FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Oklahoma Water Resources Board's Series 2023A SRF Revs 'AAA'; Outlook Stable

Thu 23 Mar, 2023 - 10:05 AM ET

Fitch Ratings - New York - 23 Mar 2023: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the Oklahoma Water Resources Board (OWRB):

--Approximately $175.0 million revolving fund revenue bonds, series 2023A (2019 master trust).

The bonds will be used to finance loans to borrowers for eligible drinking water state revolving fund (DWSRF) projects, to reimburse OWRB for amounts previously advanced to make such loans, to provide state matching funds, and to pay costs of issuance. The bonds are expected to price via negotiation on April 18.

In addition, Fitch has affirmed the following:

--Approximately $203.9 million outstanding revolving fund revenue bonds (2003 master trust) at 'AAA'.

--Approximately $673.0 million outstanding revolving fund revenue bonds (2019 master trust) at 'AAA'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Oklahoma Water Resources Board (OK) [State Revolving Fund]			
Oklahoma Water Resources Board (OK) /State Revolving Fund Revenues - 2003 MTA/1 LT	LT	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable
Oklahoma Water Resources Board (OK) /State Revolving Fund Revenues - 2019 MTI/1 LT	LT	AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The 2019 master trust bonds, including the series 2023A bonds, are secured by pledged loan repayments (excluding administrative fees), annual surplus and reserve releases from the 2003 master trust program, amounts in certain funds and accounts, and account earnings.

The 2003 master trust bonds (the prior indenture bonds) are secured by pledged loan repayments, amounts in certain funds and accounts, and account earnings.

KEY RATING DRIVERS

SOUND FINANCIAL STRUCTURE: Fitch's cash flow modeling demonstrates that the state revolving fund (SRF) programs' (the program) pledged resources are sufficient to withstand hypothetical pool defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's Portfolio Stress Model (PSM).

LOSS PROTECTION PROVIDED BY OVERCOLLATERALIZATION AND RESERVES: OWRB's aggregate outstanding bonds benefit from overcollateralization as surplus loan repayments provide minimum annual debt service coverage of 1.3x. In addition, reserves under the prior indenture protect related bondholders from losses on a senior lien basis, and are available to all bondholders on a subordinated basis.

MODERATE POOL CONCENTRATION, LARGE OBLIGOR: The top 10 borrowers represent 64% of the pool, displaying somewhat higher concentration relative to Fitch's 2022 'AAA' median of 57%. The largest borrower represents just under 25% of the pool. Concentrated pools are inherently stressed at greater rates in Fitch's PSM and related risks are therefore captured in the assigned rating.

BELOW-AVERAGE POOL QUALITY: Approximately 53% of OWRB's loan pool consists of borrowers exhibiting investment-grade ratings, which is generally lower than similar programs rated by Fitch. This contributes to pool quality that is somewhat worse than sector peers. Regardless, the program's financial strength is sufficiently robust to absorb projected losses at a 'AAA' stress level as demonstrated in Fitch's cash flow modeling.

EFFECTIVE 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:

--The rating is at the highest level on Fitch's scale and cannot be upgraded.

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

--Inability to pass Fitch's 'AAA' liability rating stress hurdle due to material increases in leveraging, increases in pool concentration, and/or significant deterioration in aggregate borrower credit quality.

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

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

Pool and financial metrics have been sound over time. This issuance comes after the series 2023 bond issuance in January 2023 for clean water projects. With these issuances, the percentage of investment-grade pool participants is up since Fitch's review in September 2021, resulting in an improved PSM stress hurdle. Minimum annual debt service coverage has declined slightly with this issuance, and is down from years prior.

Funds and assets of the CWSRF and the DWSRF are cross-collateralized with one another, providing common security for any bonds issued or outstanding under the indenture. For this reason, Fitch combines the CWSRF and DWSRF programs in its modeling analyses.

FINANCIAL STRUCTURE EXHIBITS STRONG DEFAULT TOLERANCE

Fitch's cash flow modeling demonstrates that the availability of program resources allows for hypothetical loan defaults of 59% in the first four years, 83% in the middle four years and 100% in the 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 42%, thereby indicating a passing result under Fitch's quantitative 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 pledge funds divided by total scheduled bond debt service. The resulting PASR for OWRB's program is strong but has declined to approximately 1.4x, which is below Fitch's 2022 'AAA' median level of 1.9x.

LOSS PROTECTION PROVIDED BY OVERCOLLATERALIZATION AND RESERVES

The prior indenture 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 1.3x, which is favorable and mostly in-line with Fitch's 'AAA' rating-category median of 1.6x. Debt service reserve funds from the prior indenture bonds currently stand at approximately $24.4 million, which equates to 2% of total projected bonds outstanding.

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 CWSRF and DWSRF, 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.

MIXED LOAN POOL WITH MODERATE CONCENTRATION

The combined loan pool is composed of approximately 160 pledged obligors. Around 53% of the portfolio is considered to be investment grade, which is below-average in comparison to Fitch's 'AAA' median of 73%. As a result of the higher than average concentration of unrated pool participants and an elevated weighted-average life, the program's 'AAA' liability hurdle of 42% is worse than Fitch's 'AAA' median of 31% (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.

The Oklahoma City Water Utilities Trust (OCWUT; 25% of the pool total), Enid Municipal Authority (11%), and Tulsa Metropolitan Utility Authority (8%) are the pool's largest obligors. (Each of these entity's parity bonds are not rated by Fitch but they are assessed to be of high to very high credit quality). The remaining top 10 borrowers range from 2.0% to 5.0% in size relative to the aggregate pool. To account for concentration risk, the PSM by default assessed an additional stress on the top five risk contributors that adversely affect pools with higher concentration, and thus the risk is captured in the rating. Given the implied credit strength of the OCWUT, no additional recovery sensitivities were run in Fitch's analysis.

EXPERIENCED PROGRAM MANAGEMENT AND SOUND UNDERWRITING

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

The board's formal SRF underwriting procedures consist of 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.

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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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

State Revolving Fund and Municipal Finance Pool Program Rating Criteria (pub. 27 Sep 2021) (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, v1.11.1 (1)

State Revolving Fund Cash Flow Model, v1.18.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Oklahoma Water Resources Board (OK)	EU Endorsed, UK Endorsed

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