Fitch Affirms Met Wtr Reclamation District of Greater Chicago, IL GO Bonds at 'AAA'; Outlook Stable

Fitch Ratings - New York - 09 Sep 2021: Fitch Ratings has affirmed the 'AAA' rating on the following obligations of the Metropolitan Water Reclamation District of Greater Chicago, IL (the District):

--Approximately $687.4 million unlimited tax bonds;

--Approximately $1.1 billion limited tax bonds.

Additionally, Fitch has affirmed the District's Issuer Default Rating (IDR) at 'AAA'.

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AAA' IDR and bond ratings reflect the District's very strong revenue defensibility and very low operating risk profiles. The rating also incorporates the District's ability to access the resource base of its favorable service area through ad valorem taxing authority; the District does not collect a retail user charge. Fitch assesses the District's financial profile at 'aa' given the leverage ratio, measured as net adjusted debt to adjusted funds available for debt service (FADS), approximating 9.6x in 2020 (PYE Dec 31).

Fitch has also considered the District's leverage profile in the context of the service area's (Cook County) resource base. From this vantage, its long-term obligations approximate 1.3% of total personal income. When combined with the District's ability to levy taxes to pay debt service and operations, this expanded view of leverage supports its overall rating.

CREDIT PROFILE

The District is an independent unit of government focused on wastewater treatment, stormwater management and flood control, and related environmental sustainability. It encompasses over 90% of the land area and virtually all of the equalized assessed valuation (EAV) of Cook County (IDR A+/Stable). The District provides wastewater treatment services to a population in excess of 5.2 million people located in the city of Chicago and 128 suburban municipalities. The city of Chicago comprises over 50% of the district's population and approximately 55% of the EAV.

The District collects wastewater from municipalities in its service area, conveys it to wastewater reclamation plants, provides full secondary treatment, and discharges clean water to local waterways. The District is also responsible for stormwater management for all of Cook County, including areas outside the District's boundaries for wastewater services. The District's total treatment capacity exceeds 2.0 billion gallons per day (BGD) and in 2020 it treated an average of 1.25 BGD.

Coronavirus Considerations
The District's 2020 financial performance was not materially impacted by the outbreak of coronavirus and related government containment measures. Management reports that, based on performance to date, 2021 performance has not been impacted thus far.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Very Strong Revenue Defensibility Supported by Stable Revenues and Favorable Service Area

The District's favorable service area is broad and diverse and includes the vast majority of Cook County. Ad valorem taxes are its primary source of revenue, insulating it from volatility associated with volumetric changes. While operating levies are generally limited by statute, the District retains strong revenue raising flexibility when viewed against the relative stability of this revenue source.

Operating Risks 'aa'

Very Low Operating Cost Burden; Significant Capital Investment Supports a Low Life Cycle Ratio

The District's operating cost burden is very low, less than $1,120 per million gallons (MG) treated, and reflects the significant economies of scale of operations as well as its focused operating mandate. The life cycle ratio is just 4% and should remain low as it continues to implement a still large capital improvement program (CIP).

Financial Profile 'aa'

Very Strong Financial Profile Supported by Access to Broad Resource Base

The District's leverage ratio of 9.6x in 2020 reflects a historically significant and largely debt funded CIP. Its revenue structure enables it capture the broad resource base of the favorable service area. The liquidity profile remains neutral to the assessment.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affected this rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable given the 'AAA' rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Long-term liability burden as measured in the context of the resource base that no longer supports an enhancement as reflected in the rating;

--Downward revision in the revenue defensibility assessment, reflecting sustained economic contraction in the service area.

Best/Worst Case Rating Scenario
International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

**SECURITY**

The bonds are direct and general obligations of the District, the payment for which the full faith and credit of the District are pledged. The unlimited tax bonds are payable from ad valorem taxes levied upon all taxable property within the District without limitation as to rate or amount. The limited tax bonds are payable from ad valorem taxes levied upon taxable property within the District without limitation as to rate, but the amount of the taxes that may be extended to pay them is limited as provided by law.

In addition to the full faith and credit security provisions of all bonds, the 2014 series B and 2016 series E bonds are also payable from stormwater management tax receipts. The District is required to deposit into the debt service fund on or before the last business day of February of each year stormwater management tax receipts to pay debt service payments through the following Dec. 1. This funding must occur before the District may abate the direct annual tax levy also securing 2014 series B and 2016 series E bonds.

**Revenue Defensibility**

The District's revenue defensibility incorporates the favorable service area, which includes the majority of Cook County. Cook County median family income is marginally above national levels, as the wealthier suburban area offsets the urban core. The unemployment rate was 4.0% in 2019, in line with that of the state and marginally above that of the nation (3.7%). In 2020, the unemployment rate grew to 11.1%, and was over 135% of the national rate of 8.1%. Unemployment rates have not improved materially through the first half of 2021, and while the gap relative to the state has narrowed, unemployment relative to the nation has deteriorated. Sustained weakness in employment, could result in a revision of the revenue defensibility assessment.

