

Research

Summary:

Hartford County Metropolitan District, Connecticut; General Obligation; Water/Sewer

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

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Credit Profile

US\$84.755 mil GO bnds ser 2023 due 08/01/2043

<i>Long Term Rating</i>	AA/Stable	New
Hartford Cnty Metro Dist GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Hartford Cnty Metro Dist clean wtr proj rev bnds		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Hartford Cnty Metro Dist GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Hartford Cnty Metro Dist GO (AGM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings assigned its 'AA' rating to Metropolitan District Hartford County (MDC), Conn.'s \$84.7 million general obligation (GO) bonds, issue of 2023.
- At the same time, S&P Global Ratings affirmed its 'AA' rating on MDC's clean water project (CWP) revenue and revenue refunding bonds outstanding.
- S&P Global Ratings also affirmed its 'AA' rating on MDC's GO bonds outstanding.
- The outlook is stable.

Security

The district's full-faith-and-credit pledge secures the GO bonds.

The clean water project charge (CWPC) revenues secure the revenue-supported bonds. The CWPC is available only to pay debt service on CWP-related debt and to pay capital expenditures for CWP capital expenses. The surcharge is not available to pay district operating expenses. Under the special obligation indenture that governs the CWP revenue bonds, the rate covenant requires the district to ensure pledged revenues available for debt service provide at least 1.2x annual debt service coverage (DSC). For calculating revenues available for debt service, bond provisions permit inclusion of transfers from the rate stabilization fund, although without exceeding 35% of annual debt service. An additional bonds test requires historical revenues available for debt service to be at least 1.2x annual DSC for one of the two years prior to additional debt issuance.

As of the last audited fiscal year ended Dec. 31, 2022, MDC had debt outstanding totaling \$656 million of GO debt,

\$309 million of CWPC supported revenue debt, and \$488 million of state revolving fund loans.

Credit overview

The 'AA' ratings reflect our view that MDC benefits from its large and affluent service area, along with strong historical financial performance. Partially offsetting these strengths is the district's sizable capital improvement plan (CIP), largely reflecting regulatory compliance needs.

While the CWP revenue bonds benefit from a dedicated pledge of CWPC revenues, the interaction between MDC's primary business lines of water and sewer services provided to its member municipalities is sufficient to consider the credit quality of all of MDC's debt as the same. On the one hand, we believe GO bondholders benefit from the ability to fund a significant amount of regulatory-driven CWP projects using a dedicated surcharge, helping diversify MDC's revenue stream. On the other hand, we believe CWP revenue bondholders benefit from MDC's ability to fund its operations from both an unlimited ad valorem tax and water/sewer usage rates because those revenue streams help keep the surcharge affordable.

MDC's diverse revenue stream helps distribute costs over a wide base of users and helps with affordability considerations, as follows:

- Water and sewer user fees (\$182 million, 2022 revenues)--designed to collect charges from large metered users with meters of 4" or larger;
- Ad valorem property taxes (\$53 million, 2022 revenues)--collected directly from member municipalities, designed to support usage costs for residential and tax-exempt users; and
- Intergovernmental revenues (\$29 million, 2022 revenues)--collected to support MDC's sludge operations and operating and capital grants.

All three of these revenue sources represented 95% of total governmental and business-type revenues in 2022.

Environmental, social, and governance

Overall, we believe environmental risks are elevated because regulatory compliance is generating a large amount of capital spending and as a result of the required revenue requirements to fund those projects. However, management continues to rehabilitate and expand its overflow treatment processes to help ensure continued compliance. The new storage tunnel being built as part of the consent order is designed to mitigate future flooding and overflow risks. Treatment capacity and water supply are adequate for current demand and for multiple years of growth. The water pollution control plant is along the Connecticut River, and the district has been improving its nitrogen removal capacity to assist with the nitrogen loading in the river and Long Island Sound. In addition, it has taken flood protection measures, including maintaining and improving dikes around all treatment facilities.

