

CREDIT OPINION

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Hartford County Metropolitan District, CT

Update to credit analysis

Summary

The credit quality of the [Hartford County Metropolitan District](#) (Aa3 GO, Aa2 revenue bond rating) reflects the MDC's large and stable service area with well above average income levels particularly in the suburban cities. The wealth of these areas helps to offset the well below average wealth indicators of the City of Hartford (Ba2 positive), which is the largest city in the system. The credit position is also inclusive of the credit quality of the underlying member municipalities. While its credit position has improved, the [City of Hartford's](#) (Ba2 positive) rating remains well below investment grade and is considerably weaker than the other member municipalities, which are generally high-Aa rated credits. The exposure to Hartford's low credit quality is in opposition to the beneficial provisions of Public Act 17-1. The act stipulates that in the event of non-payment by a member, the district can establish an emergency budget increasing the levy on other members to cover short-fall that cannot be met by the established budget. The act also allows the state to redirect a member municipality's PILOT payments to the MDC if the city fails to pay its ad valorem taxes. MDC also has a substantial debt load that will continue to grow as the system works to finance a sizeable \$2 billion capital program.

The Aa3 rated GO bonds are payable from general property tax revenues collected from the City of Hartford and the Towns of Bloomfield, East Hartford, Newington, Rocky Hill, West Hartford, Wethersfield and Windsor, Connecticut. The district is authorized to levy unlimited taxes upon the member municipalities comprising the district proportionately.

The nature of this pledge differs from the Aa2 rated revenue bonds, which are backed by a gross revenue pledge of the district's dedicated Clean Water Project Charge revenues, including transfers from the Rate Stabilization Fund. Unlike the levy for the GO bonds, the charge is billed directly to system's customers, not the member municipalities. The MDC has unlimited ability to increase the charge.

Credit strengths

- » Large service area customer base
- » Solid resident income
- » Ample water supply and treatment capacity
- » Healthy financial operations
- » Provisions of Public Act 17-1

Credit challenges

- » Sizable debt burden
- » Substantial capital plan
- » Weak credit quality of City of Hartford, the largest member municipality

Rating outlook

The stable outlook reflects our expectation that the MDC will continue to produce financial operations in line with historic performance. This view includes only moderate changes to solid liquidity and reserves.

Factors that could lead to an upgrade

- » Improved credit quality of member cities
- » Service area expansion and growth including strengthened wealth indicators
- » Further improvement in sewer and water funds' financial position, including increased liquidity and unrestricted reserves
- » Substantial debt burden decrease

Factors that could lead to a downgrade

- » Significant deterioration of member city credit quality
- » Weakening of the service area, including income and wealth metrics
- » Material reduction of MDC's cash reserves and financial flexibility
- » Weakened liquidity resulting in need for cash flow borrowing

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Key indicators

Exhibit 1

Hartford MDC

Hartford County Metropolitan District, CT

System Characteristics

Asset Condition (Net Fixed Assets / Annual Depreciation) 47 years

System Size - O&M (in \$000s) \$112,705

Service Area Wealth: MFI % of US median 121.3%

Legal Provisions

Rate Covenant (x) 1.00

Debt Service Reserve Requirement No DSRF (Baa and Below)

Management

Rate Management Aaa

Regulatory Compliance and Capital Planning A

Financial Strength

	2017	2018	2019	2020	2021
Operating Revenue (\$000)	\$144,458	\$147,325	\$167,714	\$197,970	\$169,043
System Size - O&M (\$000)	\$100,438	\$100,052	\$117,141	\$112,705	\$117,469
Net Revenues (\$000)	\$44,020	\$47,273	\$50,573	\$85,265	\$51,572
Net Funded Debt (\$000)	\$618,225	\$621,324	\$590,006	\$553,390	\$896,816
Annual Debt Service (\$000)	\$44,494	\$54,164	\$56,848	\$72,094	\$59,250
Annual Debt Service Coverage (x)	1.0x	0.9x	0.9x	1.2x	1.0x
Cash on Hand	256 days	255 days	249 days	260 days	306 days
Debt to Operating Revenues (x)	4.3x	4.2x	3.5x	2.8x	2.8x

Source: Moody's Investors Service and Hartford MDC audited financial statements

Profile

The district provides water supply, sewer collection, treatment and disposal services to its eight member communities including Bloomfield, East Hartford, Hartford, Newington, Rocky Hill, West Hartford, Wethersfield, and Windsor. The district also has special agreements for water supply and sewage disposal facilities with 10 non-member towns and various state facilities.

