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Ratings

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Summary:

Texas Water Development Board; State Revolving Funds/Pools

Primary Credit Analyst:
Adam Torres, New York + 1 (212) 438 1141; adam.torres@spglobal.com

Secondary Contact:
John Kennedy, CFA, Chicago +1-312-233-7088; john.kennedy@spglobal.com

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Credit Profile		
US$915.545 mil st wtr implementation rev fd for texas, rev bnds ser 2022 due 04/15/2039		
Long Term Rating	AAA/Stable	New
Texas Wtr Dev Brd SFRP		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd SRFP		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' rating to the Texas Water Development Board's (TWDB) anticipated $916 million series 2022 State Water Implementation Revenue Fund for Texas (SWIRFT) revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on the TWDB's SWIRFT bonds outstanding.
- The outlook is stable.

We borrowed elements of our criteria "Commercial Paper, VRDO, And Self-Liquidity," published July 3, 2007, specifically the adoption of asset discount factors, to stress the market value of certain SWIFT fund holdings, namely equities, that may be used for SWIRFT purposes.

Security

Bond proceeds will be used to purchase 17 political subdivision obligations (PSOs) from 13 different entities. The bonds are secured by the repayment of those PSOs, along with funds transferred from the State Water Implementation Fund for Texas (SWIFT) to the SWIRFT.

Credit overview

We assessed SWIRFT's enterprise risk profile as very strong, given that the program was established through the passage of a constitutional amendment, was capitalized via a direct equity contribution, and is managed by a governmental agency. We believe the program's financial risk profile is extremely strong, reflected by the loss coverage score (LCS), operating performance, and financial policies.

The combination of the risk profiles scoring, along with a positive overriding factor due to the lack of any default or delinquency in all TWDB programs for an extended period, leads to the 'AAA' rating. Key to the rating is that, if necessary, the SWIFT account may address PSO delinquencies and defaults; we have stressed these funds during our loss coverage analysis and our evaluation of the financial risk profile.

Outlook

The stable outlook reflects our expectation that, in line with historical trends, embedded policies and procedures will remain consistent; proactive financial management will ensure stable cash flows that meet program goals and objectives; and the SWIFT funds, while established to provide for growth in the fund, will also provide for a high level of potentially available funds for SWIRFT programs, including addressing any potential defaults or delinquencies. The stable outlook also incorporates our expectation that TWDB management will maintain the ability and willingness to address any SWIRFT account shortfalls through additional bond-enhancement agreements as required.

Downside scenario

We could lower the rating if the SWIFT is leveraged to the point of creating a stress level for which the fund is unable to compensate. A change in the policies, procedures, or governing legislation that allows for, or creates significant dilution of available SWIFT balances could pressure the rating. Finally, if management demonstrates an unwillingness to take appropriate steps to cure any revenue shortfalls in the respective SWIRFT accounts, we could also take a negative rating action.

Credit Opinion

SWIRFT program

In November 2013, voters approved an amendment to the state constitution, which created the SWIFT and the SWIRFT. To initially capitalize the SWIFT, $2 billion was transferred from the state's economic-stabilization fund and placed in the SWIFT. Funds held in the SWIFT are managed by the Texas Treasury Safekeeping Trust Co. The SWIFT was established to provide financial assistance for state water plan projects and had a market value of $1.8 billion as of March 31, 2022.

Although the balance in the SWIFT is not pledged to the bonds, the use of the funds in the SWIFT is highly restricted and they can be used only for state water plan projects. Although these projects could include other TWDB programs, it remains the board's intent that the corpus of the SWIFT be available to make annual transfers to the SWIRFT to fund local water projects. The availability of the S&P Global Ratings-stressed SWIFT balance and the board's willingness to approve additional transfers to cover any shortfalls in the SWIRFT accounts remain, collectively, a critical factor in our assignment and maintenance of the 'AAA' rating.

With each issuance of bonds, a bond-enhancement agreement is executed and a transfer of funds from the SWIFT to the SWIRFT occurs. This transfer is sized to provide for the targeted subsidy amount determined by the TWDB. The corpus of the transfer, coupled with projected interest earnings and the scheduled repayments of the PSOs, is designed to provide 1.0x annual debt service coverage for each series of bonds. The transfer amount is determined in connection with each bond issue. Bonds projected to be issued in subsequent years will not be on parity with these, or with any previously issued, bonds. Each bond series is supported by a specific revenue stream, although that stream will always include certain PSO repayments and the related transfer from the SWIFT to the respective SWIRFT assistance account under that specific bond-enhancement agreement. The TWDB is authorized to execute no more than two bond-enhancement agreements each fiscal year.

Enterprise profile

The very strong market position score reflects the fact that the program was established through the passage of a constitutional amendment, was capitalized via a direct equity contribution, and is managed by a governmental agency. However, additional governmental support or contributions are not anticipated. The TWDB was created in 1957, with a mission of providing leadership, information, education, and support for planning, financial assistance, and outreach for the conservation and responsible development of water. It is responsible for long-term water planning and is primarily responsible for the state's financial programs associated with the water industry, including the establishment of policy for the financial programs.

We do not consider the program to be geographically concentrated, although densely populated areas of the state will likely require more funding.

Financial profile

Revenues from the PSOs do not initially provide 1.0x coverage of the annual bond principal and interest payments. The initial transfer of funds from the SWIFT is designed to cover that shortfall, which in effect creates a subsidy to the program participants. As the cash flows are currently structured, and assuming less than 100% recovery of any PSO defaults within the program, only a minimal level of defaults can be absorbed unless either projected interest earnings on any of the indenture accounts are significantly higher than projected or funds are accumulated in surplus accounts. Because of this, the rating is dependent on the mechanism that allows, but does not require, TWDB management to execute additional bond-enhancement agreements to address any SWIRFT shortfalls. TWDB management's ability and willingness to transfer funds if necessary is a key credit consideration.

Another factor that supports the extremely strong loss coverage score is the generally high credit quality of the participants. Following this round of funding, there will be 160 PSOs. Although there is some concentration in the SWIRFT program, with the top five borrowers representing 65% of PSOs by dollar amount, these borrowers are all rated at least 'AA-'. Furthermore, throughout the program, no single borrower exceeds 20% of PSO dollars; we expect diversification to continue.

Management's intent is to eventually provide financial assistance of more than $27 billion, which would be supported by PSO repayments and future bond-enhancement agreements. Because of this, the investment strategy related to the SWIFT will become more critical as additional leveraging takes place. The SWIFT is actively managed by the Texas Treasury Safekeeping Trust Co., with many investment options available to maximize returns through a dynamic financial analysis model. In our view, a sufficient portion of the SWIFT is liquid, with a target allocation of 10% to be held in cash. This is in addition to the amount annually transferred to the SWIRFT program. Other investments include global equities, hedged equities, and global fixed income. The SWIRFT accounts are held at the trustee levels, and invested subject to the Texas Public Funds Investment Act.

Other factors supporting the extremely strong financial risk profile are the strong policies and procedures in place for administration of the SWIFT and SWIRFT. Management has an established application process for all of the board's financial assistance programs. Each year, TWDB staff review every SWIFT program participant's financial status. In addition, to guard against effects on future debt service payments, sufficiency of PSO revenue is required to be calculated at least 40 days in advance of the upcoming principal or interest payment date. Management also has well-established investment policies and guidelines.

Rating above the sovereign

Because we view securitizations backed by pools of public-sector assets as highly sensitive to country risk, the rating on the securitization is capped at two notches above the sovereign. However, no specific sovereign default stress is applied, given that the U.S. sovereign rating is 'AA+'.