Management has begun to include an integrated planning concept into its consent order, in compliance with the Connecticut Department of Energy and Environmental Protection. We believe this should provide management with considerable flexibility to meet its consent order requirements while demonstrating compliance through rehabilitation and relining of existing infrastructure, instead of solely through new construction.

Rate affordability is considered in MDC's annual rate-setting and capital planning process, and while rates are

currently affordable, should they outpace the service area's income growth rate, it could become more of a risk, thereby increasing social risks.

We consider governance risks on balance credit neutral, but MDC's disclosure indicates some litigation regarding the CWP tunnel project, with potential claims totaling about \$80 million. Management has represented a significant amount of available contingency to mitigate the financial effects, but any negative outcome could have a material effect on CWP costs and our view on governance risk. However, strong relations with the state government and frequent outreach to the member and nonmember communities served help mitigate external political pressures on governance decisions. As with any district this size, technology is becoming more and more critical for most aspects of operations, and the district has a business continuity plan, as well as an emergency response plan, with annual vulnerability assessments, and a disaster recovery plan that includes cyber security controls.

Outlook

The stable outlook reflects our expectation that management will continue to address regulatory obligations and maintain regulatory compliance while still maintaining financial performance on par with or better than historical trends. Our analysis of MDC's financial performance combines all of its water and sewer operations to gauge traditional net revenue coverage of all its debt service costs, both GO and CWP revenue debt, and available liquidity across the entire organization.

Downside scenario

Significant consent order cost escalation, leading to liquidity draws, or unexpected revenue pressures would likely lead to downward rating pressure. If the member municipalities' tax base starts to become stagnant, leading to higher tax rates to support MDC's operations, we could also lower the rating. Additionally, the ratings on the GO and CWPC-backed bonds could be lowered if the CWPC begins to be heavily leveraged as a result of consent order cost overruns or cost escalation, in a way that leads to significant surcharge increases beyond management's current expectation of eventually needing to increase it to \$4.97 per hundred cubic feet (ccf) by 2026, from the \$4.25 currently, or meaningfully lower DSC on the CWP bonds. Management projects CWP capital project spending from 2023-2027 to be about \$424 million.

Upside scenario

We are unlikely to raise the ratings further in the near term, given the size, duration, and regulatory nature of the CIP, but could consider doing so in the long term as regulatory-related capital projects near substantial completion.

Credit Opinion

Large ad valorem tax base contributes to rating strength and stability

MDC benefits from its service to a large tax base serving a population centered in and around Hartford. The eight member municipalities, which combined have a 2022 net taxable grand list of more than \$29 billion, are Bloomfield, East Hartford, Hartford, Newington, Rocky Hill, West Hartford, Wethersfield, and Windsor. The district's fiscal 2023 full valuation of \$40.8 billion is about \$113,000 per capita, which we consider extremely strong. While Hartford's

median household effective buying income (MHHEBI) is only 60% of the national average, many of the member towns demonstrate median income levels well above the national average.

The creditworthiness of the city of Hartford (BBB/Stable) informs our view of MDC's rating. The city represents 26.2% of MDC's 2022 tax base but contributes just 15.5% of 2022 general fund revenues. To date, Hartford has made all payments on time.

Overall financial performance demonstrates strong liquidity and debt service coverage

Across all of MDC's governmental and business-type activities, which generally include water operations, sewer operations, and CWP, total cash and cash equivalents was \$182 million at Dec. 31, 2022. Historically, this figure has hovered generally around \$200 million, and we expect it to remain approximately in this range because management funds its operations and capital projects from ongoing revenues without reliance on permanent draws on its liquidity.

When considering all revenues collected for its water, sewer, and CWP operations, and netting out current expenditures for operations (excluding things like capital expenses, debt service, and depreciation), net overall revenues have covered total GO, state revolving fund, and CWPC-backed debt service by at least 1.2x since 2019, and was 1.4x in 2022. While most of the fluctuations in operating revenues and expenses have recently been due to shifts in intergovernmental receipts and noncash other postemployment benefits (OPEB) costs, respectively, we expect overall operations to remain generally stable due to the large service base and management's continued willingness to adjust rates as needed.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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