Detailed credit considerations

Service area and system characteristics: Large and stable service area and system

The district draws water from the Barkhamsted Reservoir, which at 30.3 billion gallons, is the single largest water source in Connecticut. MDC also has access to the Nepaug Reservoir, which holds 9.5 billion gallons. These sources provides the MDC with ample supply to meet its average daily use of approximately 40 mgd, which is a mark that has held fairly steady over the last several years. Though the pandemic drove significant declines in commercial, industrial and public water customers this was offset by increased residential water customers, which constitute 95% of ratepayers. Nonetheless, fiscal 2021 average daily consumption was 36 mgd, which was the lowest level of the last five years.

The district provides sewer service to a population of approximately 364,000 through the operation of four water pollution and treatment facilities that have a total design flow capacity of 105 mgd and a treatment capacity of 200 mgd. This compares favorably to the MDC average daily sewer flow of 80 mgd.

The district service area is large and stable. The district has a diverse set of revenue streams and is authorized to levy unlimited assessments on its member municipalities in proportion to their participation in the MDC and the revenue they provide to support debt service on the GO bonds. Current assessment proportions are: Town of Bloomfield (Aa2) 7%; Town of East Hartford (Aa3) 12%; City of Hartford 26%; Town of Newington 9%; Town of Rocky Hill 6%; Town of West Hartford (Aaa stable) 23%; Town of Wethersfield

(Aa2) 8%; and Town of Windsor 9%. In aggregate, the member communities' tax bases (equalized net grand lists or ENGLs) is quite substantial at approximately \$40 billion.

The weighted average median family income is approximately 121% of the US median, as the concentration of wealth in the suburban ring is balanced by the City of Hartford's well-below average resident incomes.

Financial operations, debt service coverage and liquidity: Water and sewer operations remain healthy

The district's financial position is solid and marked by healthy reserves and cash for both sewer and water operations. The district has benefitted from regular rate increases and generally consistent expenditure control despite the occurrence of a small deficit in the sewer fund in fiscal 2021. Moody's anticipates that the district will continue to ably manage the budget and produce financial operations in line with historical results.

Audited 2021 sewer (general fund) operations indicated a \$2.4 million decline in fund balance driven by 1.4% decline in total revenue and an 11.6% increase in spending. The decrease in revenue was driven by lower flow though offset by the district's increased sewer user charge, which rose to \$5.21 in fiscal 2021 from \$5.15 in fiscal 2020. The uptick in spending was largely driven by increased spending for capital projects and higher energy costs. Though the deficit is not substantial, it is in contrast to the projected \$6.6 million operating surplus when the district anticipated higher payroll savings and lower debt service at the time of our last review. Nonetheless the \$29.7 million fund balance is a healthy 36% of total sewer revenues and includes an unassigned portion of \$25.6 million.

For fiscal 2022 (ending December 31), the district projects a moderate \$1.2 million surplus on the strength of another sewer charge increase, which will bring it to \$5.90 per hundred cubic feet.

Audited results for fiscal 2021 show that the clean water fund produced a \$5.6 million surplus, which, as expected, is considerably better than the conservatively projected \$1.9 million deficit based on last year's mid-year forecast. This result brought reserves to \$70.7 million or a very strong 81% of revenues. Though the water fund again projects a \$1.6 million deficit based the current mid-year forecast, we expect the district to reverse this course once it receives the largest portion of its revenues, which normally occurs between June and August. We anticipate that actual results will show another modest surplus.

Fiscal 2022 debt service coverage of the revenue bonds is projected to be 2.4x. Debt service coverage including the clean water fund loan and general obligation bonds (GO bonds that were issued to support water projects) is approximately 1.05 times. However, coverage is 1.21 times with inclusion of the rate stabilization fund. The district projects revenue bond coverage to be between 2.5 and 3 times for the next three years, with coverage on all debt for the CWP projected to be between 1x and 1.2x.

