accomplished to date. The city has entered a consent order to remediate issues associated with the facilities and has been working with the Maryland Environmental Service to address the deficiencies and reach compliance. Management indicates about 79% of the injunctive relief has been

completed to date with the remaining projects expected to be completed by 2034. Our operational management assessment (OMA) on the city remains 'vulnerable', reflecting aged assets, and organizational challenges that both constrain the rating and could complicate capital prioritization and operational effectiveness in the future. Under our criteria, an OMA of 'vulnerable' caps the rating at 'A+'.

The rating further reflects our view of the city's:

- Broad and diverse economy that is somewhat offset by higher poverty rates that could stress its market position;
- 'Vulnerable' OMA, although recent changes have improved its compliance in recent years;
- Weakened financial resources, in particular debt service coverage; and
- Moderate debt to capitalization ratio, which suggests capacity for future issuances.

Environmental, social, and governance

Environmental risks remain elevated given the sensitive waterways, regulatory pressures, and resultant health and safety considerations. Governance risks also remain elevated relative to its peers and are somewhat uncertain given its past infrastructure issues and the current efforts to reform the water and wastewater enterprises. Social risks may emerge given the city's higher poverty rate and essentiality of the service. Management has been effective in leveraging local and federal customer service support which partly mitigates this risk.

Outlook

The stable outlook assumes that the progress made under the interim public works director will continue under the new public works director and that compliance and infrastructure investments will remain a priority. The stable outlook also assumes that management will adopt a rate package that will maintain coverage above sum sufficiency without the use of one-time funds.

Downside scenario

We could lower the rating if debt service coverage falls below current levels, the city fails to adopt a rate package that supports cost recovery, or there are infrastructure deficiencies that result in regulatory or health and safety risks.

Upside scenario

We could raise the rating if the city successfully reforms the utility's governance structure to improve operational performance, reduce political instability, and returns debt service coverage to higher levels without the use of one-time funds.

Credit Opinion

Enterprise profile

The service area is broad and diverse with several anchor employees and a growing population in the county area. The service territory has been transitioning from primarily city customers to primarily county customers for the past several decades. We believe the water and wastewater enterprises benefit from economies of scale given the system's

large size but we also believe the market position is challenged by above-average poverty rates (in excess of 20%) in the city, which could pressure rate-setting flexibility.

Our operational management assessment of the city remains 'vulnerable' although we note that management has taken positive actions during the past year improve compliance and established a path for system repair and operational improvement. In 2021, in conjunction with independent consultants, the city and county released a joint report that identified six shortcomings of the current governance structure. Primarily, the report highlighted challenges with customer billing, coordination, and systematic obstacles to long-term planning and improvements. These system characteristics align relatively closely with those we evaluate in our criteria and contribute to the current assessment.

In 2023, the Maryland State Legislature created the Baltimore Regional Water Governance Task Force (the task force) to make recommendations to amend the governance structure of the water and wastewater utilities. final report was released in January, and recommended specific changes to address operational and infrastructure challenges, billing complications, staffing issues, and planning shortcomings. While the final report also recommended several improvements to the utilities' existing structure, it did not fully address governance issues, due to what it cited as insufficient time to ultimately assess and address the problem. It further recommended that the legislature establish a dedicated group with sufficient resources to further evaluate those issues.

In our view, the task force's proposed governance changes could be beneficial to the enterprise if they improve: operational efficiencies, maintenance of critical infrastructure, political obstacles, and environmental compliance. We view these efforts to reform its governance structure favorably and believe they are stabilizing credit factors. However, according to management, the task force's most comprehensive recommended changes could take at least three years to implement, given necessary analysis of the criteria in the House bill and other issues identified in the consultant's report from July 2021.

In the interim, we expect the utilities will make incremental improvements to their operational and capital management but also believe there could be unanticipated problems related to deficient assets, labor shortages, and political bottlenecks that can challenge management and system reliability. Finally, we view the implementation of rate increases to meet the associated rising operational and capital costs as critical to the utility's rate-setting abilities and our OMA.

