

THE BOND BUYER

S&P cuts Baltimore Mayor, Council water bonds due to EPA order

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S&P Global Ratings cut the ratings on the Baltimore Mayor and City Council, Maryland's outstanding water bonds to A-plus from AA-minus and lowered the ratings on the city's subordinate water obligations to A from A-plus.

The outlook on the credit is negative.

"The lowered ratings reflect our view of the system's ongoing operational management vulnerabilities that led to an Environmental Protection Agency administrative order and alleged violations of the Federal Safe Drinking Water Act," said S&P Global Ratings credit analyst Jenny Poree.

"The vulnerable operational management assessment caps the rating at A-plus under our criteria," she said.



An EPA administrative order and alleged violations of the Federal Safe Drinking Water Act, "reflect our view of the system's ongoing operational management vulnerabilities," says S&P's Jenny Poree.

The EPA [on May 17](#) issued a unilateral administrative order (UAO), which cited noncompliance with the long-term enhanced surface water treatment rule.

"We downgraded the water bonds one notch, which reflects the recent EPA order (a 45-day stay was just granted) and the broad asset vulnerabilities within the system," Poree told *The Bond Buyer*.

"We have concern that the ongoing regulatory challenges may pressure the system's financial position and rate-setting flexibility over time — especially if the recurring health and violations erode management's credibility with its retail base and regulators," she said.

"We believe the system is exposed to significant capital pressures to comply with the order and other health and safety requirements in a timely manner, while there is growing likelihood that the necessary rate increases to fund this capital may not be approved," S&P said in its report.

The EPA also claims the city hasn't fully complied with a 2010 consent order and the UAO requires the city to address these deficiencies by the end of 2023 and provide monthly reporting.

In its statement, the EPA cited the city for noncompliance with those regulations designed to protect public drinking water supplies from threats posed by cryptosporidium and other bacteria.

According to EPA, the city hasn't fully complied with the order requiring it to cover or provide treatment for its uncovered finished water reservoirs by Dec. 31, 2018. Two of the city's finished water reservoirs — Druid Lake and Ashburton — remain uncovered and untreated, the agency said.

"EPA is in communication with the city of Baltimore on this matter and remains hopeful to reach an agreement to address concerns with compliance," the agency said. "However, EPA has determined that a unilateral order is appropriate at this time because of repeated delays by the city."

The EPA is requiring the city to respond in writing, outlining actions it has taken and will take to comply with the order; conduct monthly monitoring and sampling of the Druid Lake and Ashburton reservoirs; and submit monthly reports on the progress it is making to install tanks to replace the two uncovered finished reservoirs.

"According to public sources, the city believes the projects can be completed by the end of the year, but has requested the EPA reconsider the requirements in the order," S&P said.

Looking at the environmental, social, and governance factors, S&P said it believes the city's utilities face heightened ESG risks.

"Environmental risks include continued regulatory findings that expose the city to potential penalties and litigation that could result in draws on liquidity or weaker financial performance," S&P said. "Primarily, our rating action and the most recent incident with the UAO stems from governance risks that include management, culture, and oversight risks as well as transparency and reporting issues that led to a vulnerable operating management assessment, given their influence on the system's assets."

"Furthermore, health and safety risks could arise if the system is unable to rectify the drinking water violations. We also believe social risks and the city's underlying demographics could constrain the system's ability to raise rates to rectify the infrastructure deficiencies," S&P said.

The rating agency noted its negative outlook on the credit "reflects a one-in-three chance that we could further lower the ratings during the two-year outlook period should the city be unable to comply with the EPA order and the potential financial implications of noncompliance."

"In our view, the city has ample liquidity, and sufficient financial capacity to incur additional debt and pay potential fines associated with noncompliance but regulatory and litigation risks remain elevated, exposing the utilities to financial deterioration," S&P said.

The federal Safe Drinking Water Act is the main federal law ensuring the quality of Americans' drinking water supply. Under this statute, the EPA sets standards for drinking water quality for public water systems and oversees states, localities and water suppliers. The law also protects water at its source, from rivers, lakes, reservoirs, springs and wells.