

RATING ACTION COMMENTARY

Fitch Affirms New Orleans, LA's Water and Sewerage Revs at 'BBB+'; Outlook Stable

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Fitch Ratings - Austin - 07 Nov 2024: Fitch Ratings has affirmed the 'BBB+' ratings on the following bonds issued by the city of New Orleans, LA (the city) on behalf of the Sewerage and Water Board of New Orleans (SWBNO):

--\$189.9 million water revenue and refunding bonds;

--\$252.7 million sewerage service revenue and refunding bonds.

Additionally, Fitch has assessed the SWBNO's Standalone Credit Profile (SCP) at 'bbb+'. The SCP represents the consolidated credit profile of SWBNO's water, sewerage and drainage systems on a standalone basis irrespective of its relationship with and the credit quality of the city of New Orleans (Issuer Default Rating A/Negative).

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡	PRIOR ⚡
New Orleans Sewerage & Water Board (LA) [Water, Sewer]		

New Orleans Sewerage & Water Board (LA) /Sewer Revenues/1 LT	LT	BBB+ Rating Outlook Stable	BBB+ Rating Outlook Stable
		Affirmed	

New Orleans Sewerage & Water Board (LA) /Water Revenues/1 LT	LT	BBB+ Rating Outlook Stable	BBB+ Rating Outlook Stable
		Affirmed	

[VIEW ADDITIONAL RATING DETAILS](#)

The bond ratings reflect a financial profile assessed at 'a', but ratings of 'BBB+'. The ratings remain constrained by extensive capital needs that, if more fully executed, would result in higher leverage, measured as net adjusted debt to funds available for debt service (FADS). If SWBNO spends around \$250 million annually on capex over the next five years, which Fitch believes is feasible based on historical spending levels, leverage could potentially increase to over 10.0x in Fitch's Analytical Stress Test (FAST) rating case. This is the primary factor when assessing the financial profile at 'a'. The financial profile is considered within the framework of revenue defensibility assessed at 'a', and an operating risk profile assessed at 'bbb'.

Under normal operating conditions, leverage is typically very low but susceptible to spikes due to weather events and unexpected expenditures. Leverage has averaged 4.5x over the last five years (2019-2023, FYE Dec. 31) and most recently measured 4.2x in 2023. However, capital needs continue to significantly exceed identified funding sources. Additionally, the ratings reflect the systems' demonstrated vulnerability to outages, boil water notices and a high amount of non-revenue water (water that is treated but not billed to a consumer).

Fitch's maintenance of the same rating on the separately secured water and sewerage bonds reflects this close financial relationship between the funds, as well as the common governance structure, rate setting process, customer base, billing system and management team.

SECURITY

The water revenue and refunding bonds are payable from net revenues of SWBNO's water utility system. The sewerage service revenue and refunding bonds are payable from net revenues of SWBNO's sewer utility system.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

Essential Service Provider in Stable Service Area

The revenue defensibility assessment reflects SWBNO's role as a monopoly provider of water, sewer and drainage service within the city. The service area generally exhibits stable characteristics and is anchored by shipping and tourism, with a diversifying economic base into health care and technology. New Orleans' population was estimated at 390,000 pre-pandemic, but has not rebounded to this level and was approximately 365,000 in 2023.

SWBNO has the independent ability to raise rates, subject to city council and board of liquidation approval (BOL). Additionally, Fitch considers the monthly bill affordable for a majority of the population (around 60%). The last year of an eight-year rate package implemented a 10% rate increase on both water and sewer rates in 2020. Rates have been held flat since that time and no rate adjustments are anticipated for 2025.

The revenue defensibility assessment is further supported by management's continued efforts and focus on recouping past due balances. Billing system issues several years ago increased the number of disputed bills, leading to higher past dues balances. This issue was exacerbated by the pandemic when shut-offs were suspended. However, SWBNO has made progress collecting past due balances and the number of customers enrolled in a payment plan has increased, which should help with recouping balances over time.

Billing disputes are also expected to decrease as SWBNO continues its installation of advanced meter infrastructure (AMI). Installation is underway and complete conversion to AMI is expected by the end of 2026.

