

Texas Water Development Board

State Water Implementation Fund for Texas

New Issue Summary

Sale Date: The bonds are expected to sell via negotiation on or around the week of September 21, 2020.

Series: \$614,600,000 State Water Implementation Fund for Texas (SWIRFT) Revenue Bonds, Series 2020 (Master Trust)

Purpose: The bond proceeds will be used to provide financing to governmental entities within the state for water-related projects and to pay for the costs of issuance.

Security: Bonds are backed primarily by political subdivision obligation (PSO) repayments and certain pledged accounts tied to each series of bonds. In addition, although not pledged or a legal requirement, in its sole discretion, the Texas Water Development Board (TWDB) may request funds be transferred from the approximately \$1.6 billion (pre-issuance) 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

Program Assets Provide Support: Fitch Ratings' cash flow modeling demonstrates that program resources are sufficient to protect bondholders from losses under various default scenarios. This loss protection is primarily provided by funds available in the SWIRFT assistance account and the SWIFT investment portfolio.

Essentiality of SWIRFT Program: Fitch believes that 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).

PSO Pool Highly Rated Yet Concentrated: The combined PSO pool is backed by highly rated entities but, at only 45 individual obligors, is also small and, thus, highly concentrated. The pool's top-10 concentration is approximately 86% versus Fitch's 'AAA' rating-category median equivalent of 56%. Concentration is expected to improve over time to coincide with the growth of the SWIRFT program.

Investment Performance Vital to Program Longevity: The Texas Treasury Safekeeping Trust Company (TTSTC) is responsible for the management of the SWIFT investments, the growth of which could aid the growth of the SWIRFT program by providing future subsidies.

Strong Management of SWIRFT Expected: Management of the SWIRFT program is provided by the TWDB. The TWDB has extensive experience managing large state pool programs, such as the TWDB's State Revolving Funds (SRFs). Historical performance of the TWDB's SRF programs has been exemplary.

Rating Sensitivities

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

- Not applicable given the 'AAA' rating.

Ratings

New Issue

\$614,600,000 State Water Implementation Fund for Texas Revenue Bonds, Series 2020 (Master Trust) AAA

Outstanding Debt

SWIRFT Revenue Bonds AAA

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance State Revolving Fund and Municipal Finance Pool Program Rating Criteria (September 2019)

Related Research

Fitch Rates Texas Water Development Board's Series 2020 SWIRFT Revs 'AAA'; Outlook Stable (August 2020)

State Revolving Fund and Municipal Finance Pool Peer Review: 2019 (November 2019)

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

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

Credit Profile

The 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 billion from the state's economic stabilization fund.

Pool metrics and program cash flow ratios remain mostly stable. A slight decrease in the pool's year-over-year investment-grade concentration explains the small increase in Fitch's 'AAA' liability rating stress hurdle, as measured by Fitch's Portfolio Stress Model (PSM).

Coronavirus Considerations

The outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for the water and sewer sector. While the program's performance through most recently available data has not indicated impairment, changes in revenue and cost profiles are occurring across the sector. Fitch's ratings are forward-looking in nature. Fitch will continue to monitor developments in the sector as a result of the virus outbreak and incorporate any revised expectations for future performance and assessment of key risks as appropriate.

Program Resources Provide Strong Default Tolerance

Fitch's cash flow modeling demonstrates that the availability of program resources allows for hypothetical PSO defaults of 87% 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' liability rating stress hurdle of 43%, thereby indicating a passing result under Fitch's model analyses.

Although the previously issued bonds and the series 2020 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 transferred from the SWIFT account to the SWIRFT assistance accounts. The assistance account funds the subsidies provided to the eligible PSOs over the life of the SWIRFT bonds.

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 are insufficient to cover bond debt service then due, funds held in the SWIRFT assistance account may be utilized. Inclusive of outstanding amounts tied to previous series of SWIRFT revenue bonds, an estimated \$473 million is projected to be available in the respective bond series' assistance accounts at closing, equating to approximately 7.5% of total bonds outstanding.

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

Rating History (Abbreviated)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	8/14/20
AAA	Affirmed	Stable	8/20/19
AAA	Affirmed	Stable	8/17/18
AAA	Affirmed	Stable	8/15/17
AAA	Affirmed	Stable	9/1/16
AAA	Assigned	Stable	9/9/15

As of March 31, 2020, the estimated market value of the SWIFT investments was approximately \$1.6 billion, equating to approximately 25% of the outstanding bonds (post issuance). In its cash flow modeling, the SWIFT investments were discounted using the FAST Portfolio Stress Generator (PSG), as described in Fitch’s criteria. The PSG produced a base-case loss stress of negative 24%, which was scaled to a ‘AAA’ stress of negative 46%. This resulted in approximately \$821.1 million of discounted SWIFT investments to cover losses, which equates to approximately 13% of (projected) outstanding bonds.

SWIRFT Portfolio Highly Rated Yet Concentrated

Upon issuance of the series 2020 bonds, the SWIRFT portfolio is expected to consist of 45 individual PSOs, approximately 92% of which are rated investment grade and 44% 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 remain the same since Fitch’s review in August 2018. At approximately 20% of the pool total each, the North Texas Municipal Water District (not rated by Fitch but assessed at very strong credit quality) and North Harris County Regional Water Authority (A+/Stable) are the pool’s two largest obligors. The third largest is the West Harris County Regional Water Authority (A+/Stable) at 12% of the pool total. The top-10 obligors represent 86% of the total.

