FitchRatings

13 MAY 2024

Fitch Rates Great Lakes Water Authority's Water Revs 'A+'/'A'; Outlook Stable

Fitch Ratings - New York - 13 May 2024: Fitch Ratings has assigned the following ratings to the obligations issued by the Great Lakes Water Authority, MI (GLWA or the authority):

--Approximately $346.8 million water supply system revenue refunding senior lien bonds series 2024A, 'A+'

--Approximately $36.0 million water supply system revenue refunding second lien bonds series 2024B, 'A'.

The bonds are scheduled to sell via negotiation the week of May 20. Proceeds will be used to refund certain bonds and pay costs of issuance.

Fitch also has affirmed the ratings on the following GLWA bonds, including bonds previously issued by the city of Detroit (the city) and the Michigan Finance Authority, MI on behalf of the Detroit Water and Sewerage Department (DWSD) and assumed by GLWA (all pre-refunding):

--Approximately $1.6 billion senior lien water supply system revenue bonds at 'A+';

--Approximately $691 million second lien water supply system revenue bonds at 'A'.

Fitch has assessed GLWA's water system's (the system) Standalone Credit Profile (SCP) at 'a'.

The Rating Outlook is Stable.

The 'A+'/'A' bond ratings on the Great Lakes Water Authority's (GLWA, or the authority) senior and subordinate bonds, respectively, and the 'a' SCP consider the system's strong financial profile within the context of very strong revenue defensibility and operating risk profiles, both assessed at 'aa'. Leverage, measured by Fitch Ratings as net adjusted debt to adjusted funds available for debt service, was approximately 10.2x in fiscal 2023 (FYE June 30), similar to fiscal 2022 results.

The system's leverage is anticipated to rise through fiscal 2028 as it implements a robust capital improvement plan (CIP) financed in part with additional debt issuances. Revenue requirements to fund the CIP are likely to be higher than historical but are expected to remain manageable overall. Leverage may reach close to 12.0x in fiscal 2025, before falling to around 10.7x by fiscal 2028. Overall leverage should remain in line with the current rating.

The revenue defensibility assessment considers the authority's ability to reallocate any shortfalls from a non-performing customer to its performing customers via a rate increase and the overall strength of such customers. While the credit quality of DWSD's water system is considered midrange by Fitch, other significant customers have stronger credit profiles, resulting in strong overall purchaser credit quality. The operating risk profile considers the system's very low operating cost burden, coupled with its low, but recently rising life cycle ratio.

The notching distinction between the senior and the second lien bonds reflects the meaningful protection afforded to senior debt given the sizable balance of subordinated obligations, the latter of which include the second-lien bonds, state revolving fund loans, and the long-term leases payable under the lease agreement between DWSD and the authority, as well as the absence of an automatic cross-default or acceleration between the liens.

SECURITY

Senior-lien bonds are secured by a first lien on net revenues of the system. Second-lien bonds are secured by net revenues after payment of the senior-lien bonds.

KEY RATING DRIVERS

Revenue Defensibility - aa

Strong Purchaser Credit Quality, Very Strong Revenue Source Characteristics

The authority has contract provisions that allow for full cost recovery and the unlimited reallocation of costs across users. Under the Water and Sewer Services Agreements (WSSA) in place with the wholesale customers, the authority has the exclusive right to establish rates for the water service it provides. The authority has delegated to the city its right to establish rates with respect to services provided to city of Detroit customers.

Revenue defensibility is supported by purchasers that exhibit strong credit quality. The city of Detroit accounts for approximately 27% of fiscal 2023 operating revenues (inclusive of the local water system operating revenues). Other key wholesale customers include Southeastern Oakland County Water Authority, Shelby Township, Livonia and Sterling Heights. Although the city's system exhibits midrange credit quality, the strong PCQ incorporates the credit quality of suburban members. The local water system is the portion of the water system that provides service directly to the city's retail customers.

Operating Risk - aa

Very Low Operating Cost Burden, Moderate Investment Needs

In fiscal 2023, the system's operating cost burden was considered very low at $2,568 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was very low at 35% in fiscal 2023. Capex to depreciation has been weak, but improved to a five-year average of 84% in fiscal 2023. Planned capital spending for the next five years should generally outpace historical depreciation, supporting a continued very low life cycle ratio.