Operating Risk - 'bbb'

Very Low Operating Cost Burden, Significant Capital Investment Needed

Fitch assesses SWBNO's operating risk profile at 'bbb' despite an operating cost burden related to water production and sewer flows considered very low on a per unit basis. Capex has exceeded annual depreciation expense for many years, averaging 298% for the five years ended in 2023. Fitch's concern is that each system (the water, sewer, and drainage system)s is vulnerable to outage or failure events and require significant investment to limit this vulnerability. Challenges related to the implementation of the capital program,

including securing sufficient funding, maintenance system assets, and positioning within the capital cycle, limits the operating risk assessment at the current level.

SWBNO's capital program will be updated as part of the upcoming 2025 budget process. The most recent program, spanning 2024-2033, totals \$3.223 billion, up from the prior 2023-2032 plan of \$2.48 billion. A significant driver of the increase is the addition of \$343 million for Lead and Copper Rule (LCR) compliance. SWBNO is in compliance with the recent LCR requirement to disclose the composition of its service line inventory. It has also secured \$86 million in state revolving fund financing for the LCR initiative.

Cost estimates specific to the LCR will likely continue to be refined in upcoming capital programs. Other projects remain unfunded, and the system continues to prioritize projects based on its asset management plan. Historical actual capex usually ranged between \$150 million and \$200 million from 2018 through 2022 but increased to nearly \$274 million in 2023, a level SWBNO intends to continue targeting.

The rate of non-revenue water was high before Katrina, reflecting an aging system of water mains and distribution pipelines, underground pipes below sea level and deferred investment in the system. Additional leaks and ruptures occurred after Katrina, with the rate of non-revenue water now typically around 70%. This represents a cost to the system in terms of water treatment and delivery (pumping) costs. It also represents a significant cost to the drainage utility, which must regularly pump all excess water out of the service area. With the aid of Federal Emergency Management Agency (FEMA) funding, SWBNO continues to detect and repair leaks and replace distribution pipelines.

Wet-weather events have historically overwhelmed the wastewater treatment plants (WWTP), causing sanitary sewer overflows (SSOs). As a result, the sewer system is under a consent decree (CD) from the U.S. Environmental Protection Agency (EPA) to reduce SSOs. In Nov. 2021, SWBNO closed on \$275 million Water Infrastructure Finance and Innovation Act (WIFIA) loan. The loan proceeds will fund the improvements and upgrades needed under the CD, and management reports that CD projects remain on track to meet the October 2025 deadline.

Financial Profile - 'a'

Recent Stability in Financial Performance

For the last five years leverage has remained relatively stable, ranging from a low of 3.6x in 2019 to a high of 5.1x in 2021. Over this period SWBNO was able to implement cost

control measures that resulted in operating expenses increasing by an average of 2.2% annually, close to the rate of revenue increases in most years. Fitch considers the liquidity profile neutral to the assessment as the liquidity cushion has remained over 90 days since 2019. Coverage of full obligations (COFO) and Fitch-calculated total debt service coverage both measured 2.5x in 2023.

The FAST considers the potential trend of key ratios in a base case and stress case over a five-year period. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capital expenditures, user charges and rate of revenue and expenditure growth.

Based on historical levels of actual spending, Fitch assumed capex that averaged around \$250 million over the 2024-2028 period, despite formal CIP projections above this figure. SWBNO has also secured funding with principal forgiveness, which is also included in Fitch's analysis.

In the base case scenario, the leverage ratio is on an upward trend from 6.0x in 2025 to potentially reaching 11.2x by 2028. In the stress case, which is considered the rating case, leverage also increases gradually year over year reaching 12.7x by 2028. As the FAST does not assume any rate increases over the next five years, any future rate adjustments would likely drive stronger performance. The 'a' financial profile assessment reflects Fitch's expectation that in most years leverage remains below 11.0x, supporting the current assessment. The liquidity profile is expected to remain neutral to the assessment over the five-year horizon.