The District does not levy a retail utility charge, instead funding debt service and the majority of its operating costs through ad valorem taxes. It imposes incremental charges for large users, and receives Personal Property Replacement Taxes, which together accounted for 19% of 2020 General Corporate Fund revenues. Based on the District's total tax rate in 2020, the monthly charge is affordable for approximately 90% of its service area.

Although the District's ability to raise ad valorem taxes is limited for certain operations, it retains meaningful revenue raising flexibility in the context of the relative stability of this revenue, which largely insulates it from revenue fluctuations related to changes in treated volumes. The District is not limited in its ability to levy taxes for debt service.

**Operating Risks**

The District's operating risk is assessed at 'aa', reflective of both a very low operating cost burden and life cycle ratio, which is supported by ongoing capital investment. Its service area is large, but its operational
focus limits the likelihood of unexpected or significant cost increases driven by changes in its mandate or operational requirements.

Operating costs were less than less than $1,120 per MG treated in 2020. Operating costs per MG reflect the approximately 1.25 billion gallons per day treated and nature of the District's operations. Operating costs are expected to grow generally in line with inflation. The District levies a tax for retirement costs that is separate from and in addition to other levies, limiting the impact on funding for operations.

The District continues to have a significant unfunded pension liability, which approximated $1.5 billion in 2020 (as calculated by Fitch). However, annual costs (approximately $133 million in 2020) are manageable in the context of overall District operations and considering the separate levy. The District has made contributions to the pension fund in excess of those actuarially required since 2014, including $20 million 2020.

The District's other post-employment benefits (OPEB) Trust Fund is projected to be fully funded by 2026, providing additional financial flexibility. Once fully funded, it will eliminate the need for $5 million annual advance funding and the Trust Fund is projected to be able to support approximately $10 million in claims annually.

The CIP approximates $1.1 billion for 2021 through 2025, compared to the $892 million for 2020 through 2024. The plan remains focused on stormwater (32% of total), water reclamation plants and solids management (27% of total) and facilities replacement (23% of total). The District anticipates issuing $475 million to fund the CIP, with the potential for additional debt toward the end of the five-year period or into 2026 should conditions warrant. The remaining funds will come from current revenue and accumulated funds, including the stormwater levy. Overall, Fitch expects capital spending to be relatively stable compared to historical levels even as key projects related to water reclamation facilities and the Tunnel and Reservoir Plan are completed.

Financial Profile

The District's very strong financial profile reflects its leverage ratio of 9.6x in 2020. Leverage has declined from 11.3x in 2016 and should continue to gradually decline as CIP and associated borrowing continue to be moderate. Fitch's recent leverage calculation incorporates a more refined view of liabilities, resulting in a revised view of the District's leverage.

Liquidity remains neutral to the assessment. Coverage of full obligations (COFO) has averaged 1.1x over the past five years and is expected to remain stable through 2025 given current estimates for revenue and anticipated borrowing plans. Cash on hand is in excess of 250 days as measured by Fitch.

The District's bonds are secured by a pledge of ad valorem taxes, providing access to a broader economic base than user charges generally afford. To capture the benefit of this taxing capacity, Fitch additionally analyzed the District's long-term liability burden in the context of this resource base. As compared to the service area's personal income, the long-term liability burden is approximately 6.9%, including debt of overlapping governmental entities. When considering only the District's long-term obligations, including its unfunded pension liability, the burden is 1.3% of personal income. This low burden, and the ability to levy taxes as necessary to pay debt service, lend support to the rating despite its leverage ratio and financial profile assessment, which are less of a consideration in the final rating.

Fitch Analytical Stress Test (FAST)
The FAST considers the potential trend of key ratios in a base case and a stress case. The stress case is designed to impose capital costs 10% above expected levels and evaluate potential variability in projected key ratios.

Overall, revenue and expenditure development are based recent growth rates (around 3%), with the expenditure growth adjusted to exclude the District's additional $20 million contribution to the pension fund in 2020. Capital spending reflects the CIP as outlined in the 2021 budget, including $475 million in anticipated debt issuances, but Fitch also assumed approximately $130 million of additional debt in the latter portion of the scenario analysis to preserve proposed pay-go and cash balances.

Based on these assumptions, leverage in 2021 peaks at 9.5x and 9.6x in the base and stress cases, respectively, but then follows a gradual decline through 2025 to about 8.3x in the base case and 8.6x in the stress case, which remains supportive of the financial profile assessment.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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### Rating Actions

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**RATINGS KEY**  

- **POSITIVE**: 
  - **OUTLOOK**: 🔺  
  - **WATCH**: 🔺
- **NEGATIVE**: 
  - **OUTLOOK**: ⬇  
  - **WATCH**: ⬇
- **EVOLVING**: 
  - **OUTLOOK**: ⬇  
  - **WATCH**: 🔺
- **STABLE**: 
  - **OUTLOOK**: 🔺  
  - **WATCH**: 🔺

**Applicable Criteria**

- Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)
- U.S. Water and Sewer Rating Criteria (pub.18 Mar 2021) (including rating assumption sensitivity)

**Additional Disclosures**

**Solicitation Status**

**Endorsement Status**

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