FitchRatings

Texas Water Development Board (State Water Implementation Revenue Fund for Texas)

Ratings

New Issue

$964,770,000 State Water Implementation Revenue Fund for Texas Revenue Bonds, Series 2023A (Master Trust)	AAA
$5,095,000 State Water Implementation Revenue Fund for Texas Revenue Bonds, Series 2023B (Taxable) (Master Trust)	AAA

Sale Date

Oct. 12, 2023

Outstanding Debt

$7,323,635,000 State Water Implementation Revenue Fund for Texas Revenue Bonds	AAA

Rating Outlook

Stable

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (April 2023)

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

Related Research

Fitch Rates Texas Water Development Board's Series 2023 SWIRFT Revs 'AAA'; Outlook Stable (August 2023)

The 'AAA' rating reflects the ability of the State Water Implementation Revenue Fund for Texas (SWIRFT) program's (the program's) financial structure and funding mechanisms to absorb hypothetical pool defaults in excess of Fitch Ratings' 'AAA' stress scenario without causing an interruption in bond payments. Fitch's cash flow modeling demonstrates that the program can continue to pay bond debt service even with a default tolerance rate of up to 67%. The default tolerance rate remains well in excess of the 'AAA' liability rating stress hurdle (LRSH) of 35%, which is determined by Fitch's Portfolio Stress Model (PSM). The PSM stress hurdles reflect the pool's aggregate credit risk.

Security

Bonds are backed primarily by political subdivision obligation (PSO) repayments and certain pledged accounts tied to each series of bonds. In addition, although neither pledged nor a legal requirement, in its sole discretion, the Texas Water Development Board (TWDB) may request that funds be transferred from the approximately $1.7 billion (as of March 31, 2023) balance of the State Water Implementation Fund for Texas (SWIFT) to the SWIRFT program to protect against bond debt service shortfalls. SWIFT funds are constitutionally protected and are only available to support TWDB's Texas State Water Plan (SWP) projects.

Key Rating Drivers

Portfolio Credit Risk: The combined PSO pool credit quality is very strong — approximately 87% of the portfolio is rated at least investment grade — but the pool remains somewhat concentrated. The pool's top 10 concentration is approximately 83%, which is above Fitch's 'AAA' rating category median of 55%. The SWIRFT program pool, which has diversified over the past eight years as new obligors have been added to the portfolio, is expected to become less concentrated over time as the SWIRFT program grows.

Financial Structure: Fitch's cash flow modeling demonstrates that program resources are sufficient to protect bondholders from losses under various default scenarios. While the majority of the funds for debt service on the bonds are provided by the program's PSO repayments, funds in the program's SWIRFT assistance accounts are required to ensure full and timely payment of debt service.

Additional loss protection can be provided by funds available in the SWIFT investment portfolio, if necessary, although the funds are not pledged, and the transfer of such funds remains at the sole discretion of TWDB. The Texas Treasury Safekeeping Trust Company (TTSTC) is responsible for managing the SWIFT investments, the growth of which could aid growth of the SWIRFT program by providing future subsidies.

Program Management: TWDB handles management responsibilities for the SWIRFT program. TWDB has extensive experience in managing large state pool programs, such as TWDB's State Revolving Funds (AAA/Stable). Additionally, Fitch believes the essentiality of the SWIRFT program, given its role in implementing the Texas SWP, has been demonstrated by strong state and voter support that led to the enabling legislation and creation of a constitutionally dedicated fund to capitalize the program (the SWIFT account).

Analysts

Tim Morilla
+1 512 813-5702
tim.morilla@fitchratings.com

Major Parkhurst
+1 512 215-3724
major.parkhurst@fitchratings.com

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/downgrade

- Deterioration in aggregate pool credit quality or large increases in program leverage.
- Substantial reductions in the availability of investment assets due to encumbrance, market value declines or a move toward less liquid asset types.

Factors that could, individually or collectively, lead to positive rating action/upgrade

- The ratings are at the highest level on Fitch's scale and cannot be upgraded.

Credit Profile

TWDB's SWIRFT program facilitates the issuance of revenue bonds, the proceeds of which provide favorable financing to local governmental entities for eligible SWP projects. The SWIRFT and SWIFT programs were approved by voters in 2013 for the purpose of meeting the state's rapidly growing water needs. The SWIFT program was capitalized the same year with a one-time transfer of $2.0 billion from the state’s economic stabilization fund.

Recent pool metrics and program cash flow ratios are mixed but have remained relatively stable since Fitch's August 2022 review. Cash flow model results have weakened, albeit marginally, as the projected increase in debt service payments is not fully offset by the projected increase in loan repayments. Still, cash flow model results passed Fitch's 'AAA' stress hurdle with ample cushion. The SWIFT investment remained relatively stable at $1.7 billion as of March 31, 2023. PSM LRSHs remained in line with the prior review and continue to reflect the pool’s robust credit quality (lower LRSHs represent an overall improvement in pool metrics).