Even with the highly rated pool, because of the elevated concentration and the pool’s longer-than-average life of nearly 30 years, the pool’s aggregate credit quality is somewhat below average. This is reflected in the Fitch’s ‘AAA’ liability rating stress hurdle of 43% versus Fitch’s ‘AAA’ median level of 32% (higher liability stresses correlate to lower credit quality), as produced by the PSM.

Largest Borrowers

Borrower	Outstanding (\$)	% of Portfolio
North Texas Municipal Water District	1,441,095,000	20.4
North Harris County Regional Water Authority	1,418,835,000	20.1
West Harris Co Regional Water Authority	811,730,000	11.5
North Fort Bend Water Authority	778,270,000	11.0
City of Houston	468,805,000	6.6
Coastal Water Authority	298,175,000	4.2
Tarrant Regional Water District	269,680,000	3.8
Upper Trinity Regional Water District	251,470,000	3.6
El Paso Public Service Board	182,205,000	2.6
Guadalupe Blanco River Authority (Mid-Basin Project)	140,705,000	2.0
Total	6,060,970,000	85.9

Source: Fitch Ratings, TWDB.

Swift Account Investments Managed by the TTSTC

The TTSTC manages the SWIFT investments in the name of the TWDB. TTSTC’s investment objective is to maintain sufficient liquidity while striving to preserve the purchasing power of the fund. The SWIFT investment policy targets have remained the same since Fitch’s review last year, with equities at 30%, fixed income at 25%, private debt at 20%, real assets at 15%, and cash at 10%.

The TTSTC is annually audited and provides its financial reporting to the TWDB, 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 state Senate appointed by the lieutenant governor and three members of the state House of Representatives appointed by the speaker of the House.

Strong Management and Underwriting

The TWDB, the administrator of 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, the TWDB has initiated more than \$29 billion in commitments under various water and sewer-related programs. The 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 general obligation (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 growth, which is projected to increase 70% by 2070, 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 2017 SWP is projected to cost approximately \$63 billion. The SWIRFT is intended to provide funding for \$27 billion of these costs.

Series Comparison

	2019 'AAA' Median ^a	Ser. 2020	Ser. 2019AB	Ser. 2018A	Ser. 2017AB	Ser. 2016
Revolving Fund Type	–	Water Utility				
Purpose	–	Financing	Financing	Financing	Financing	Financing
Total New Issuance (\$ Mil.)	–	614.6	859.8	805.4	1208.2	579.3
Fitch Rating	–	AAA	AAA	AAA	AAA	AAA
Rating Date	–	8/14/20	8/21/19	3/21/18	8/14/17	9/2/16
Fitch Default Tolerance Test (%)						
Minimum Default Tolerance Rate	100.0	86.6	95.5	76.2	100.0	100.0
Less: Fitch PSM Stress Hurdle	31.6	42.7	41.0	32.9	36.0	38.2
Rating Stress Cushion	68.4	43.9	54.5	43.3	64.0	61.8
Financial Structure (\$ Mil.)						
Total Outstanding Program Bonds	577	6,278	5,750	3,226	2,601	1,390
Program Assets (\$ Mil.)						
Total Pledged Revenues Excluding Reserves	1,853	10,545	10,182	5,575	4,213	2,422
Total Pledged Revenues Including Reserves	1,996	11,366	11,106	6,303	4,880	3,029
Debt Service Reserve Fund Balance	23	821	924	339	292	140
Program Liabilities (\$ Mil.)						
Total Debt Service	752	10,459	10,178	5,897	4,516	2,585
Financial Ratios						
Projected Minimum Annual DSC (x)	1.5	1	1	1	1	1
Program Asset Strength Ratio (x)	1.9	1.1	1.1	1.1	1.1	1.2
DSRF as % of Bonds Outstanding	6.6	13.1	16.1	10.5	11.2	10.1
Portfolio Summary						
No. of Borrowers	227	45	44	42	42	29
Implied WA Pool Rating (PSM)	BBB	A–	A	A	A	A
WA Life (Years)	17	28.9	28.9	28.5	28.7	28.2
% Investment Grade	74.3	91.8	93.6	95.9	94.9	91.7
Top 10 Concentration (%)	55.7	85.9	88.7	87.8	84.7	85.8
Largest Single Borrower (%)	16.6	20.4	22.9	23.1	24.1	25.9
Largest Borrower Composite Rating	AA	AA	AA	AA	A+	AA
Security Pledge Distribution (%)						
Pledge 1	–	Utility Revenues (98.9)	Utility Revenues (96.1)	Utility Revenues (86.6)	Utility Revenues (82.3)	Utility Revenues (81.1)
Pledge 2	–	GO and Utility (1.0)	GO and Utility (1.1)	Other (11.4)	Other (15.0)	Other (15.8)
Pledge 3	–	GO (0.1)	GO (0.1)	GO and Utility (1.9)	GO and Utility (2.5)	GO and Utility (3.0)
Pledge 4	–	–	–	GO (0.1)	GO (0.2)	–

^aBased on data collected for Fitch's peer review (through Oct. 2019). WA - Weighted average.
Source: Fitch Ratings, TWDB.

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