

RatingsDirect®

Summary:

Great Lakes Water Authority, Michigan; Water/Sewer

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Summary:

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Credit Profile		
US\$350.11 mil wtr supp sys rev rfdg bnds sr ln bnds ser 2024A due 07/01/2037		
Long Term Rating	AA-/Stable	New
US\$36.665 mil wtr supp sys rev rfdg bnds 2nd ln bnds ser 2024B due 07/01/2036		
Long Term Rating	A+/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AA-' rating to the Great Lakes Water Authority (GLWA), Mich.'s series 2024A (senior-lien) and its 'A+' rating to GLWA's series 2024B (second-lien) water supply system revenue refunding bonds.
- At the same time, S&P Global Ratings affirmed its 'AA-' rating on GLWA's existing senior-lien bonds and its 'A+' rating on GLWA's second-lien bonds.
- The outlook is stable.

Security

The bonds are secured by a statutory lien on pledged assets of the system, pursuant to both the bond ordinance and Michigan Act 94 of 1933 (as amended), and prioritized by the lien status. Pledged assets include net revenue of GLWA's water supply system, along with investments credited to the water system and earnings on those investments. The net revenue pledge is constituted from gross revenue of the Detroit Water and Sewer Board (DWSD) retail and GLWA regional wholesale systems, which cover both systems' operating and maintenance (O&M) expenses. A rate covenant stipulates that the GLWA board set rates to produce at least 1.2x coverage of senior-lien debt, 1.1x for second-lien bonds, and 1x for junior-lien bonds. The ability to issue additional bonds exists if net revenue for the previous fiscal year, or net revenue adjusted by approved rate increases and system expansion for the current or next fiscal year, produces coverage of maximum annual debt service (MADS; including the proposed bonds) of at least those levels indicated in the rate covenant for the particular liens.

In conjunction with the series 2024 issuances, GLWA is eliminating the debt service reserve requirement on its outstanding and future bonds because two credit rating agencies rate its senior-lien bonds no lower than 'AA-' or the equivalent; this change has no effect on the rating. The reserves originally funded with bond proceeds are being contributed to the escrow related to the 2024 refinancing.

Credit overview

- GLWA's water system has a large service base, complex service delivery considerations, and significant strategic coordination requirements between GLWA's management and both its retail customer class in Detroit and wholesale contractual customers. Management's successful navigation of these factors continues to provide key credit support.

- GLWA serves the city of Detroit retail customer class, whose relationship with the city and its water and sewer department (DWSD) is governed by a number of foundational agreements and other documents stemming from GLWA's incorporation. These agreements serve as additional support for the rating because they provide a basis for codification of financial and operational practices for DWSD while GLWA retains ultimate rights for rate-setting, billing and collecting revenue from the retail class customers.
- Sophisticated financial and capital planning combined with a wholesale rate structure that has a 60% fixed-cost recovery component helps add predictability to GLWA's future financial performance, in our view.
- To meet GLWA's financial forecasts, management will rely on continued rate adjustments for both its retail and wholesale customer classes, which could cause downside financial risks if either they aren't implemented as forecast or other positive variances aren't achieved.
- Revenue from Detroit retail customers only represents about 25% of revenue collected within the GLWA water trust, and there are significant social risks to consider given the economic disparities within the city. GLWA and DWSD will need to continue active management of delinquent accounts in Detroit (DWSD's collection rate for its 248,000 active retail accounts is reported by management to be 87%). Both GLWA and DWSD management will need to continue balancing implementation of its assistance programs while also achieving higher collection rates within Detroit.
- GLWA and DWSD are party to litigation, some of which could cause material financial impacts depending on the outcome. As these suits resolve, we would incorporate any material financial effects into our analysis.

Environmental, social, and governance

Minimizing governance risk lies primarily in maintaining collaboration with both suburban wholesale customers and DWSD management. All these efforts require considerable staff resources, but these efforts also are credit supportive as long as GLWA is able to continue providing its services without significant customer discord that disrupts revenue collections. Litigation with Highland Park has been ongoing for decades, but has just been resolved with financial assistance for improvements to Highland Park's utility system coming from the State of Michigan.

Many procedures involving DWSD regarding capital and budget planning, management of budget variances, sharing of services to gain efficiencies, and reporting requirements are built into key documents to which GLWA and Detroit are party. The "One Water Partnership" between GLWA and its suburban wholesale customers generally facilitates information sharing, capital project coordination, and technical assistance.