Financial profile

The city's financial profile for the wastewater enterprise has weakened due to its substantial reliance on the rate stabilization funds to meet sum sufficiency and no formal plans to replenish the rate stabilization fund. Management forecasts 1.05x debt service coverage for fiscals 2023-2025. Fiscal 2023 unaudited actuals show 1.05x coverage (0.74x without the rate stabilization fund), with similar coverage in fiscal 2024--though with a lesser reliance on the rate stabilization funds. Liquidity remains healthy, with nearly 250 days of cash on hand projected for fiscal 2023. Although current coverage is commensurate with a lower rating, we believe, based on discussions with management, that the city will adopt a rate package that supports the utility's full cost recovery without the use of one-time funds. Failure to do so would further pressure the rating.

We believe rates remain affordable but cost escalations that have been necessary to improve operations and compliance have strained financial performance and will necessitate significant rate increases in the future. Given the

Summary: Baltimore Mayor & City Council, Maryland; Water/Sewer

city's heightened poverty rate, we expect affordability will be a potential challenge for management to maintain its financial margins. The city has successful customer service plans in place and takes a proactive approach to supporting enrollment amongst customers. However, the moratorium on shutoffs remains in place which effectively limits the city's available remedies to improve enforcement and increases the likelihood of elevated delinquencies.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of March 15, 2024)

Baltimore Mayor & City Council proj rev bnds (Rehabilitation & Replacement Program Projs, Wifia Loan) ser 2019 due 07/01/2052

<i>Long Term Rating</i>	A+/Stable	Downgraded
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Baltimore Mayor & City Council (wastewtr proj) WS (BAM) (SECMKT)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Downgraded
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Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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Summary:

Sonoma County Water Agency, California; Water/Sewer

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

Summary:

Sonoma County Water Agency, California; Water/Sewer

Credit Profile

Sonoma Cnty Wtr Agy wtr

Long Term Rating

AA+/Stable

Downgraded

Credit Highlights

- S&P Global Ratings lowered its long-term rating to 'AA+' from 'AAA' on Sonoma County Water Agency, Calif.'s outstanding water obligation bonds.
- The outlook is stable.
- The lowered rating reflects the agency's recently weaker all-in coverage, which is not commensurate with that of higher-rated peers at about 1.2x for fiscal 2023, down from above 3.0x during the past three fiscal years and projected to be thinner at below about 1.5x through 2025. The decline in all-in coverage, and overall financial performance, was due to extreme drought conditions for three consecutive years, reduced minimum instream flow requirements, mandatory conservation, and the agency's reduced volumetric demand.

Security

The bonds are secured by net revenues of the agency's water transmission system, on parity with the agency's series 2012, 2015, 2019, and 2022 bonds and a state loan. We consider the bond provisions standard. A rate covenant requires the agency to generate debt service coverage of at least 1.15x. The bonds have a reserve, funded at the lowest of 10% of par, maximum annual debt service, or 125% of average annual debt service. As of fiscal year June 30, 2023, the transmission system supported about \$49.8 million of long-term bonds payable.

Credit overview

The rating reflects our opinion of the recent decline in all-in coverage, and projected adequate-to-strong all-in coverage until fiscal 2026 due to consecutive years of severe drought conditions and the lowest water sales in two decades at 36,000 acre-feet (AF) (2022-2023), even lower than 39,900 AF in 2016-2017. Since then, a series of atmospheric rivers improved the Russian River Watershed to 129% of the yearly average rainfall for water year 2023, which provided some relief. Additionally, management adopted a 6% rate increase in 2023 and a 10.5% increase in 2024, and approved a rate increase for 2025 of between 8.14% and 9.98% (depending on the aqueduct), which it anticipates will improve financial metrics unless hydrologic conditions materially deteriorate. Due to the fully volumetric rate, without a substantial increase in water deliveries, management is projecting annual rate increases to remain within 8%-10%.

