

Texas Water Development Board

State Revolving Fund Program

New Issue Summary

Sale Date: The bonds are expected to price via negotiation around the week of June 6, 2022.

Series: \$264,595,000 State Revolving Fund (SRF) Revenue Bonds, New Series 2022

Purpose: Bond proceeds will be used to finance eligible clean water and drinking water projects within the state, to meet state match requirements, and pay for the costs of issuance.

Security: The bonds are primarily secured by pledged clean water SRF (CWSRF) and drinking water SRF (DWSRF) obligor repayments payable from the political subdivision entities, and amounts held in certain pledged accounts.

Key Rating Drivers

Strong Financial Structure: Fitch Ratings' cash flow modeling demonstrates that Texas Water Development Board's (TWDB's) combined CWSRF and DWSRF pool programs can continue to pay SRF bond debt service, even with defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's Portfolio Stress Model (PSM).

Strong Pool Quality: Approximately 78% of the TWDB's SRF obligor portfolio is calculated to be investment grade, resulting in strong overall pool credit quality. Obligor security is also strong, with all pool obligors backed by utility or general obligation pledges, or a combination of utility/general obligation pledges.

Average Pool Concentration: The largest single obligor and the top 10 obligors account for approximately 13% and 51% of the pool, respectively, which compares favorably relative to Fitch's SRF sector 'AAA' medians of 15% and 55%, respectively.

Effective Program Management: TWDB maintains solid underwriting guidelines and monitoring procedures. Delinquencies are very rare and no permanent defaults have occurred in the TWDB's CWSRF/DWSRF programs' histories.

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:

- Significant deterioration in aggregate borrower credit quality, increased pool concentration or increased leveraging resulting in the program's inability to pass Fitch's 'AAA' liability rating stress hurdle would put downward pressure on the rating.

Ratings

New Issue

\$264.595 State Revolving Fund Revenue Bonds, New Series 2022 AAA

Outstanding Debt

State Revolving Fund Revenue Bonds AAA

Rating Outlook

Stable

Applicable Criteria

State Revolving Fund and Municipal Finance Pool Program Rating Criteria (September 2021)

Related Research

Fitch Rates TX Water Development Board's Series 2022 SRF Revenue Bonds 'AAA'; Outlook Stable (May 2022)

State Revolving Fund and Municipal Finance Pool Peer Review: 2021 (December 2021)

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Credit Profile

Through its SRF programs, the TWDB provides below-market financing to governmental entities within Texas for eligible clean water (CW) and drinking water (DW) projects. The new series 2022 bonds are the fifth issuance of obligations under the 2018 Master Resolution (2018 MR). The 2018 MR combined the previously separate CW and DW financing programs via cross-collateralization of the two funds. While the 2018 MR program is relatively new, concentration is improving with pool growth.

Financial Structure Exhibits Strong Default Tolerance

Cash flow modeling demonstrates the combined program can continue to pay bond debt service even with hypothetical obligor defaults of 96% in the first four years of the program's life and 100% in the middle and last four years of the program's life (as per Fitch criteria, a 90% recovery is also applied in its cash flow model when determining default tolerance). This is in excess of Fitch's 'AAA' liability rating stress hurdle of approximately 30%, as produced by the PSM. The rating stress hurdle is calculated based on overall pool credit quality as measured by the rating of underlying obligors, size, term and concentration.

As an additional measure of financial strength, Fitch calculates the program asset strength ratio (PASR) of the combined CWSRF/DWSRF programs. The PASR calculation includes total scheduled pledged obligor repayments plus pledged account funds divided by total scheduled SRF bond debt service. The resulting PASR is approximately 2.5x, which is considered very strong relative to Fitch's 2021 'AAA' median PASR of 2.0x.

Substantial Loss Protection

TWDB's SRF programs benefit from loss protection provided both by pledged obligor repayments in excess of bond debt service due (overcollateralization) and by amounts held in certain accounts pledged to bondholders. Obligor repayments overcollateralize bond debt service by a minimum of 2.0x annually, which compares very favorably with the 'AAA' rating category median of 1.6x.

The cross-collateralization feature of the CWSRF and DWSRF allows for shortfalls in one program to be covered by surpluses in the other, and vice versa. Fitch consequently combines the programs in its modeling analyses. Fitch views the cross-collateralization feature favorably, as it improves overall diversity and provides the program with additional credit enhancement if there is a shortfall in either of the CWSRF and DWSRF programs.

Highly Rated Pool with Average Concentration

TWDB's CWSRF and DWSRF programs exhibit strong credit quality, with approximately 78% of the pool obligations held by investment-grade borrowers, including 65% rated at or above 'AA-'. Obligor security is also strong, with nearly all backed by net system revenue pledges or a combination of utility revenue and general obligation pledges.

The combined pool is larger than average with approximately 338 obligors. The top 10 obligors represent approximately 51% of TWDB's portfolio, which is slightly better than Fitch's 2021 'AAA' median of 55%. The three largest obligors include the City of Houston (AA/Stable; 13% of the total), North Texas Municipal Water District (not rated by Fitch; 10% of the total) and the San Antonio Water System (AA/Stable; 6% of the total). Each of the remaining obligors within the top 10 range from about 2% to 6% of the total pool.

