

30 AUG 2021

Fitch Rates Texas Water Development Board's Series 2021 SWIRFT Revs 'AAA'; Outlook Stable

Fitch Ratings - Austin - 30 Aug 2021: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the Texas Water Development Board (TWDB):

--Approximately \$428.92 million State Water Implementation Fund for Texas (SWIRFT) revenue bonds, series 2021 (Master Trust).

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. The bonds are expected to price via negotiation the week of Sept. 27.

In addition, Fitch has affirmed the 'AAA' rating on the following bonds:

--Approximately \$6.182 billion (as of May 31, 2021) outstanding SWIRFT revenue bonds.

The Rating Outlook is Stable.

SECURITY

The 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 nor a legal requirement, in its sole discretion, the TWDB may request that funds be transferred from the approximately \$1.8 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's 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 50 individual obligors, remains small and concentrated. The pool's top-10 concentration is approximately 80% versus Fitch's 'AAA' rating-category median equivalent of 54%. The SWIRFT program pool, which has diversified over the past six years as new obligors have been added to the portfolio, is expected to become less concentrated over time as the SWIRFT program grows.

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 in managing large state pool programs, such as the TWDB's State Revolving Funds (SRF) (AAA/Stable).

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:

--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.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

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 show some marginal improvement since Fitch's August 2020 review. PSM Liability Rating Stress Hurdles (LRSBs) declined due to some portfolio diversification with the addition of new obligors associated with the series 2021 issuance (lower LRSBs represent an overall improvement in pool metrics). Additionally, cash flow model results improved primarily due to the increase in the SWIFT investment balance, which increased to \$1.8 billion in June 2021 from \$1.6 billion as of March 2020.

PROGRAM RESOURCES PROVIDE STRONG DEFAULT TOLERANCE

Fitch's cash flow modeling demonstrates that the availability of program resources allows for hypothetical PSO defaults of 95% 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 2021 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 cumulative total of \$365 million is projected to be available in the respective bond series' assistance accounts at closing, equating to approximately 5.5% of total bonds outstanding at each future bond payment date as detailed in the respective bond series' indentures.

Further, 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.

As of June 30, 2021, the estimated market value of the SWIFT investments was approximately \$1.8 billion, equating to approximately 27% 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 22% which was scaled to a 'AAA' stress of negative 44%. This resulted in approximately \$971.4 million of discounted SWIFT investments to cover losses, which equates to approximately 15% of (projected) outstanding bonds.

SWIRFT PORTFOLIO HIGHLY RATED YET CONCENTRATED

Upon issuance of the series 2021 bonds, the SWIRFT portfolio is expected to consist of 50 individual obligors, approximately 91% of which are rated investment grade and 43% 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 2020. North Harris County Regional Water Authority (A+/Stable), which increased its funding amount by \$39 million with the series 2021 bond issuance, replaces North Texas Municipal Water District (not rated by Fitch but assessed at very high credit quality) as the largest obligor. Both entities now represent approximately 19% of the portfolio. The third largest obligor is the West Harris County Regional Water Authority ('A+'/Outlook Stable) at 10% of the pool total.

The SWIRFT portfolio 'AAA' liability rating stress hurdle is 35% (as produced by the PSM) and remains slightly above Fitch's 'AAA' median level of 32% (higher liability stresses correlate to lower credit quality). The hurdles remain somewhat elevated due to the portfolio's relatively high concentration and longer weighted average life.

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

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 \$32 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 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 to 51 million by 2070 (from 8 million in 2010), 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. The most current SWP (the 2022 SWP) was adopted by the TWDB on July 7, 2021. 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.

CORONAVIRUS IMPACT LIMITED

The program's performance through most recently available data has not indicated impairment as a result of the coronavirus pandemic. The TWDB continues to monitor the spread of the coronavirus across the state and management intends to work with the local governments and state agencies to address any economic impacts.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Texas Water Development Board (TX) [State Water Implementation]			
<ul style="list-style-type: none"> Texas Water Development Board (TX) /Water Revenues/ 1 LT 	LT	AAA 	Affirmed
			AAA 

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub.23 Feb 2021\) \(including rating assumption sensitivity\)](#)

[State Revolving Fund and Municipal Finance Pool Program Rating Criteria \(pub.11 Aug 2021\) \(including rating assumption sensitivity\)](#)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v1.3.2 (1)

Portfolio Stress Model, v1.11.0 (1)

State Revolving Fund Cash Flow Model, v1.18.1 (1)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Texas Water Development Board EU Endorsed, UK Endorsed

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