Fitch Rates Oklahoma Water Resources Board's Ser. 2020 SRF Revs 'AAA'; Outlook Stable

Fri 25 Sep, 2020 - 4:11 PM ET

Fitch Ratings - Austin - 25 Sep 2020: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the Oklahoma Water Resources Board (OWRB):

--Approximately $95.0 million revolving fund revenue bonds, series 2020 (2019 master trust).

The bonds will be used to finance loans to borrowers for eligible drinking water state revolving fund (DWSRF) projects, to provide state matching funds, to reimburse OWRB for amounts previously advanced to make such loans and to pay costs of issuance. The bonds are expected to price via negotiation the week of Oct. 5, 2020.

In addition, Fitch has affirmed the following:

--Approximately $287.5 million outstanding revolving fund revenue bonds (2003 master trust) at 'AAA'.

--Approximately $154.4 million outstanding revolving fund revenue bonds (2019 master trust) at 'AAA'.

The Rating Outlook is Stable.
SECURITY

The 2019 master trust bonds, including the series 2020 bonds, are secured by pledged loan repayments (excluding administrative fees), surplus and reserve releases from the 2003 master trust program, amounts in certain funds and accounts and account earnings.

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KEY RATING DRIVERS

SOUND FINANCIAL STRUCTURE: Fitch's cash flow modeling demonstrates that OWRB's combined pool programs can continue to pay bond debt service even with loan defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's Portfolio Stress Model (PSM).

ABOVE-AVERAGE CONCENTRATION: The top 10 borrowers and the largest single borrower represent 63.6% and 27.2% of the pool, respectively. Both levels are higher than Fitch's equivalent medians, but the high credit quality of the largest two borrowers helps to mitigate some of the concentration risk.

LARGELY UNRATED PORTFOLIO: Approximately 57% of the pool obligors do not carry a public rating. In its PSM analysis, Fitch conservatively assumes unrated borrowers to be of below-investment grade quality ('BB'). This assumption contributes to overall pool quality falling to below average compared to similar programs rated by Fitch.

STRONG PROGRAM MANAGEMENT: Management has demonstrated strength and capability in its underwriting and monitoring processes, as evidenced by the fact that the program has never experienced a pledged loan default.

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:

--Significant deterioration in aggregate borrower credit quality, increased pool concentration or increased bond leveraging resulting in an inability to pass Fitch's 'AAA' liability rating stress hurdle.

### 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](https://www.fitchratings.com/site/re/10111579).

### CREDIT PROFILE

OWRB was established in 1957 as an agency and department of the state of Oklahoma, and it serves as the state's financing vehicle for local government water and wastewater capital funding. In addition to managing the clean water state revolving fund (CWSRF) and DWSRF programs, the OWRB administers an additional state loan program and two grant programs.

Although the number of aggregate pool obligors has remained stable over the past five years, increases in exposure from the pool's largest two borrowers have occurred, resulting in higher overall concentration. However, given the very strong credit quality of these borrowers, the favorable obligor loan security and financial strength of the combined program, Fitch is not concerned at this time. However, measurable increases in single-obligor concentration simultaneous with erosion of the program's financial strength could result in rating pressure over time.
FINANCIAL STRUCTURE EXHIBITS SOUND DEFAULT TOLERANCE

Fitch's cash flow modeling demonstrates that the availability of program resources allows for hypothetical loan defaults of 100% in the first, middle and last four years of the program's life (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 65%, thereby indicating a passing result under Fitch's quantitative analysis. The rating stress hurdle is calculated based on overall pool credit quality as measured by the ratings of underlying obligors, obligation size, term and pool concentration.

In accordance with the amended 2003 master trust, on a semi-annual basis, excess funds released from the 2003 master trust are transferred to the 2019 master trust's revenue fund and are then available for debt service payments. Because of this feature and the cross-collateralization of the clean water and drinking water SRFs, which allows for shortfalls in one program to be covered by surpluses in the other, Fitch combines the two funds and two master-trust programs in its modeling analyses.