GLWA has significant social risks to manage given the wide diversity in economic and demographic bases served by the utility. We consider social risks credit neutral, but both GLWA and DWSD management will need to continue balancing implementation of its assistance programs while also achieving higher collection rates within Detroit. GLWA's Water Residential Assistance Program (WRAP) is designed to both provide bill assistance and household water audits to all qualified residents within GLWA's service territory. DWSD management also has a dedicated shut-off program implemented by an outside contractor. In 2022, DWSD also launched a lifeline program for residents in Detroit that is funded by WRAP and other state grants and federal resources such as the Low Income Water Assistance Program (LIWAP). WRAP is supported from revenue generated from water and sewer rates.

We view environmental risks to be credit neutral, with the most acute potential risk being exposure to future lead and copper rule changes and Polyfluoroalkyl Substances (PFAS) regulation. We believe lead and copper rule changes

would mostly directly affect DWSD operations and capital requirements, but could also affect GLWA's operations if corrosion control measures need to be substantially modified. Management has represented that PFAS is currently undetectable in its drinking water but has a monitoring program to identify point sources of the substances. GLWA's five water treatment plants provide significant excess capacity of 1,720 million gallons per day (mgd), which typically provides about 60% headroom compared to maximum daily usage.

Outlook

The stable outlook reflects our expectation that GLWA will continue its steady financial performance while funding all its needed capital projects and adjusting its budget if economic headwinds or inflationary pressures are having meaningful budget impacts. Because the authority's CIP is not currently regulatory driven, we believe that flexibility to shift capital spend targets and/or revenue requirements due to economic or inflationary pressures will help minimize downside risks to meeting or outperforming near-term projected financial projections.

We would also expect management to continue its collaborative efforts with both member partners and DWSD to minimize environmental, social, and governance risks that could have a negative influence on credit quality.

Downside scenario

The rating or outlook could be affected if future financial performance falls below historical trends. Significant deferral of capital projects, while providing cash flow flexibility, could also lead to downside pressure on the rating or outlook if the deferrals weaken GLWA's asset renewal and replacement efforts.

Upside scenario

If economic recovery in Detroit continues and starts to have meaningful positive effects on its economic fundamentals and utility collection rates, then the rating could be improved. We also would consider an upgrade if GLWA meaningfully outperforms historical financial trends, funds its capital improvement plan (CIP) generally as planned, and the improvements are sustainable over a long-term horizon.

Credit Detail

A number of key provisions in the lease agreement, service agreement, and memorandum of understanding (MOU) between GLWA and Detroit support the ability of the GLWA regional system to help make the net revenue originating from Detroit's local system more predictable despite various economic and collection risks:

- GLWA sets revenue requirements for DWSD that are related to the costs for providing services, and, in turn, Detroit sets retail rates in a fashion that meets GLWA's revenue requirement.
- Explicit language that requires all revenue collected by Detroit be held in segregated accounts in trust and remitted within five days of receipt to a trustee-held pledged revenue account under the Master Bond Ordinance.
- A services agreement between GLWA and Detroit that holds the city to performance and administrative standards to maintain its agency relationship with GLWA for rate-setting and revenue collection.
- Requirements that both GLWA and Detroit retail maintain a biennial budget and a five-year CIP.

- DWSD is required to submit periodic budget and operational reporting requirements to GLWA and discuss these results at a Reconciliation Committee, which is also the initial mechanism to develop a plan for DWSD to cure any budget shortfalls. If there are any, then the MOU between the two entities describes a workout mechanism to recover the budget shortfalls over a period no longer than the next three fiscal years.

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 May 14, 2024)		
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2005-SRF1 due 10/01/2026		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2005-SRF2 due 10/01/2026		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2006-SRF due 10/01/2026		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2008-SRF due 10/01/2028		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2016A-SRF due 04/01/2048		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2016B-SRF due 04/01/2048		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr supp sys rev bnds ser 2017-SRF due 10/01/2048		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (Sr lien)		
Long Term Rating	AA-/Stable	Affirmed
Great Lakes Wtr Auth wtr (Sr lien) (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (Sr lien) 2005B (BHAC)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (2nd lien)		
Long Term Rating	A+/Stable	Affirmed
Great Lakes Wtr Auth wtr (2nd lien) (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of May 14, 2024) (cont.)

Great Lakes Wtr Auth wtr (2nd lien) (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (2nd lien) (MBIA)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Great Lakes Wtr Auth wtr (2nd lien) (MBIA) (National)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Michigan Finance Authority, Michigan		
Great Lakes Water Authority, Michigan		
Michigan Fin Auth (Great Lakes Wtr Auth) wtr (AGM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) wtr (BAM) (SECMKT)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) wtr (National)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) WTRSWR		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) WTRSWR		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) WTRSWR		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Michigan Fin Auth (Great Lakes Wtr Auth) WTRSWR (AGM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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