Research Update:

Rural Water Financing Agency, KY Series 2025C And D Public Projects Revenue Bonds Rated 'AA-'; Outlook Is Stable

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Overview

- S&P Global Ratings assigned its 'AA-' long-term rating to the Rural Water Financing Agency (RWFA), Ky.'s $54.250 million series 2025C and $23.065 million series 2025 D public projects revenue bonds (flexible term program).
- At the same time, we affirmed our 'AA-' rating on RWFA's bonds outstanding, and on RWFA's bonds outstanding that were initially issued by Kentucky Rural Water Finance Corp. (KRWFC) and were assigned in 2023 to the RWFA by the KRWFC.
- The outlook is stable.

Rationale

Security

The bonds are secured by loan repayments from program borrowers made to the program trustee. Assistance agreements with the municipal borrowers are assigned to the trustee and govern the borrower repayments. In addition, a debt service reserve (DSR) provides further bondholder security.

Debt service payments are backed by the combined repayments from the borrower pool and a debt service reserve fund (DSRF), which consists of maturing investments and their associated earnings. The proceeds from the 2025C bonds will be allocated to provide loans to 17 obligors, while the 2025D bonds will specifically fund a two-year loan to the Warren County Water District, matching the term of the 2025D bonds. All obligors receiving these new loans have pledged their general obligation (GO) revenue or utility revenue to loan repayment.

Following the current debt issuance, there will be approximately $304 million in bonds outstanding, $273.3 million in pledged loans, and 108 participants enrolled in the agency's flexible term program.

Credit highlights

We assessed RWFA's enterprise risk profile as very strong, based on the agency's strong market position, and because the loan program has no geographic concentration. RWFA was formed under specific Kentucky statutes, which we view as a governmental entity. Under our criteria, we incorporate into our market position the view that one purpose of the agency--formed by an interlocal agreement--is to create programs for its members and the power to establish programs. This is a key factor in our view of the program's overall market position. We believe RWFA's financial risk profile is very strong, reflected by the loss coverage score (LCS), operating performance, and financial policies. With the transfer and assignment of KRWFC's rights, title, and interest in the flexible term program to RWFA, the agency has indicated that all board-approved policies and practices of the flexible term program will remain in place under RWFA. In addition, all existing borrower and program accounts, including the debt service reserve fund and the administrative fee fund, have been transferred to RWFA. This action did not require any new or amended agreements between the borrowers and the agency. In addition, Kentucky law allows for participants in RWFA's program to come from all 50 states. In the current issuance, RWFA management has extended its reach beyond state boundaries, offering loan facilities to obligors in Pennsylvania, Kentucky, Utah, Texas, Indiana, Missouri, and Arkansas. This expansion has resulted in a geographically diversified loan pool for RWFA.

The rating reflects our view of the program's:

- Program administration, in which a governmental entity works with its governing body to address Kentucky public agency policy initiatives to provide cost-effective financing for local entities;
- Overcollateralization, primarily in the form of reserves, which is capable of withstanding S&P Global Ratings' loss-coverage scenario, based on the credit quality of the asset pool and consolidated cash flows, run at our 'A' category stress level;
- Strong operating performance, with no borrower defaults or delinquencies; and
- Generally strong financial management policies and conditions.

Outlook

The stable outlook reflects our view that overcollateralization will remain commensurate with the rating and that other program features, especially the financial performance of the agency's loan portfolio, will not deviate from historical trends and practices.

Downside scenario

If reserves become insufficient for the rating, or if any other program factors negatively affect the financial risk profile, we could lower the rating. We are also focused on loan delinquencies as a potential downside risk, particularly if reserves are not large enough to absorb losses during a period of stress.

Upside scenario

Conversely, if our view of the financial profile and LCS improves, without deterioration of any other significant credit factor, and the program maintains its enterprise risk factors, we could raise the rating.

Credit Opinion

Enterprise Risk Profile: very strong

We view the program's enterprise risk profile as very strong. This is due to a combination of a low industry risk profile for municipal pools and our view of the program's market position as strong. RWFA is an interlocal agency, established under Kentucky law, that is governed by a nine-member board. The agency's board members are the same as the members of KRWFC's board, with one exception. The Kentucky Rural Water Association (KRWA) acts as the financing program sponsor. KRWA is a statewide association offering membership to water and wastewater utilities throughout Kentucky, with more than 300 voting members. RWFA provides financing to entities inside, and increasingly outside, the Commonwealth of Kentucky. We believe these factors suggest a moderate level of state support with some possibility of fluctuations in program demand.