The rating further reflects our opinion of the agency's long-term water supply agreements, which require customers to make full payments sufficient to cover debt service and operating expenses regardless of their individual operational

Summary: Sonoma County Water Agency, California; Water/Sewer

performance or level of service. We also consider the very strong credit profiles of the four largest members, the cities of Santa Rosa (water bonds, AA+/Stable) and Petaluma, North Marin Water District, and Marin Municipal Water District (MMWD; AA+/Stable), which together account for approximately 80% of the agency's system revenues, to support the rating. We believe the leading customers have the financial resilience to cover the agency's obligations in the unlikely event of a default of a weaker participant.

The rating further reflects our view of the agency's:

- Wholesale water contractors' large and affluent service area throughout Sonoma and Marin counties and long-term restructured water supply agreements that extend until 2040 or until all revenue bonds have been paid off;
- Volumetric rate structure and recent rate increases that were insufficient to maintain historically extremely strong all-in coverage metrics, but adopted wholesale water rate increases at 9.88% for 2025 and projected at between 8%-10% annually that should stabilize financial metrics but could pressure affordability at the local level;
- Manageable debt-to-capitalization ratio at 23% in fiscal 2023, which we expect will modestly rise in the outer years as management projects future debt plans to fund a portion of its \$94.5 million capital plan through fiscal 2029; and
- Robust liquidity position at about \$71 million for fiscal 2023, equivalent to about 795 days of operating expenses, that management projects it will modestly spend down to fund a portion of the capital plan.

Environmental, social, and governance

Given its location in California, the agency faces above-average environmental risk, in our view, due to the region's drought cycle, flooding, wildfire, and seismic exposure. We believe the agency is taking action to mitigate these risks, in particular, using a sophisticated weather forecasting and water management model to selectively retain or release water from its reservoirs for increased drought and flood resiliency. In 2023, the agency also initiated a project to store water in one of the wells. Moreover, the agency has successfully worked with its contractors to strategically fill local reservoirs when conditions permitted to maximize local and regional drought resiliency. Additionally, due to drought conditions, in 2023 and April 2024, the agency requested modifications to the minimum instream flow requirements to comply with the 2008 Biological Opinion. There are no current issues with wildlife or fish mitigation, under the 2008 Biological Opinion that ended in 2023. The agency has a drought risk element of the Urban Water Management Plan and is working with the county on developing a drought resilience plan. As required under state water code, the agency and its contractors prepare urban water management plans every five years (which per state guidelines, must include a water shortage contingency plan). The agency performs inspections and condition assessments on water infrastructure annually and has development an asset management program and implementation plan to keep up with aging infrastructure.

In our view, the agency's financial disclosure is a credit weakness, as Water Transmission System data, as reported in the audit, is condensed with unpledged fund activities. The annual continuing disclosures provide the breakout of unpledged funds. Beyond financial disclosure, the agency has formalized financial policies and practices that are credit supportive. We understand management also has adequate cyber security protocols and practices in place and maintains a cyber insurance policy to cover potential incidents.

From an affordability perspective, we believe future rate increases could weaken affordability at the local level, but we believe the agency's service area income indicators can support these rate increases without significant pressure.

Outlook

The stable outlook reflects the combination of less dire water supply conditions in the Russian River watershed and recent and approved rate increases that we expect will provide meaningful cost recovery. The stable outlook further reflects the agency's robust liquidity position, coupled with the member contractors' sound credit quality.

Downside scenario

We could lower the rating further if hydrological variance continues to adversely influence the agency's operating margins, if its liquidity is spent down more than planned to fund upcoming capital spending or other agency obligations, or if key member contractors' credit quality deteriorates.

Upside scenario

Although unlikely given the recent and projected lower all-in coverage metrics expected through fiscal 2025, we could raise the rating if financial metrics rebound and can be sustained at much higher levels through various hydrologic cycles, and if key member contractors' credit quality materially improves.

