STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

South Dakota Conservancy District; State Revolving Funds/Pools

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Table Of Contents

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Credit Profile		
US$60.0 mil rev bnds (State Revolving Fd Prog Bnds) ser 2014B due 08/01/2034		
Long Term Rating	AAA/Stable	New
US$9.0 mil taxable rev bnds (State Revolving Fd Prog Bnds) ser 2014A due 08/01/2019		
Long Term Rating	AAA/Stable	New
South Dakota Conserv Dist (State Revolving Fd Prog)		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating to the South Dakota Conservancy District's series 2014 state revolving fund program bonds. We have also affirmed our 'AAA' long-term rating on various district bond issues outstanding.

The 'AAA' long-term rating on the district's state revolving fund program bonds reflects the combination of very strong enterprise risk and financial risk scores, resulting from:

- A market position reflecting support from multiple levels of government that creates a growing equity position;
- Collateralization levels that enable the program to absorb a very high level of borrower defaults, resulting in an extremely strong loss coverage score;
- Extremely low historical levels of borrower defaults and delinquencies; and
- Generally strong financial management policies and practices.

The proceeds of the series 2014 bonds will be used to fund the state match of federal capitalization grants and to make new loans.

The bonds are secured by repayments made under the pledged loan agreements and other various funds pledged under the master indenture. Separate state match and leveraged series bonds for each program are not issued, but each series is separated into a state match and leveraged portion for each program as applicable. The principal and interest payments from the loan agreements are segregated: The interest payments secure the state match portion of the bonds, with principal payments and excess interest payments (after state match debt service is paid) securing the leveraged portion of the bonds.

We consider the district's enterprise risk score extremely strong, given the combination of a low industry risk score and an extremely strong market position ranking. Ongoing support from state and federal sources leads to a growing equity position available for additional loan activity.

The state created South Dakota Conservancy District in 1959 for planning, developing, and managing the use and conservation of the water resources of the state. The district is governed by the seven-member Board of Water and Natural Resources, which sets certain policies for the state Department of Environment and Natural Resources (DENR), including water policy and the state water plan. Board members are appointed by the governor. Employees of the state DENR serve as the staff of the district and perform its administrative functions.

Detail of the extremely strong financial risk profile

Overcollateralization is achieved through annual revenues structured to be well in excess of annual debt service costs, as well as surplus revenues generated from prior-year cash flows. For both clean and drinking water, minimum annual debt service (MADS) coverage just from loan revenues exceeds 1.4x in all years, and generally grows stronger over the course of the debt amortization schedule. The district currently has about $135 million of available funds invested in guaranteed investment contracts (GICs) and about $35 million of cash-equivalent funds. Investments in GICs are with providers with ratings that currently range from high investment grade to speculative grade. If the district can't draw cash out of its various GICs to pay debt service in a timely manner, the availability of other reserves as well as annual revenues that well exceed debt service requirements provide enough of a cushion that this circumstance would not impair credit quality, in our opinion. As portions of these funds are used to make additional loans, the loan revenues would then likely provide additional debt service coverage (DSC).

The pool's cross-collateralization mechanism helps to further cushion the pool from risks associated with loan defaults. If loan interest payments are insufficient to pay debt service on the state match portion of bonds, excess interest payments from either the clean- or drinking-water program can be used. If loan principal payments are insufficient to pay debt service on the leveraged portion of the bonds, excess principal and interest payments from either the clean- or drinking-water program can be used. Federal law does not allow the use of loan principal payments for payment on any state match portion of bonds, which is why the cross-collateralization mechanism does not permit excess loan principal payments to be used for payment of debt service on the state match portion of bonds.

There are currently $196 million of state revolving fund bonds outstanding. Supporting these are more than 400 loans either outstanding or pending, with more than $600 million of principal due on those loans. The borrower portfolio consists of loans to 273 separate entities, though some entities have loans with different pledges. The largest borrower is Sioux Falls, with $149 million of loans payable, representing 24% of all loans. There have been no loan defaults or delinquencies for the past 12 months. The loan agreements require the borrowers using utility revenue pledges to maintain 1.1x coverage and a 1.1x rate covenant. Sales tax pledges require 1.2x coverage.

District management prepares and updates its intended use plan annually and including the project priority list. Projects are ranked and funded in order of priority. The creditworthiness of potential borrowers is evaluated by district staff and there are minimum coverage levels that must be met depending on the security provided. Once loans are funded, there are annual reporting requirements that include financial statement and coverage certificates.

Outlook

The stable outlook reflects Standard & Poor's expectation that the district's strong management of the loan portfolio will continue, and that collateralization levels will continue to enable coverage of a very high level of potential defaults and delinquencies. The program is able to withstand default stresses sufficient for a 'AAA' rating even if the vast majority of reserves are fully discounted.

Therefore, we do not anticipate nonperformance of any investment contracts to weaken the rating. Currently, there is no downward pressure on the rating given DSC solely from loan revenues that provides a strong cushion for any potential defaults, in our opinion.

Related Criteria And Research

Related Criteria

- USPF Criteria: U.S. Public Finance Long-Term Municipal Pools, March 19, 2012
- Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance, Sept. 19, 2014

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