As an additional measure of financial strength, Fitch calculates the program asset strength ratio (PASR). The PASR, an asset-to-liability ratio, includes total scheduled loan repayments plus any additional pledged funds divided by total scheduled bond debt service. The resulting PASR for OWRB's SRF program is favorable at approximately 2.1x, besting Fitch's 2019 'AAA' median level of 1.9x. The PASR is stable from Fitch's last review in November 2019.

LOSS PROTECTION PROVIDED BY RESERVES AND OVERCOLLATERALIZATION

The series 2013B and 2014A bonds use a reserve-fund structure wherein loss protection for bondholders is provided primarily by dedicated debt service reserve funds. All other outstanding bonds issued since 2010, including those issued under the 2019 master trust, use a cash flow structure wherein loss protection is provided primarily by surplus pledged loan repayments in excess of bond debt service, or overcollateralization. The 2003 master trust was closed with the issuance of the series 2019 bonds.

On an annual basis, aggregate loan repayments plus reserve releases overcollateralize bond debt service by a minimum of 1.6x, which is favorable and mostly consistent with Fitch's 'AAA' rating category median of 1.5x. Debt service reserve funds from the series 2013B and 2014A bonds currently stand at approximately $32 million, which equates to 6% of total projected bonds outstanding after this issuance.
LARGELY UNRATED LOAN POOL WITH AVERAGE DIVERSITY

The combined loan pool comprises 160 pledged obligors. Approximately 43% of the portfolio is considered to be investment grade - this compares unfavorably to Fitch's 'AAA' median of 62%. As a result of the largely unrated loan pool and a higher-than-average weighted average life, the program's 'AAA' liability hurdle is an elevated 65%, versus a 'AAA' median of 32% (higher stress hurdles correlate with lower pool quality). However, as all borrowers are secured by water and/or wastewater revenue pledges, loan security is strong and thus helps to balance the overall pool quality.

At 27.2% and 9.7% of the pool total, respectively, the Oklahoma City Water Utilities Trust and Tulsa Metropolitan Utility Authority remain the pool's largest obligors (neither of these entities' parity bonds are rated by Fitch; however, they are assessed to be of very high quality). The remaining top 10 borrowers range from 2.1% to 5.0% in size relative to the aggregate pool. To account for concentration risk, the PSM assesses an additional stress on pools' top five risk contributors that adversely affects pools with higher concentration.

EXPERIENCED PROGRAM MANAGEMENT AND SOUND UNDERWRITING

The OWRB is responsible for administering state laws related to water rights, promulgating state water standards and developing and updating the state comprehensive water plan.

The board's formal SRF underwriting procedures consist of the approval of clean water or drinking water project feasibility, review of loan credit and application and approval by OWRB. Borrower loan agreements typically must demonstrate 1.25x annual debt service coverage on outstanding loans, including any planned additional debt. Loans to smaller systems are secured further by a mortgage on the local borrower's system facilities.

In the event of a loan default, OWRB has the right to directly impose, enforce and collect charges on users of the defaulting system. OWRB has never experienced a default by any borrower within its pledged loan programs. It is the sole administrator of the CWSRF, while administration of the DWSRF is shared between OWRB and the state's Department of Environmental Quality.

CORONAVIRUS CONSIDERATIONS

The ongoing coronavirus pandemic and related government containment measures create an uncertain environment for the water and sewer sector. While the OW RB'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; as such, Fitch will continue to monitor developments in the sector resulting from the pandemic and incorporate any revised expectations for future performance and assessment of key risks as appropriate.

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.

RATING ACTIONS

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APPLICABLE CRITERIA
U.S. Public Finance State Revolving Fund and Municipal Finance Pool Program Rating Criteria (pub. 18 Sep 2019) (including rating assumption sensitivity)
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

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

Portfolio Stress Model, v1.10.2 (1)
State Revolving Fund Cash Flow Model, v1.18.0 (1)

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Dodd-Frank Rating Information Disclosure Form
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