Credit Opinion

The agency is a wholesale water supplier to 10 cities and water districts serving more than 600,000 residents in portions of Marin and Sonoma counties located north of San Francisco. In our view, Sonoma and Marin counties' median household effective buying incomes are extremely strong, at 130% and 160%, respectively, of the national level. The unemployment rate was 3.6% in Sonoma County and 3.3% in Marin County for 2023, lower than the state's 4.8% rate and in line with or lower than the national average of 3.6% during the same year.

The agency manages and operates the Russian River water supply system in conjunction with the U.S. Army Corps of Engineers. The agency's transmission system and pipelines include the Santa Rosa Aqueduct, the Sonoma Aqueduct, the Petaluma Aqueduct, and the Russian River. The agency diverts water from an aquifer adjacent to the Russian River using large diameter collector wells. The agency has rights to divert up to 75,000 AF annually. The agency can also store water in Lake Mendocino and Lake Sonoma. Actual water deliveries totaled 36,031 AF in fiscal 2023, historically low due to the drought. Fiscal year 2024 deliveries are projected to be about 16% higher, and delivery estimates for fiscal 2025 are projected to be stronger at 42,826 AF, or 18% higher than 2023. Although we believe that the agency's future sales will continue to fluctuate with weather and hydrology, we understand that, according to its 2020 Urban Water Management Plan, the agency has sufficient water rights through 2045, with the potential need for increased diversions after this time.

The agency's top customers are the city of Santa Rosa (36% of fiscal 2023 revenues), Marin Municipal Water District (19.0%), the city of Petaluma (15.0%), North Marin Water District (11.0%), and the city of Rohnert Park (4.7%). Only MMWD, Rohnert Park, and the North Marin Water District have significant alternative water sources.

All customers except for MMWD receive wholesale water from the agency under similar long-term water supply agreements. Pursuant to the agreements, the agency assesses capital charges and maintenance and operations charges on a per-acre-foot basis to cover the transmission system's operating expenses, capital expenses, and debt service, and

Summary: Sonoma County Water Agency, California; Water/Sewer

to meet bond covenant requirements. If a wholesale customer is delinquent on its payments, the agency can suspend water deliveries, use reserves to cover any shortfalls, and set rates the following year to stabilize revenues if needed. MMWD receives water from the agency through a 40-year supplemental water supply agreement, renewed on July 1, 2015, which requires MMWD to take 5,300 AF on a take-or-pay basis and provides up to 14,300 AF per year.

S&P Global Ratings calculates the agency's financial metrics using water transmission segment information as reported in the agency's continuing disclosure filings, as the audited financial statements combines transmission system operations with charges for urban water management planning, recycled water, local supply, and watershed conservation and planning, which are included in the agency's rates. These payments and credits are unpledged and are therefore excluded from the calculation of the agency's net revenues.

All-in coverage was extremely robust at above 3.0x for fiscal 2019-2023. However, due to record drought conditions, all-in coverage was significantly lower in fiscal 2023 at 1.2x, despite a 6% rate increase that year. Based on our analysis of management-provided projections, which include higher operating expenses in 2024 and 2025 due to various projects and rate increases, we expect all-in coverage will remain below around 1.5x until fiscal 2026 (when metrics are projected to materially increase to historical levels). Management's projections assume a 16% increase in water sales in 2024 and water delivery estimates of 42,826 AF in 2025, with about a 10% rate increase in 2024 and 2025. In 2026, all-in coverage is projected to rebound to an extremely strong level in 2026, depending on hydrologic conditions. Management indicated if water deliveries and sales remain low, it will re-evaluate rates, capital plan timing, and other expenses to maintain the debt coverage covenant at 1.15x.