Financial Risk Profile: very strong

We view the program's financial risk profile as very strong, reflecting a combination of the strong LCS and the program’s generally strong historical operating performance and management policies. Overcollateralization includes annual revenue from pledged administrative fees, excess cash held in miscellaneous funds, and approximately $28 million in DSR investments. The program's cash flows are structured so that loan repayments match debt service on the portion of bonds used to make loans, while the DSR and its interest earnings are used for debt service on bonds used to fund the DSR. Overcollateralization arising from the DSR, principal and interest, administrative fees, and trustee-held excess cash all provide sufficient revenue, in our view, to make full payments on all bonds, given the level of defaults consistent with the pool rating. Our LCS applies credit default stress to loan repayments and measures the required draws on DSR principal and other reserves. Accordingly, the scenario envisions that the pool's reserve interest earnings could be reduced in line with the modeled reduction in available DSR principal balances. For the RWFA pool, if a DSR draw occurs, participants must repay it within one year. As further protection, participants must agree to set rates sufficient to provide 1.2x maximum annual debt service coverage on all system obligations.

Program reserves include municipal bonds rated at least 'A+', guaranteed investment contracts (GICs), forward delivery agreements (FDAs), and accrued cash balance amounts. Termination, collateral, and substitution requirements are in effect for both GIC and FDA investment providers.

We view the program's financial policies and practices as ranging from adequate to strong. Management has the flexibility to enter into several loan agreements, including general obligations and revenue pledges, that can involve any governmental agency. Program staff require all participants to submit annual financial statements. Loan payments in most cases are made monthly, with funds on hand of at least 30 days before semiannual debt service payment dates. Management prioritizes projects as loan demand develops, with a credit review process for each new loan. The board undertakes bimonthly investment portfolio reviews, with adjustments as needed, depending on either the program's investment strategy or the credit quality of investment counterparties.

Management reports no loan defaults or delinquent payments since the program's inception in 2001.

Credit Snapshot

- Program description: RWFA is an interlocal public agency established under Kentucky law, designed to allow participants of the agency to join together for the purposes of financing water and wastewater projects on a pooled basis. Kentucky law allows for agency participants to come from all 50 states, as long as they are legally permitted. Currently, the flexible term program borrowers are spread across 10 states. The agency was created by Kentucky public agencies with the assistance of the KRWA, which is a related entity providing technical assistance but does not actually make the loans or engage in financing. KRWA is a statewide association that offers membership to all water and wastewater utilities in Kentucky. In 2023 RWFA assumed responsibility for the repayment of the previous KRWFC bonds, pursuant to an assignment and assumption agreement. The agreement between KRWFC and RWFA effectively transfers all assets, liabilities, funds, agreements, and obligations of the flexible term program to RWFA, including all the bond obligations and related cash, and funds related to these. Since 2023, RWFA has been the issuer for bonds under the program.
- Flow of funds: The program's cash flows are structured so that loan repayments match debt service on the portion of bonds used to make loans, while the DSRF and its interest earnings are used for debt service on bonds used to fund the DSRF. Overcollateralization arising from the DSRF, principal and interest, administrative fees, and trustee-held excess cash all provide sufficient revenue, in our view, to make full payments on all bonds, given the level of defaults consistent with the pool rating.
- Summary statistics: The 2025C and D bond issuances mark the seventh and eighth transactions undertaken by RWFA since it assumed responsibility for repaying the previous KRWFC bonds, following an assignment and assumption agreement that became effective in 2023. This agreement transfers all assets, liabilities, funds, agreements, and obligations of the flexible term program to RWFA, including all bond obligations and related cash. Following the issuance of the Series 2025 C and 2025 D bonds, there will be $304 million in bonds outstanding within the flexible term finance program. These bonds are supported by approximately $273.3 million in loans, which facilitate bond repayment. Borrower repayments, along with administrative fees and interest earnings from reserves, yield an average debt service coverage ratio of approximately 1x. The borrower portfolio consists of 161 distinct loans, with the largest borrower, Warren County Water District, holding $26.2 million in existing loans, representing 9.6% of the total loans outstanding.

Ratings List	
New Issue Ratings	
US$23.065 mil pub projects rev bnds ser 2025D due 07/01/2027	
Long Term Rating	AA-/Stable
US$54.25 mil pub projects rev bnds ser 2025C due 02/01/2055	
Long Term Rating	AA-/Stable
Ratings Affirmed	
Water & Sewer	
Rural Water Financing Agency, KY State Revolving Fund	AA-/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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