SWIRFT Portfolio Highly Rated Yet Concentrated

Upon issuance of the series 2023 bonds, the SWIRFT portfolio is expected to consist of 51 individual PSOs, of which approximately 87% are rated investment grade and 42% are rated at or above 'AA–'. Favorably, nearly the entire pool of PSOs is secured by utility revenues or utility contract revenues.

The three largest pool obligors represent nearly half of the total portfolio. North Texas Municipal Water District, which was previously the second largest obligor in the pool prior to the series 2023 issuance, will increase its funding amount by $533 million and will become the largest obligor, accounting for approximately 20% of the total loan portfolio. North Texas Municipal Water District is not rated by Fitch but is assessed at a very high credit quality. North Harris County Regional Water Authority and West Harris County Regional Water Authority (both senior and subordinated pledged loans) represent 20% and 10%, respectively, of the total loan portfolio. Fitch’s Issuer Default Ratings for both North Harris County Regional Water Authority and West Harris County Regional Water Authority are 'A+'/Stable.

The SWIRFT portfolio’s 'AAA' LRSH of 34% (as produced by the PSM) remains slightly above Fitch's 'AAA' median level of 31% (higher liability stresses correlate to lower credit quality). The hurdles are somewhat elevated due to the portfolio's relatively high concentration and longer weighted average life, but these risks are somewhat mitigated by the high aggregate credit quality of the portfolio.

Program Resources Provide Strong Default Tolerance

Fitch's cash flow modeling demonstrates that the availability of program resources allows for hypothetical PSO defaults of 67% in the first four years of the program's life and 100% in both the middle and last four years (as per Fitch criteria, a 90% recovery is also applied in its cash flow model when determining default tolerance) while still paying bond debt service in full. This is in excess of Fitch's 'AAA' LRSH of 34%, thereby indicating a passing result under Fitch's model analyses. Although the previously issued bonds and the series 2023 bonds are separately secured, the respective series' pools and associated cash flows were combined in Fitch's analysis given that the moneys credited to the SWIFT account are not tied to any specific series of bonds.

Loss Protection Provided Primarily by Investment Funds

SWIRFT bondholders are secured primarily by PSO repayments and amounts in the SWIRFT assistance accounts. The series 2023 assistance account will be funded initially with proceeds from the SWIFT investment account. Inclusive of outstanding amounts tied to previous series of SWIRFT revenue bonds, an estimated $416 million cumulative total is projected to be received as FCFs from the respective bond series' assistance accounts. The total amount of the SWIRFT assistance accounts will represent approximately 5.0% of the total bonds as of the closing on the series 2023 bonds.

Transfers from the SWIRFT assistance accounts to pay bond debt service are made pursuant to scheduled transfers under the respective bond series' indentures. The sufficiency of PSO repayment revenue is calculated 40 days prior to the bond debt service payment date, allowing time to work out any potential delinquencies. If PSO repayments and scheduled transfers from the SWIRFT assistance accounts are insufficient to cover bond debt service then due, additional transfers from the SWIRFT assistance accounts may be made upon board approval.

Furthermore, if funds available in the assistance accounts are not used or are not available, TWDB, in its sole discretion and subject to the laws of the state, has the ability to enter into a funds transfer agreement with TTSTC whereby funds could be transferred from the SWIFT corpus to benefit SWIRFT bondholders. Although the transfer of funds from SWIFT to SWIRFT is not a legal requirement, Fitch views the likelihood of such a transfer as high due to the essentiality of the SWIRFT program in implementing the SWP and Texas constitutional restrictions that limit the use of SWIFT to SWP-related funding, such as the SWIRFT program.

As of March 31, 2023, the estimated market value of the SWIFT investments was approximately $1.7 billion, equating to approximately 21% of the outstanding bonds (post issuance). In its cash flow modeling, the SWIFT investments were discounted using the Portfolio Analysis Model (PAM), as described in Fitch's criteria. The PAM produced a base case loss stress of negative 24% (−24%), which was scaled to a 'AAA' stress of negative 48% (−48%). This resulted in approximately $917 million of discounted SWIFT investments to cover losses, which equates to approximately 11% of (projected) outstanding bonds.

Swift Account Investments Managed by TTSTC

TTSTC manages the SWIFT investments in the name of TWDB. TTSTC's investment objective is to preserve its purchasing power while maintaining sufficient liquidity to meet the needs of TWDB. The SWIFT investment policy asset allocation targets 30% equities, 25% fixed income, 20% private debt, 15% real assets and 10% cash.

TTSTC is annually audited and provides its financial reporting to TWDB, the state comptroller's investment advisory board and the SWIFT advisory committee. The advisory committee is a seven-member group established by legislation to monitor and advise SWIFT. The committee consists of the state comptroller or designee, three members of the Texas Senate appointed by the lieutenant governor and three members of the Texas House of Representatives appointed by the speaker of the House.