The agency has historically maintained a strong liquidity position. In fiscal 2023, unrestricted cash and investments (cash balances less funds earmarked for biological opinion projects and other restricted purposes) was \$71.4 million, equivalent to about 790 days of operating expenses. We expect cash will decline during the next couple of years as the agency draws down reserves to fund the capital improvement plan (CIP) but remain at a level we consider supportive of the current rating--exceeding a year's operations during the upcoming five-year period.

The agency's five-year CIP for the water transmission system totals about \$95 million and is primarily focused on hazard mitigation and system improvements. Priority projects include seismic, flood, and drought hazard mitigation projects for collector wells, storage tanks, pump stations, and aqueducts. Remaining projects are for renewal and replacements of pipeline and storage, and a hydro turbine retrofit. Management projects funding to consist of about 53% from reserves and rate revenue, 28% from grants, and 16% from debt. The forecast assumes about \$15 million of new-money debt in fiscal 2026.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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Summary: Sonoma County Water Agency, California; Water/Sewer

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Albuquerque-Bernalillo County Water Utility Authority, NM Rating Outlook Revised To Negative On Below-Average Coverage

January 31, 2025

CHICAGO (S&P Global Ratings) Jan. 31, 2025--S&P Global Ratings revised the outlook to negative from stable on Albuquerque-Bernalillo County Water Utility Authority, N.M.'s debt. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the authority's senior-lien debt, and its 'AA' rating on the authority's subordinate-lien debt.

"The negative outlook reflects recent all-in debt service coverage metrics, particularly in fiscal 2023 at 1.1x, that were not comparable with those of peers at the 'AA+' rating level," said S&P Global Ratings credit analyst Diana Cooke. It also reflects uncertainty about future rate increases and the related effect on both cash and coverage, given the postponement of rate increases in the past.

We could lower the rating by one or more notches if all-in debt service coverage (DSC) were to remain consistently weaker than peers', which would likely be due to the deferral of rate increases without offsetting budgetary adjustments. We could also lower the rating if the authority were to spend down unrestricted liquidity more than planned.

We could revise the outlook to stable if management is able to implement timely and sufficient rate increases that result in DSC at levels comparable with peers' while maintaining robust liquidity as it progresses through its capital plan.

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Table Of Contents

Credit Highlights

Outlook

Related Research

Summary:

Charleston, West Virginia Charleston Sanitary Board; Water/Sewer

Credit Profile

Charleston San Brd, West Virginia

Charleston, West Virginia

Charleston San Brd

Long Term Rating

A/Stable

Downgraded

West Virginia Wtr Dev Auth, West Virginia

Charleston San Brd, West Virginia

West Virginia

West Virginia Wtr Dev Auth (West Virginia) wtr (Loan Program Iv)

Long Term Rating

A/Stable

Downgraded

Credit Highlights

- S&P Global Ratings lowered its rating on the Charleston Sanitary Board (CSB), W. Va.'s outstanding sewer revenue bonds and West Virginia Water Development Authority's (WDA) water development refunding revenue bonds 2018 series A-IV bonds two notches to 'A' from 'AA-'.
- The downgrade reflects uncertainty regarding the need for additional rate increases to fund capital projects related to the city's long-term control plan (LTCP). Funding requirements are also uncertain, and could lead to a significant amount of loans or debt that lead to meaningful reductions in CSB's financial ratios, notably debt service coverage (DSC) and unrestricted liquidity.
- While we consider CSB's overall financial ratios healthy for now, the uncertainty regarding how and when additional projects will be funded is the primary factor in the downgrade.
- The outlook is stable, and reflects our view that given the strong DSC and unrestricted liquidity available, CSB has near-term flexibility to continue addressing its needs while working on a long-term solution to regarding funding of the LTCP.

Security

We view bond provisions as credit neutral.

