

RatingsDirect®

Summary:

Metropolitan Water Reclamation District of Greater Chicago, Illinois; General Obligation

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Long Term Rating

AA+/Stable

Upgraded

Credit Highlights

- S&P Global Ratings raised its long-term rating to 'AA+' from 'AA' on Metropolitan Water Reclamation District of Greater Chicago (MWRD), Ill.'s general obligation (GO) debt.
- The rating is no longer under criteria observation.
- The outlook is stable.
- The raised rating is based on criteria implementation, reflecting MWRD's comprehensive operational management policies, extremely strong liquidity, and affordable rates that provide ample rate capacity for the capital plan.

Security

MWRD's full faith and credit is pledged to the GO bonds. The unlimited-tax bonds are payable from a designated property tax levy without limitation as to rate or amount. The limited-tax bonds are payable from a designated property tax levy without limitation as to rate but limited as to amount. Levies are billed and collected by Cook County and then remitted directly to the treasurer. We do not differentiate between limited and unlimited liens given the taxing capacity.

Credit overview

MWRD benefits from its extremely large, diverse service area with income levels that support a healthy market position, even assuming a nearly \$800 million capital plan. The management team has prudent operational and financial policies in place that support somewhat narrower financial margins than those of highly rated peers. The primary near-term risk for MWRD stems from an outsized pension burden, which management has a plan in place to address. Given the market volatility, pension liabilities may be exacerbated. We account for the significant pension cost, including the planned supplemental contributions to the plan.

Environmental, social, and governance

We believe MWRD's capital plans and mission to improve water quality, protect properties from flood damage, and sustainability and resiliency plans, as they are implemented, set it on the path to mitigate environmental risk and we view its social risk as neutral to the credit rating analysis. We believe that the MWRD's governance risk is elevated compared to sector standards due to its weakly funded pension plan.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that management will likely preserve the system's financial profile and maintain its strong financial and operational policies. The depth and diversity of the service area's economy and customer base provide additional rating stability, in our view.

Downside scenario

We could lower the rating if management fails to maintain structural balance, including an inability to offset unanticipated capital expenses or increased pension liabilities.

Upside scenario

If the MWRD's future pension contributions remain manageable, while it maintains or improves on other relevant credit factors, we could raise the rating.

Credit Opinion

Enterprise profile

MWRD provides flood control, wastewater treatment, and environmental sustainability to an extremely broad service area of over 880 miles within Cook County, including Chicago and 128 suburbs. The population is substantial, with over 5 million people and significant commercial and industrial anchor customers. The size and depth of the service area is a credit strength, especially given that most revenues are derived from property taxes. Income levels are sufficient to support the expected capital plan, reaching roughly the national average. The poverty rate is nearly 13%, which we deem as slightly elevated, but rates are extremely low relative to both income and regional levels, supporting our view that district has a very strong market position.

MWRD collects wastewater, conveys it to wastewater reclamation plants, provides full secondary treatment, and discharges clean water to local waterways. The facilities are compliant with permits, and there is significant additional capacity. The comprehensive pollution and flood control program has been effective, eliminating about 85% of the pollution attributed to sewer overflow. We believe the asset management is prudent and includes significant maintenance (and renewal and replacement) and a detailed pay-go program. The capital improvement program (CIP) includes improvements to sewage treatment works, administrative buildings, water quality improvement projects, and flood control facilities. This strengthens our view of operational stability given that MWRD has a comprehensive plan to maintain assets, which reduces the likelihood of infrastructure-related risks. From a regulatory perspective, new state and federal rules on perfluoroalkyl and polyfluoroalkyl substances may affect MWRD, but the cost is uncertain and we believe MWRD currently has significant rate cushion and tax capacity to mitigate some of this risk. Management is addressing reduced phosphorus at its operating facilities before those requirements are required in 2024 at the Calumet facility. Several projects are included in the capital plan to address these needs.

Organizational effectiveness is also strong. While MWRD doesn't have formal succession planning, there are strong informal succession practices that incorporates diversity goals and retainment objectives. The result has been extremely low turnover and strong labor relations. MWRD also has comprehensive strategic and emergency response

planning and detailed cyber management, which we view favorably. Climate resilience and environmental stewardship are integrated into all aspects of planning, which we view favorably given associated risks to the system. Management has developed a Climate Action Plan (CAP) to support wastewater treatment and stormwater management services in its service area to adapt to climate-related challenges. The CAP objectives are consistent with the Paris Agreement and the U.S. Climate Alliance. Rate-setting practices are also sufficient and include incorporation of capital and debt needs. The enforcement of collections is strong given the ability to attach liens for nonpayment of property taxes. Overall, we believe MWRD's operational management assessment is a significant credit strength.

Financial profile

MWRD has a healthy financial position, with coverage averaging above 1.2x and ample liquidity that is nearly equal to a year of expenses. MWRD's primary challenge in its budget, in our view, is absorbing continuing pension contributions in a climate of tepid revenue growth, given that its budget is mainly property tax funded. While the MWRD is not seeking revenue increases that go beyond statutory limits, we note that local taxpayers are facing growing tax burdens from a variety of jurisdictions, which may contribute to future taxing considerations, despite sufficient capacity. The general corporate fund increased by \$63.5 million in 2021 (\$30 million of which was a supplemental contribution to the pension fund in 2022). Management projects a \$50 million increase in the fund balance in 2022, which will be dedicated to one-time expenditures such as supplemental pension contributions and pay-as-you-go capital projects. Management notes the potential for increased costs of purchasing equipment and supplies in 2022 due to both inflation and supply chain issues. In addition, expected higher interest rates over the longer term, which could result in higher investment interest income but also higher borrowing costs, including for recently authorized (but unissued) pension obligation bonds (POBs). Tax revenues are trending positively while user fees are down slightly due to refunds and credits. Overall, MWRD expects positive operating performance for fiscal year-end (Dec 31). The 2023 budget is in progress and will be issued in October.

Given the funding levels of the pension plan, we anticipate contributions will continue to rise and could pressure the budget, especially since revenue-raising flexibility is limited. However, MWRD officials have a history of managing discretionary expenditures and we expect fiscal balance will be maintained in 2022 and 2023. Overall, management has demonstrated sound financial management including:

- Use of historical information and forecasts from external sources;
- Quarterly updates of revenue and expenditure performance;
- Five-year forecasting;
- Long-term capital planning for five years and 30 years; and
- Policies that guide reserve levels in the corporate fund, working cash fund, and reserve claim fund, all geared toward ensuring cash flows in the event of unanticipated revenue fluctuations.

The five-year CIP is nearly \$800 million and is funded through a mix of pay-go and debt. Major elements in the CIP include the collection system, water reclamation plants and solids management, Tunnel and Reservoir Plan ("TARP"), stormwater management, and replacement of facilities. MWRD may issue POBs, which, given market conditions, could exacerbate pension-related financial stress if investment returns fail to reach assumptions.

The debt burden is manageable but on the higher side, especially when incorporating pension and other postemployment benefits (OPEB) costs. MWRD has nearly \$3 billion of total debt outstanding. We consider MWRD's overall debt burden moderate on a per capita and market value basis but more elevated relative to capitalization. Amortization is slower than average, with 47% of debt service due to be retired within 10 years. Pension and OPEB contributions accounted for 11% of total governmental funds expenses in fiscal 2021 and are likely to increase, which we accounted for in the debt assessment.

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 August 17, 2022)		
Metro Wtr Reclamation Dist of Greater Chicago GO		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
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