Rating History

| Rating | Action | Outlook/ Watch | Date |
|--------|----------|-------------------|---------|
| AAA | Affirmed | Stable | 5/12/22 |
| AAA | Affirmed | Stable | 9/9/21 |
| AAA | RNA | Stable | 3/26/21 |
| AAA | Affirmed | Stable | 4/7/20 |
| AAA | RNA | Stable | 1/30/20 |
| AAA | Affirmed | Stable | 2/15/19 |
| AAA | Assigned | Stable | 3/7/18 |

Largest Borrowers

| Borrower | Outstanding (\$) | % of Portfolio |
|--------------------------------------|----------------------|----------------|
| City of Houston | 622,685,000 | 12.9 |
| North Texas Municipal Water District | 493,765,000 | 10.2 |
| San Antonio Water System | 284,715,000 | 5.9 |
| Pearland | 268,985,000 | 5.6 |
| Dallas | 251,610,000 | 5.2 |
| Guadalupe Blanco RA | 112,495,000 | 2.3 |
| Riverbend Water Resources | 111,000,000 | 2.3 |
| Austin | 107,585,000 | 2.2 |
| Arlington | 102,850,000 | 2.1 |
| Fort Worth | 102,685,000 | 2.1 |
| Total | 2,458,375,000 | 50.9 |

Source: Fitch Ratings, TWDB.

Strong Program Management, Underwriting and Management

The TWDB establishes the financial terms of the obligors. In doing so, the board determines that an eligible obligor has the financial capability to ensure payment of debt service. TWDB's staff is also responsible for monitoring obligors' compliance with covenants and their overall financial profiles. Delinquencies are very rare and no permanent defaults have occurred in the TWDB's CWSRF/DWSRF programs' histories.

Series Comparison

| | 2021 'AAA' Median ^a | TWDB Ser. 2022 | TWDB Ser. 2021 | TWDB Ser. 2020 | TWDB Ser. 2019 |
|---|-----------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Revolving Fund Type | — | CWSRF/DWSRF | CWSRF/DWSRF | CWSRF/DWSRF | CWSRF/DWSRF |
| Purpose | — | Financing | Financing | Financing | Financing |
| Total New Issuance (\$ Mil.) | — | 264.6 | 413.6 | 481.7 | 267.2 |
| Fitch Rating | — | AAA | AAA | AAA | AAA |
| Rating Date | — | 5/13/2022 | 9/9/2021 | 4/7/2020 | 2/14/2019 |
| Fitch Default Tolerance Test (%) | | | | | |
| Minimum Default Tolerance Rate | 100.0 | 95.7 | 100.0 | 100.0 | 100.0 |
| Less: Fitch PSM Stress Hurdle | (30.6) | (30.3) | (28.4) | (33.5) | (31.2) |
| Rating Stress Cushion | 69.4 | 65.4 | 71.6 | 66.5 | 68.8 |
| Financial Structure (\$ Mil.) | | | | | |
| Total Outstanding Program Bonds | 369 | 1,452 | 1,215 | 984 | 556 |
| Program Assets (\$ Mil.) | | | | | |
| Total Pledged Revenues Excluding Reserves | 1,638 | 5,215 | 4,983 | 4,478 | 4,527 |
| Total Pledged Revenues Including Reserves | 1,774 | 5,215 | 4,983 | 4,478 | 4,527 |
| Debt Service Reserve Fund Balance | 2.6 | 0 | 0 | 0 | 0 |
| Program Liabilities (\$ Mil.) | | | | | |
| Total Debt Service | 625 | 2,123 | 1,781 | 1,522 | 872 |
| Financial Ratios | | | | | |
| Projected Minimum Annual DSC (x) | 1.6 | 2.0 | 2.4 | 2.3 | 3.4 |
| Program Asset Strength Ratio (x) | 2.0 | 2.5 | 2.8 | 2.9 | 5.2 |
| DSRF as % of Bonds Outstanding | 2.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Portfolio Summary | | | | | |
| No. of Borrowers | 202 | 338 | 341 | 318 | 297 |
| Implied WA Pool Rating (PSM) | BBB | BBB | BBB+/BBB | A- | BBB+ |
| WA Life (Years) | 16.9 | 24.9 | 24.8 | 24.0 | 22.6 |
| % Investment Grade | 72.9 | 77.9 | 81.5 | 86.4 | 84.6 |
| Top 10 Concentration (%) | 55.4 | 50.9 | 50.9 | 52.1 | 54.3 |
| Largest Single Borrower (%) | 15.3 | 12.9 | 11.7 | 15.8 | 17.5 |
| Largest Borrower Composite Rating | AA- | AA | AA | AA | AA |
| Security Pledge Distribution (%) | | | | | |
| Pledge 1 | — | Utility Revenues (78.5) | Utility Revenues (77.9) | Utility Revenues (76.4) | Utility Revenues (61.4) |
| Pledge 2 | — | GO and Utility (20.8) | GO and Utility (21.5) | GO and Utility (22.6) | GO and Utility (37) |
| Pledge 3 | — | GO (0.7) | GO (0.6) | GO (1) | GO (1.6) |

^aBased on data collected for Fitch's peer review (through Nov. 30, 2021). WA - Weighted average.
Source: Fitch Ratings, TWDB.

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