S&P Global Ratings

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Summary:

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

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Table Of Contents

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Credit Profile		
2019 WIFIA Loan		
Long Term Rating	AA-/Stable	New
Narragansett Bay Comm swr		
Long Term Rating	AA-/Stable	Affirmed
Narragansett Bay Comm swr		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' underlying rating to Narragansett Bay Commission (NBC), R.I.'s 2019 WIFIA Loan and affirmed its 'AA-' underlying rating on NBC's wastewater bonds outstanding, based on its view of the commission's 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 bond 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. 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
- Operational management practices and policies that we view as strong.

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

- Financial metrics that include all-in debt service coverage (DSC) of at least 1.2x and a days' cash equivalent of around 160-190 days' cash over the last four fiscal years;
- High leverage, at 54% debt to capitalization ratio and a sizeable $588 million five-year capital plan; and
- Financial management practices and policies that we view as strong.

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, especially given NBC's large capital plan; and
- A large service base that extends beyond the city of Providence into much of the surrounding MSA.

Debt service on NBC's 2019 WIFIA loan are payable from the revenues of the commission, which are on parity with revenue bonds outstanding and 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 loan provisions include the following:

- A covenant to set rates that generate an amount that represents at least 125% of annual debt service on the WIFIA loan and 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 WIFIA loan and revenue bonds and 1.35x the debt service requirement for (RIIB) loans;
- No debt service reserve for the series 2019 C loan; and
- There are additional events of default, including if the principal project contracts are terminated before scheduled expiration or project completion is delayed more than two years; however, there are a variety of cures including finding a suitable replacement contract and providing justification for construction delay to the lender's satisfaction.

Enterprise risk

NBC was established in 1980 and serves 10 communities of approximately 360,000 residents and 7,800 businesses in northeastern Rhode Island, primarily Providence and Pawtucket. The commission does not have any taxing authority; it derives revenues from user charges.

The commission owns and 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 with a dry weather capacity of 46 mgd and wet-weather capacity of 116 mgd. Systemwide average daily flow of 65 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 8.5% of operating revenues in fiscal 2018, which we consider a diverse customer base.

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 90% of the national average. Monthly-equivalent water and sewer rates are $50.26 for 800 cubic feet of usage, which is our standard benchmark for monthly consumption, or only 1.3% of MHHEBI when annualized. When considering that the county's poverty rate is close to 18%, 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. That said, our rating reflects our understanding that the service base extends well beyond the city of Providence, which is likely to lead to greater rate affordability than conservative assumptions used in our analysis.

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 5.88% went into effect July. 1, 2019. The rate increase is an adjustment to the rate base and will also provide additional revenues to support operations and maintenance expense. 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. Examples of the commission's strong operational controls include a fully mapped GIS system, an asset management program that has been in place since the mid- 2000s and, a capital improvement plan that is prioritized within the long-term capital plan.

Financial risk

The commission's financial performance remains strong, in our opinion. For audited years 2015-2018, net revenues covered debt service by at least 1.2x; unaudited 2019 figures look similar. Also, unrestricted cash has not dropped below a level representing 157 days' operating expenses since 2015, and it was at 188 days in unaudited 2019 (equivalent to $21.2 million). Management does not expect a substantial change in financial results, although in the long run further rate increases will be needed to support the costs of the CIP.

The commission's capital improvement plan is large, at $629 million over the eight years from 2020 through 2027. The majority of this amount--$548 million or 87%--is for phase IIIA of the combined sewer overflow (CSO) program. Phase IIIA involves construction a 30-foot internal diameter deep rock tunnel in Pawtucket and 12 other construction projects. Presently, the commission is in the design phase and will award the design build contract for the tunnel at the end of the calendar year in 2020. Pursuant to a consent agreement with the state, the phase III CSO program should end by 2041.

In addition to the 2019 WIFIA loan, we understand management plans to issue a revenue debt and state revolving fund loans (SRF) of approximately $220 million, apply for an additional $15 million in WIFIA loans, and use $48.4 million of the restricted funds to pay for the five-year CIP. As part of the WIFIA loan requirements, the WIFIA financing can only cover 49% of the projects costs and the utility must fund the remaining 51% through alternate sources. We view NBC as being highly leveraged, with a debt-to-capitalization ratio of 54%. About 60% ($332 million) of the commission's $575 million of debt outstanding (as of June 30, 2018) is low-interest state revolving fund debt, and about 10% ($56 million) is variable-rate debt. The commission is not engaged in any interest-rate swaps.

In addition, the commission's proportionate share of the net pension liability for the Employee's Retirement System of Rhode Island is underfunded at 52%. 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 financial performance should continue in a fashion consistent with historical trends, given a good history of credit-supportive rate decisions by the PUC.

Downside scenario

If, for some reason, future rates do not generate sufficient revenues to help maintain this consistent financial performance and support the large capital plan, we could lower the rating.

Upside scenario

If NBC's financial performance becomes significantly stronger compared to historical trends, and we believe that these trends are sustainable, then the rating could improve. However, given the need for continued PUC support and ongoing debt and capital needs, we believe the likelihood for upward rating movement is likely to be well after the two-year outlook period.