Fitch also considered a sensitized scenario with increased CIP execution (closer to \$300 million annually) with debt financing to cover the increased costs. Under such a scenario, leverage could reach 14.0x or higher. Fitch recognizes SWBNO continues to pursue grants, principal forgiveness loans and that there is still flexibility within the capital plan to adjust the timing of some projects to keep leverage from reaching that level.

However, the sensitized scenario demonstrates that to more fully fund identified capital projects, pay-go and/or third-party financing would need to increase substantially to keep leverage at a level supported by the current rating. Fitch believes future rate adjustments eventually would be needed to accommodate a ramp up spending.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Actual leverage and sustained projections in Fitch's rating case of leverage closer to 11.0x, assuming stability in the revenue defensibility and operating risk assessments;

--A weakening in the revenue defensibility assessment to 'bbb,' either by a sustained weakening of the service area or rate flexibility.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Sustained levels of capex that improve the execution rate of the system's CIP;

--Increased revenue generation, whether by successful implementation of rate adjustments or other measures, in support of upcoming capex needs;

--Successful completion of consent decree (CD) projects by the 2025 deadline;

--Leverage consistently closer to 6.0x and in Fitch's rating case, assuming stability in the revenue defensibility and operating risk assessments.

PROFILE

SWBNO was created by the Louisiana legislature in 1899 as a special board operating independently of the government of the city. SWBNO provides retail water and sewerage service to approximately 140,000 customers in the city, along with managing the city's drainage system. Fitch considers SWBNO to be a related entity to the city for rating purposes given rate adjustments that must be approved by SWBNO's board of directors, (which includes the city's mayor and two members of the BOL), the city council and the BOL (of which the mayor is also a member). The BOL serves as debt custodian for all SWBNO debt and as custodian for several other city agencies.

The credit quality of the city does not currently constrain the bond rating. However, as a result of being a related entity, the issue ratings could become constrained by a material decline in the general credit quality of the city.

The sanitary sewer system consists of two WWTPs: one on the west bank of the Mississippi River with 40 million gallons per day (mgd) capacity and one on the east bank with 122 mgd

capacity. Wastewater treatment capacity is well in excess of total average flows (114 mgd in 2022). The city has ample water supply provided by the Mississippi River, with four raw water intakes and two water treatment plants (one located on each side of the river). Water treatment capacity is well in excess of the system average daily demand, generally less than 40 mgd, but flows through the plants are much higher (159 mgd in 2022) given the very high amount of water loss in the distribution system.

Updated EPA Regulations

SWBNO is addressing new regulations set forth by the U.S. EPA. The EPA's enhanced focus on lead and copper lines and per- and polyfluoroalkyl (PFAS) contaminants has led to the finalized Lead and Copper Rule Improvements (LCRI) along with specific testing requirements for PFAS. SWBNO does not expect any changes or upgrades will be needed to its current treatment operations in relation to the finalized PFAS rule. As noted, SWBNO recently disclosed its service line inventory as stipulated by the LCRI and is already incorporating cost estimates in its capital plan to address compliance and line replacement in upcoming years.

SUMMARY OF FINANCIAL ADJUSTMENTS

The bond ratings and SCP are based upon a consolidated fund analysis of SWBNO's water, sewerage and drainage funds. Despite each system issuing separately secured debt, there is a close financial relationship among all three funds as demonstrated by historical intra-fund borrowings and reallocation of costs and assets. The drainage system's debt is secured by a dedicated millage rate (with operations supported by a total of three dedicated millage rates) and, in Fitch's analysis, adjustments are made to exclude the self-supporting drainage debt, as appropriate.

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 Sewerage & Water Board of New Orleans (LA) [Water, Sewer] has an ESG Relevance Score of '4' for Exposure to Environmental Impacts due to the potential for flooding event and historical weather events that have affected operations and financial performance, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The Sewerage & Water Board of New Orleans (LA) [Water, Sewer] has an ESG Relevance Score of '4' for Water & Wastewater Management due to the system's high level of non-revenue water that significantly exceeds industry standards, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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APPLICABLE CRITERIA

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 12 Jan 2024\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub. 29 Feb 2024\) \(including rating assumption sensitivity\)](#)

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