The 2018 series A-IV bonds are secured by a pledge of local bonds and related bond payments from WDA's Loan Program IV, which include those from CSB, Kenova, and Hurricane. The bonds have been structured so that repayments from CSB are sufficient to pay debt service on the bonds in all years. A debt service reserve (DSR) also secures repayment on the bonds. Replenishment of the reserve is a moral obligation pledge of the state of West Virginia.

Net revenues derived from the sewer system secure the senior-lien bonds. They include a restriction on issuing bonds

only if net revenues are at least 115% of pro forma maximum annual debt service (MADS) and a covenant to set rates that generate net revenues of no less than 115% of annual debt service or 110% if DSRs are funded at MADS.

Credit overview

CSB management has represented that about \$100 million of LTCP projects have been completed since 2009. While the original plan contemplated \$250 million of total projects, that was in 2009 dollars; the plan is expected to be completed in 2037.

The last rate increase by CSB was in the 2016 fiscal year, and management is working on future rate plans in light of a significant of stimulus funding that may help support the LTCP.

However, in the current inflationary and potentially recessionary environment, combined with the economic challenges facing the Charleston economy, we believe there is significant uncertainty regarding how future projects will be funded and if the board will need an extension past its 2037 scheduled completion.

While these factors are the primary factors in the downgrade, historical financial ratios have been able to help management continue with consistent maintenance and upkeep of its current asset base while continuing work on LTCP projects. Net revenues have covered annual debt service costs by over 1.4x routinely and unrestricted cash and investments ranging from about \$12 million-\$15 million in recent years, or from 375-460 days' cash.

Environmental, social, and governance

The primary environmental risk relates to maintaining compliance with discharge requirements and being able to successfully close out its LTCP. Significant cost increases or inability to demonstrate compliance could lead to a lower rating. We do not view either social or governmental risks as elevated relative to those of peers given the city's currently low sewer rates, autonomy to make rate decisions, and other operational and financial policies consistent with peers. We would note that our view of rate affordability could become less positive if additional capital and debt needs lead to meaningfully large future rate increases.

Outlook

The stable outlook reflects our expectation that the rating is currently supported by healthy financial ratios and that management, with current resources and rates, is able to continually invest in system repair and maintenance.

Downside scenario

The rating could be lowered further if CSB's DSC and unrestricted liquidity start to see meaningful declines or if LTCP project delays due to difficulty securing contracts or labor lead to additional uncertainty as to whether the LTCP will be completed on time.

Upside scenario

We do not foresee the rating moving higher in the near term, but it could be raised over the longer term if there is more funding certainty about addressing the board's LTCP.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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Summary:

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Table Of Contents

Credit Highlights

Outlook

Related Research

Summary:

Woonsocket, Rhode Island; Water/Sewer

Credit Profile

Woonsocket drinking wtr (MAC)

Unenhanced Rating

BBB+(SPUR)/Negative

Downgraded, Removed from CreditWatch

Woonsocket wtr (MAC)

Unenhanced Rating

BBB+(SPUR)/Negative

Downgraded, Removed from CreditWatch

Rhode Island Infrastructure Bank, Rhode Island

Woonsocket, Rhode Island

Rhode Island Infrastructure Bank (Woonsocket) safe drinking wtr srf prog (Woonsocket) ser 2019 due 09/01/2039

Long Term Rating

BBB+/Negative

Downgraded, Removed from CreditWatch

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings lowered its long-term rating on Woonsocket, R.I.'s water revenue bonds outstanding to 'BBB+' from 'A-' and removed the rating from CreditWatch, where it was placed with negative implications on Aug. 16, 2024.
- The outlook is negative.
- The downgrade reflects reactive rate setting resulting in financial erosion at the water fund before a recent large rate hike, compounded by poor transparency characterized by delayed audits and budgeting, which we view as governance weaknesses in risk management and transparency. The negative outlook reflects our concern that near-term financial performance could weaken further if recently approved rate increases are insufficient to cover rising operating costs and sufficiently fund capital reinvestment in the system.