Liquidity

The district's liquidity position is solid and includes \$26.9 million in cash for the sewer system (201 days cash on hand) and \$71.6 million for the clean water fund (608 days cash on hand). Available cash is also broadened by reserves held in the rate stabilization fund. We anticipate that the fiscal 2022 audit will reflect cash in line with historical averages.

Debt and legal covenants

The district is highly leveraged with debt totaling approximately 4% of the tax bases of the towns it services. The high debt burden, however, is somewhat mitigated by the self-supporting nature of the CWP.

The district entered into a consent order and a consent decree with the State Department of Environmental Protection, Department of Justice and US Environmental Protection Agency to address sanitary sewer overflow, nitrogen reduction and combined sewer overflow issues. The district developed the CWP to resolve these issues by 2029. To date, approximately \$1.74 billion in projects have been authorized with \$1.4 billion in funds spent on CWP.

Overall, the project is estimated to cost approximately \$2.1 billion. Moving forward, the district plans to fund the remaining CWP costs through SRF loans, state and federal grants and, to a lesser extent, revenue bonds, debt service on all of which will be covered by the Clean Water Project Charge.

Legal security

The GO bonds are payable from general property tax revenues collected from the City of Hartford and the Towns of Bloomfield, East Hartford, Newington, Rocky Hill, West Hartford, Wethersfield and Windsor, Connecticut. The district is authorized to levy unlimited taxes upon the Member Municipalities comprising the district proportionately.

The revenue bonds are secured by a gross revenue pledge of the district's dedicated Clean Water Project Charge revenue, including transfers from the rate stabilization fund. The charge is billed directly to system customers, not the member municipalities. The MDC has unlimited ability to increase the charge.

Debt structure

All outstanding debt is fixed-rate. The district has \$1.4 billion in debt consisting of \$912 million of general obligation bonds, revenue bonds and loans.

The revenue bonds have adequate legal protections including a rate covenant and additional bonds test of 1.2 times, as well as a closed loop flow of funds. The flow of funds mandates that the Clean Water Project Charge may only be used for debt service on CWP debt and the revenue bonds have a senior claim on clean water charges. After debt service on the revenue bonds is paid, residual charge revenues are deposited in the RSF, where they are legally available to pay debt service on any debt issued to fund the CWP as well as capital expenses for the CWP. During any period, the district can make transfers from the RSF to the revenue fund to an overall maximum of 35% of debt service on the bonds; these transfers can be included as revenue for coverage calculations to meet the rate covenant. There is no limitation on the amount of the RSF that can be used for debt service.

Debt-related derivatives

The MDC is not party to any interest rate swaps or other derivative agreements.

Pensions and OPEB

MDC maintains the Metropolitan District Employees' Retirement System ("MDERS"), which is a defined benefit, single employer retirement system. The MDERS provides retirement, disability and death benefits to plan members and beneficiaries.

The district's pension costs are manageable and only about 4% of water and sewer system revenue. In addition, the district's pensions contribution was 147% of the "tread water" indicator or the amount necessary to prevent the liability from rising over time. The district's has a \$173 million OPEB liability. However, expenses for post-employment benefits were paid out of the OPEB trust fund during fiscal year ended December 31, 2021.

ESG considerations**Environmental**

MDC is an area with low exposure to heat and water stress and medium risk for hurricanes and extreme rain. Because of its inland location, the MDC has no exposure to sea level rise. As such, environmental risks are not a material credit weakness for the district.

Social

Social factors do not represent a new material credit risk and are incorporated into the rating. Though the economy and resident income levels of the City of Hartford are weaker than the remaining portions of the district, this has not resulted in a significant change to the customer base and is somewhat offset by economic quality of the other participating municipalities.

Governance

The district is governed by a 33-member board of commissioners, with 17 appointed by the member municipalities, eight appointed by the governor, four appointed by the Connecticut State Legislature and 4 four nonvoting ex officio members from nonmember towns. The district has independent rate-setting authority for water, sewer and all surcharges, as well as the ability to levy unlimited assessments on the eight member municipalities.

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