The DWSD CIP is funded through the lease payments and debt issued by GLWA for local DWSD water projects. Planned CIP spending for 2024-2028 for the consolidated GLWA and DWSD water system approximates $1.6 billion. The CIP is anticipated to be primarily funded with debt, including State Revolving Fund proceeds.

Financial Profile - a

Leverage to Increase Modestly; Neutral Liquidity

The system had moderate leverage of 10.2x as of fiscal 2023, which is in line with historical performance of between 9.7x and 10.2x since fiscal 2019. The liquidity profile is neutral to the overall assessment, with a Fitch-calculated liquidity cushion of 433 days and coverage of full obligations (COFO) of 1.8x. Fitch-calculated total debt service coverage was also 1.8x in fiscal 2023.

The Fitch Analytical Stress Test (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.

In the base case scenario, the leverage ratio is projected to increase to 11.7x in fiscal 2025 and then decrease to 10.2x through fiscal 2028. In the stress scenario, which is considered the rating case, the leverage ratio follows a similar trajectory peaking at 11.9x in fiscal 2025 before declining to 10.7x over the next three years. Liquidity is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive considerations affected this rating determination.

RATING SENSITIVITIES

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

--Sustained leverage approaching 13.0x in Fitch's rating case scenario through the forward period, assuming stability in the revenue defensibility and operating risk assessments.

--Downward revisions to the system's overall PCQ.

--Material declines in liquidity that expose bondholders to the timing risk of the true-up.

--The senior-lien rating could converge at the SCP assessment if there is a significant erosion of the financial cushion afforded to senior bondholders that results in a lack of meaningful difference in the probability of payment default between the liens.

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

--Sustained improvements in leverage approaching 11.0x in Fitch's rating case scenario, assuming stability in the current revenue defensibility and operating risk assessments.

PROFILE

GLWA provides wholesale water services to a population of approximately 3.8 million, or 38% of the state's population. In January 2016, the authority assumed operational control of Detroit's system assets (excluding its local distribution infrastructure) via a 40-year lease agreement and authorized GLWA the right to set and collect rates from the customers historically served by the city.

Separately, a security interest in the city's system-related revenues was granted under the Master Bond Ordinance (MBO), while the WSSA assigned the city the right to set and collect rates from its retail customers. The agreement required GLWA to assume all liabilities of the regional water and sewer systems, including outstanding indebtedness related to the respective systems.

System assets include five water treatment plants that collectively can treat around 1.7 billion gallons per day, an extensive conveyance system and many water-storage reservoirs. Water is supplied to the treatment plants via the Detroit River, Lake Huron and Lake St. Clair. Supply and capacity are robust and more than sufficient for the long-term anticipated needs of the service area.

Updated U.S. Environmental Protection Agency (EPA) Regulations

GLWA does not expect any operational impact as a result of the EPA's recently finalized rule in relation to per- and polyfluoroalkyl substances (PFAS). Testing to date had not detected any PFAS contaminants. Compliance with the EPA's Lead and Copper Rule (LCR) Revisions and LCR Improvements is also not expect to pose a challenge; as a wholesale provider lead service lines (LSL) are not within GLWA's oversight. However, to date one of the authority's purchasers, DWSD, has secured over $100 million in American Rescue Plan Act funds for LSL replacement projects.

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.

Summary of Financial Statement Adjustments

In its analysis, Fitch adjusted GLWA's 'Statement of Revenues, Expenses and Changes in Net Position' to include information from DWSD's 'Statement of Revenues, Expenses and Changes in Net Position.' The adjustments are made to provide greater comparability of GLWA's financial position in accordance with the flow of funds under the bond ordinances and lease-related agreements.

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 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 www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Great Lakes Water Authority (MI) [Water]					
• Great Lakes Water Authority (MI) /Water Revenues (2nd Lien)/2 LT	LT	A	Affirmed		A
• Great Lakes Water Authority (MI) /Water Revenues/1 LT	LT	A+	Affirmed		A+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

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)

Additional Disclosures

Solicitation Status

Endorsement Status

Great Lakes Water Authority (MI)	EU Endorsed, UK Endorsed

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