Security

Net revenues of the city's water system secure the bonds. We view the bond provisions as credit neutral, including a 1.25x rate covenant and a 1.25x additional bonds test. The bonds have a debt service reserve funded at a three-pronged test or a surety policy at the equivalent amount. Although our calculation of coverage is below the rate covenant, we note that the city's state loans do not share the same covenants as the bonds; therefore, the city has not violated its rate covenant.

Credit overview

On Aug. 16, 2024, we placed Woonsocket, R.I.'s water revenue bond rating on CreditWatch with negative implications due to the city's lower nominal cash position in recent years, along with weaker debt service coverage (DSC) metrics that no longer support a higher rating. Recent operating expenditures have been volatile and we believe near-term financial performance could erode further. We understand nominal liquidity declined to just \$2 million (unaudited) as

of October 2024, which we consider very thin relative to identified capital needs and ongoing system operations.

Weaker financial metrics are attributed to a recent moratorium on rate hikes in order to provide relief to customers due to inflationary pressures and a failure to implement rate increases authorized by the Rhode Island Public Utility Commission (RIPUC). Favorably, the water utility successfully obtained a requested 33.2% rate increase, which went into effect in October 2024 and is intended to implement an additional adjustment in summer 2025 for further cost recovery. However, the decline in coverage and liquidity raises concerns regarding the adequacy of recent system investment and deferred maintenance, compounded by historical delays in producing both audited and interim financial statements and the continued lack of formalized forecasting analysis.

Woonsocket began delaying preapproved rate hikes in 2021 to provide COVID-19 relief to customers, as well as in response to lower-than-expected loan issuances because of cash reserve utilization. If future anticipated rate hikes do not go into effect in fiscal 2025, it may cause further softening of financial metrics. Furthermore, due to the large size of the October 2024 rate hike and anticipated 2025 rate hike, it could present affordability challenges due to the size of the rate increase. Our overall view of the rating is mitigated as Woonsocket's DSC and liquidity have worsened due to the recent lack of rate hikes, and we acknowledge levels could continue to trend downward in the short term as the city awaits further rate hike approvals from RIPUC and as it utilizes more cash for capital improvement projects. Our peer comparison analysis also indicates that economic and financial metrics are commensurate with the 'BBB+' level.

The enterprise and financial risk assessment reflects our assessment of the system's:

- Service area economy within the broad and diverse Providence-Warwick metropolitan statistical area (MSA) economy, tempered by weak median household incomes at only 71.2% of national median household effective buying income (MHHEBI) and above-average unemployment; however, the customer base is stable, with the top 10 customers accounting for about 2.7% of total revenues when excluding wholesale municipal customers;
- Current rate affordability when benchmarked against income and Providence County's poverty rate, although elevated county poverty rates and future rate increases needed to support the capital plan could pressure our affordability assessment--furthermore, the water system is somewhat restricted in its rate increases due to the need to have multiyear rate hikes approved by the RIPUC;
- Standard operational management, constrained by aging infrastructure concerns, cost pressures related to per- and polyfluoroalkyl substances (PFAS) contamination and the existence of lead service lines in the system but offset by low water loss, and the existence of emergency plans;
- Financial management, which we consider weak compared with those of higher-rated peers as a result of recent DSC volatility and continuous cash declines, as well as the lack of transparency due to the unavailability of 2023 audited financial statements and forecasting; and
- Erosion in coverage and cash position in recent years, which could continue to weaken as the water system continues through its capital improvement plan (CIP) and draws on reserves while potentially issuing new debt, with rate increases that may or may not be approved as requested by the RIPUC.

Environmental, social, and governance

We consider environmental risks as somewhat elevated in our analysis. Woonsocket's water system is currently operating well below its safe yield of water output, and it maintains emergency and drought management planning as

part of its water supply management planning. Preliminary testing revealed exposure to PFAS compounds in three of the water system's reservoirs. The system has completed the replacement of all city-owned lead lines and is actively working on completing the replacement of private lead lines. The water system is currently participating in a class action lawsuit against entities who contributed to PFAS contamination in the system.