Strong Management and Underwriting

TWDB, which administers both the SWIFT and SWIRFT programs, is responsible for the majority of long range water resource planning in the state. Since its inception in 1957, TWDB has initiated more than $33.8 billion in commitments under various water- and sewer-related programs. TWDB's performance history has been exemplary, having never experienced a permanent default in its more than 60-year existence.

PSOs are required to be secured by GO, water and/or wastewater utility system revenue pledges, or a combination of GO/assessment/utility pledges, including electric or gas revenues. Subordinate or junior revenue pledges typically also require reserves equal to 1.0x average annual debt service and a suitable additional bonds test.

Extensive State Water Needs

The state's population, which is projected to increase to 52 million by 2070 (from 30 million in 2020), coupled with the state's near-record drought from 2011 to 2015, precipitated the need for the SWIFT and SWIRFT programs. The SWP details the objectives needed to address the state's water needs over the next 50 years in a drought of record. Full implementation of the 2022 SWP is projected to cost approximately $80 billion. The SWIRFT is intended to provide funding for $27 billion of these costs.

Note on Fitch 'AAA' Medians

The medians cited in this report are based on similar 'AAA' rated municipal finance pools, which primarily consist of state revolving fund pools, and are further described in Fitch's most recent peer review. The medians are for comparative purposes only; the primary driver for an assigned rating is Fitch's model results.

Historical Program Metrics

	2022 'AAA' Median[a]	Series 2023	Series 2022	Series 2021	Series 2020	Series 2019AB
Revolving Fund Type	—	Water Utility	Water Utility	Water Utility	Water Utility	Water Utility
Purpose	—	Financing	Financing	Financing	Financing	Financing
Total New Issuance ($ Mil.)	—	969.9	915.5	428.9	614.6	859.8
Fitch Rating	—	AAA	AAA	AAA	AAA	AAA
Rating Date	—	8/25/23	8/26/22	8/27/21	8/14/20	8/21/19
Fitch Default Tolerance Test (%)						
Minimum Default Tolerance Rate	100.0	66.5	81.1	95.2	86.6	95.5
Less: Fitch PSM Stress Hurdle[b]	30.8	34.3	34.8	35.8	42.7	41.0
Rating Stress Cushion	69.2	32.2	46.3	59.5	43.9	54.5
Financial Structure ($ Mil.)						
Total Outstanding Program Bonds	345	8,294	7,416	6,611	6,278	5,750
Program Assets ($ Mil.)						
Total Pledged Revenues Excluding Reserves	1,950	14,208	12,731	11,011	10,545	10,182
Total Pledged Revenues Including Reserves	1,957	15,125	13,688	11,983	11,366	11,106
DSRF Balance	5	917	957	971	821	924
Program Liabilities ($ Mil.)						
Total Debt Service	705	14,207	12,690	10,942	10,459	10,178
Financial Ratios						
Projected Minimum Annual DSC (x)	1.6	1.0	1.0	1.0	1.0	1.0
Program Asset Strength Ratio (x)	1.9	1.1	1.1	1.1	1.1	1.1
DSRF as % of Bonds Outstanding	0.7	11.1	12.9	14.7	13.1	16.1
Portfolio Summary						
No. of Borrowers	165	51	54	50	45	44
Implied WA Pool Rating (PSM)	BBB	A–	A–/BBB+	A–	A–	A
WA Life (Years)	16.9	28.8	28.4	28.6	28.9	28.9
% Investment Grade	73.0	87.4	87.2	90.8	91.8	93.6
Top 10 Concentration (%)	57.3	83.4	77.8	79.7	85.9	88.7
Largest Single Borrower (%)	15.3	20.3	19.8	19.3	20.4	22.9
Largest Borrower Composite Rating	AA–	AA+	A+	A+	AA	AA
Security Pledge Distribution (%)						
Pledge 1	—	Utility Revenues (99.0)	GO and Utility (63.7)	Utility Revenues (98.8)	Utility Revenues (98.9)	Utility Revenues (96.1)
Pledge 2	—	GO and Utility (0.9)	Utility Revenues (36.3)	GO and Utility (1.2)	GO and Utility (1.0)	GO and Utility (1.1)
Pledge 3	—	—	—	—	GO (0.1)	GO (0.1)
Pledge 4	—	—	—	—	—	—

[a]Based on data collected for Fitch's peer review (through October 2022). [b]PSM changes on March 4, 2021 and on Sept. 22, 2021 may result in differences in liability stress hurdles before and after these dates. See Fitch's related criteria for details. DSC – Debt service coverage. DSRF – Debt service reserve fund. WA – Weighted average.
Source: Fitch Ratings, SWIRFT Revolving Fund

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

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