

RatingsDirect®

Summary:

South Dakota Conservancy District; State Revolving Funds/Pools

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Credit Profile

US\$78.975 mil st revolving fd prog rev bnds ser 2017B due 08/01/2037		
<i>Long Term Rating</i>	AAA/Stable	New
US\$16.71 mil st revolving fd prog taxable rev bnds ser 2017A due 08/01/2022		
<i>Long Term Rating</i>	AAA/Stable	New
South Dakota Conserv Dist (State Revolving Fd Prog)		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' rating to the South Dakota Conservancy District's series 2017A and B state revolving fund program bonds, and affirmed its 'AAA' rating on various series of the district's outstanding state revolving fund program bonds. The outlook is stable.

The 'AAA' rating reflects the combination of extremely 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.

Because we view securitizations backed by pools of public-sector assets as highly sensitive to country risk, the rating on the securitization is capped at two notches above the sovereign. However, no specific sovereign default stress is applied, given the U.S. sovereign rating is 'AA+'.

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 the 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.

Details of the extremely strong financial risk profile

Over-collateralization 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 \$214 million of available cash and investments in various funds. If it can't draw cash out of its various investments to pay debt service in a timely manner, the available cash flow from annual loan repayments provides enough of a cushion, in our view, that bond payments would not necessarily be impaired. Portions of these funds are used to make additional loans, so the loan revenues are designed to recycle back into the program to 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 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.

Including the 2017 bonds, there are currently \$271 million of state revolving fund bonds outstanding. Supporting these are about 500 loans either outstanding or pending, with more than \$600 million of principal due on those loans. The borrower portfolio consists of loans to 312 separate entities, though some entities have loans with different pledges. The largest borrower is Sioux Falls, with \$175 million of existing and future loans payable, representing 25% 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 DSC and a 1.1x rate covenant. Sales tax pledges require 1.2x coverage.

District management prepares and updates its intended use plan annually, 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. The district also just incorporated a new investment policy into its master trust indenture by way of a fifth restated and amended master trust indenture. Allowable investment obligations are generally restricted to U.S. Treasuries and agencies, certificates of deposit, money market funds, and other investments that are either collateralized or with investment-grade counterparties.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the district's strong management of the loan portfolio will continue, and that collateralization levels will sustain coverage of a very high level of potential defaults and delinquencies.

Downward scenario

Currently, we do not anticipate downward pressure on the rating given that DSC solely from loan revenues provides a strong cushion for any potential defaults, in our opinion.

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