We also consider social risks as credit neutral. Regarding affordability, the decision to delay water rate hikes in recent years has aided consumers. However, the water system has acknowledged that future rate increases are necessary to sustain the required debt service payments past fiscal year 2024. Should water rates increase substantially beyond the 33.2% already approved, income indicators decline, and the county poverty rate increase, rates could become less affordable.

We also view governance risk as elevated. We view positively management's efforts to communicate with customers, as well as its upcoming maintenance of its assets and steps taken to mitigate cyber security risk. This is somewhat mitigated by its lower frequency of financial forecasting compared with higher-rated peers, as well as the reduced transparency of the system's delayed audits. The most current audited financial statements available at the time of this analysis were for fiscal year 2022, which we consider delayed. The city must obtain RIPUC approval for rate increases, and there is a history of increases being disputed. Because of this relationship with the RIPUC, we believe the city's financial metrics could be stressed if approvals are not granted in a timely manner or in an amount that is satisfactory to maintain financial metrics.

Outlook

Over the outlook period, we will be monitoring to what extent proposed rate hikes are approved and implemented. S&P Global Ratings expects that the timeliness of the water system's audited financial metrics will be uncertain over the medium term until we receive additional audits, as the October 2024 rate hike will only begin to appear in fiscal 2025 financial results. There is a one-in-three chance we could lower the rating further if the system breaches its rate covenant or if sufficient rate increases over the outlook period are not adopted.

Downside scenario

If the upcoming 2025 request to the RIPUC to raise rates is not accepted, and financial metrics continue to materially decline, we could lower our rating. If additional debt is issued to address the CIP without corresponding rate increases to supplement increased debt service, and if liquidity further deteriorates, this could also lead us to lower the rating. Finally, if the 2023 audit is not produced before the end of this calendar year, we would consider lowering and/or withdrawing the rating due to vulnerabilities in information quality and transparency.

Upside scenario

Before we would consider raising our rating, the utility would need to maintain higher coverage levels along with a buildup in the system's nominal cash position to levels comparable with those of peers at a higher rating; this could happen if the water system's 2025 rate proposal is approved. We could also consider raising the rating if the demographic profile materially improves. A potential upgrade is also contingent on the water system completing all necessary rehabilitation projects to reduce PFAS and lead service line exposure in the service area.

Woonsocket, Rhode Island--Economic and financial data

	Most recent	Fiscal year-end			Median (BBB+)
		2022	2021	2020	
Economic data					
MHHEBI of the service area as % of the U.S.	71.2	--	--	--	78.0
Unemployment rate (%)	5.1	--	--	--	4.8
Poverty rate (%)	14.0	--	--	--	13.9
Water rate (6,000 gallons or actual) (\$)	51.4	--	--	--	44.0
Sewer rate (6,000 gallons or actual) (\$)	35.1	--	--	--	43.0
Annual utility bill as % of MHHEBI	1.3	--	--	--	1.5
Operational management assessment	Standard	--	--	--	Standard
Financial data					
Total operating revenues (\$000s)	--	15,495	17,084	16,600	2,093
Total operating expenses less depreciation (\$000s)	--	12,135	14,189	14,156	1,821
Net revenues available for debt service (\$000s)	--	3,360	2,895	2,444	--
Debt service (\$000s)	--	2,807	2,751	2,280	--
S&P Global Ratings-adjusted all-in DSC (x)	--	1.2	1.1	1.1	1.3
Unrestricted cash (\$000s)	--	4,031	9,802	13,212	1,164
Days' cash of operating expenses	--	121	252	341	293
Total on-balance-sheet debt (\$000s)	--	61,237	62,298	63,323	7,721
Debt-to-capitalization ratio (%)	--	64.4	65.1	65.4	50.0
Financial management assessment	Standard	--	--	--	Standard

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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