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Summary:

Texas Water Development Board; State Revolving Funds/Pools

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Summary:

Texas Water Development Board; State Revolving Funds/ Pools

Credit Profile

US\$614.6 mil st wtr implementation rev fd for texas rev bnds ser 2020 due 10/15/2055

<i>Long Term Rating</i>	AAA/Stable	New
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Texas Wtr Dev Brd SRFP

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Texas Wtr Dev Brd SRFP

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Rating Action

S&P Global Ratings assigned its 'AAA' rating to the Texas Water Development Board's (TWDB) series 2020 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.

Proceeds of the series 2020 bonds will be used to purchase 20 political subdivision obligations (PSOs) from 12 different entities. The bonds are secured by the repayment of those PSOs, coupled with funds transferred from the State Water Implementation Fund for Texas (SWIFT) to the SWIRFT.

Credit overview

The ratings reflect the combination of a very strong enterprise risk profile and an extremely strong financial risk profile, and a one-notch positive overriding factor.

The rating is 'AAA' because of a combination of the risk profile scoring and a positive overriding factor that has been applied due to the ability of the sizable SWIFT to address PSO delinquency and default dates in excess of what would otherwise be required for a 'AAA' rating. We also note that the override takes into account the lack of any default or delinquency in all TWDB programs for an extended period.

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+'.

Following mobility restrictions and closure of large segments of the economy due to COVID-19 and the swift onset of the recession, all of S&P Global Ratings' sector outlooks in U.S. public finance are now negative. For long-term municipal pools, the majority of the underlying cash flows that are either pledged for repayment of bonds or guaranteed by the programs originate from U.S. public finance asset classes. While municipal pool programs benefit from additional overcollateralization and diversity, we believe that ratings on these programs could be negatively

affected if the exceptionally low rate of loan delinquencies at or near 0% that we have typically observed balloons to significant levels for an extended period. However, the amount of excess cash flows or reserves well beyond what is needed to pay debt service on bonds acts as a cushion to any downside pressure at this time.

The stable outlook reflects our expectations that, consistent with historical trends since the SWIRFT program was formed, embedded policies and procedures will remain in place, proactive financial management will ensure stable cash flows that meet program goals and objectives, and investment strategies related to management of 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. The stable outlook also incorporated our expectation that TWDB management will maintain the ability and willingness to address any SWIRFT account shortfalls through additional bond-enhancement agreements as required.

Stable Outlook

Downside scenario

We could lower the rating should there be:

- A leveraging of the SWIFT that creates a level of stress for which the fund is unable to compensate;
- A change in the policies, procedures, or governing legislation that allows for, or creates, dilution of the available SWIFT balances below a level that we believe is commensurate with the rating; or
- Unwillingness by management to take appropriate steps to cure any revenue shortfalls in the respective SWIRFT accounts.

Credit Opinion

SWIRFT Program

In November 2013, state voters approved an amendment to the state constitution, which created the SWIFT and the SWIRFT. To initially capitalize the SWIFT, \$2.0 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 Company. The SWIFT was established to provide financial assistance for state water plan projects and had a market value of \$1.63 billion as of June 30, 2020.

While the balance in the SWIFT is not pledged to the bonds, the use of the funds in the SWIFT is highly restricted and 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 SWIFT balance and the board's willingness to approve additional transfers to cover any shortfalls in the SWIRFT accounts remain, collectively, the 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 the 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 act under this potential circumstance is absolutely the key credit consideration for determining the loss coverage score and, ultimately, the assigned rating.

Other factors that support the extremely strong loss coverage score are the generally high credit ratings on the initial participants. Following this round of funding, there will be more than 100 PSOs purchased from 43 separate and distinct entities within the state. While not all borrowers are rated, several are highly rated, including Tarrant Regional Water District (AAA/Stable), North Texas Municipal Water District (NTMWD; AAA/Stable), El Paso Water Utilities (AA+/Stable), and the City of Houston (AA/Stable). With the purchase of these PSOs, concentration in the overall program is beginning to decrease, with NTMWD and North Harris County Regional Water Authority each accounting for about 20% of the PSO balance outstanding. However, about 25% of the financial assistance is provided to entities

rated 'AAA' by S&P Global Ratings, while another 40% of the assistance is provided to entities rated in the 'AA' category. Over time, however, this percentage could change as the program issues additional debt and provides assistance to more entities not highly rated. The effect on the loss coverage score, though, should be minimal, given the availability of the balance within the SWIFT.

Management's intent is to eventually provide financial assistance of more than \$27.0 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 Company, 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 at least 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, with much stricter eligible investments than typically associated with a public finance bond offering.

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 program participant's financial status. Additionally, 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.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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