Research Update:

South Dakota Conservancy District 2025A SRF Bonds Rated 'AAA'

May 12, 2025

Primary contact

John Schulz
Englewood
1-303-721-4385
john.schulz
@spglobal.com

Secondary contact

Peter V Murphy
New York
1-212-438-2065
peter.murphy
@spglobal.com

Overview

- S&P Global Ratings assigned its 'AAA' rating to South Dakota Conservancy District's (SDCD) $198.240 million series 2025A state revolving fund (SRF) program bonds.
- At the same time, S&P Global Ratings affirmed its 'AAA' rating on SDCD's existing SRF program bonds.
- The outlook is stable.

Rationale

Security

The proceeds from the 2025 A bonds will be allocated as follows:

- A total of $171.38 million will be allocated to finance both new and existing loans for various utilities involved in the clean water and drinking water programs. Within this amount, $56.980 million is designated for clean water SRF, while $114.400 million is allocated for drinking water SRF.
- $26.86 million will be utilized to refund the series 2014B bonds.

Repayments made under pledged loan agreements and other various funds pledged under the master indenture secure the bonds.

SDCD does not issue separate state-match and leveraged series bonds for each program, but it separates each series into a state-match and leveraged portion for each program as applicable. SDCD segregates principal and interest payments from loan agreements: Interest payments secure the bonds' state-match portion, with principal payments and excess interest payments after SDCD pays state-match debt service securing the bonds' leveraged portion.

In relation to the issuance and sale of the series 2025A bonds, this will mark the second set of outstanding bonds issued following the amendment of the master trust indenture. A significant change within this amendment is the adjustment of the required projected debt service coverage (DSC) for the additional bonds test, lowering it from 1.20x to 1.05x. Importantly, this amendment does not alter our assessment of the credit quality of the bond program.

Credit highlights

The program provides loans to finance projects related to water pollution control and drinking water to a diverse mix of utilities throughout the state. The pool benefits from overcollateralization that provides excess annual cash flow to pay state revolving fund bond debt service. Reserves held in program accounts also provides a cushion against potential borrower defaults.

The rating reflects our opinion of the combination of extremely strong enterprise and financial risk scores, supported by SDCD's:

- Extremely strong market position, reflecting support from multiple levels of government that creates growing equity;
- Extremely low historical borrower defaults and delinquencies;
- Over-collateralization, which we believe to be in line with our strongest assessment, based on the credit quality of the asset pool and consolidated cash flows; and
- Strong financial management policies and practices.

Rating above the sovereign

Because we view securitizations backed by pools of public sector assets as highly sensitive to national risk, we cap the rating on the securitization at two notches above the U.S. sovereign rating. However, we do not apply any specific sovereign default stress because the U.S. sovereign rating is 'AA+'.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the pool's loan portfolio will remain diverse and that SDCD will continue to manage its loan origination process to provide sound protection against loan-default risk. The outlook also reflects S&P Global Ratings' expectation that SDCD's strong loan portfolio management will likely continue, and that collateralization will likely sustain high DSC of potential defaults and delinquencies.

Downside scenario

We do not expect to lower the rating because DSC solely from loan revenue provides a strong cushion for potential defaults.

Credit Opinion

Enterprise risk --Extremely Strong

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

Financial risk --Extremely Strong

SDCD achieves overcollateralization through annual revenue structured in excess of annual debt service costs and surplus revenue generated from prior-year cash flow. The cash flow pattern historically hovers around a 'AAA'-level default stress and consistently passes the largest obligor test. We believe the program it will continue to pass this pool will pass at the ‘AAA’ level. For the combined clean and drinking water programs, minimum annual DSC generally exceeds 1.2x; it grows stronger during the course of the debt amortization schedule. SDCD currently has about $213 million of available cash and investments in various funds. SDCD's investment pool includes roughly $120 million of investments guaranteed by AIG group. If it cannot draw cash from various investments to make timely debt service payments, available cash flow from annual loan repayments provides enough of a cushion, in our view, that bond payments would not necessarily be impaired. SDCD uses portions of these funds to make additional loans, so loan revenue recycles back into the program to provide additional DSC. There have been no loan defaults and a limited number of delinquencies during the past 12 months. Loan delinquencies typically result from administrative errors by borrowers and are cured quickly. 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 DSC.

The pool's cross-collateralization mechanism helps cushion the pool further from loan default risk. If loan interest payments are insufficient to pay debt service on the bonds' state-match portion, SDCD can use excess interest payments from the clean or drinking water program. If loan principal payments are insufficient to pay debt service on the bonds' leveraged portion, SDCD can use excess principal and interest payments from the clean or drinking water program. Federal law does not allow the use of loan principal payments for the bonds' state-match payments; this is why the cross-collateralization mechanism does not permit excess loan principal payments for the bonds' state-match debt service.

Management

We consider SDCD's financial management policies and practices strong under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

SDCD management prepares and updates its intended use plan annually, including the project priority list. It ranks projects and funds them in order of priority. SDCD staff evaluates the creditworthiness of potential borrowers, and borrowers must meet minimum DSC depending on the security. Once funded, annual reporting loan requirements include financial statement and DSC certificates.

SDCD has an investment management policy in its master trust indenture. The policy generally restricts investments to U.S. treasuries and agencies, certificates of deposit, money market funds, and other investments either collateralized or with investment-grade counterparties.

Credit Snapshot

- Program Description: The State of South Dakota created the SDCD in 1959 for planning, developing, and managing the use and conservation of water resources. A seven-member Board of Water & Natural Resources governs SDCD; the board sets certain policies for South Dakota Department of Agriculture & Natural Resources, including water policies and the state water plan. The SDCD is authorized to lend to, or purchase loan obligations of, political entities and non-profit entities within the state. The clean and drinking water SRFs were created pursuant to state statutes to carry out the provisions of the federal Clean Water and Safe Drinking Water Acts. In support of the SRF programs, the district receives federal capitalization grants and meets match requirements using bond proceeds.

- The flow of funds: It is such that principal and interest payments received from the loan obligations 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. However, if loan interest payments are insufficient to pay debt service on the state match portion of the 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.
- Summary statistics: As of May 30, 2025, there are $396.619 million in outstanding clean water SRF bonds and $190.541 million in outstanding drinking water SRF bonds. These bonds are supported by approximately $2.245 billion in clean and drinking water loans, which facilitate bond repayment. Borrower repayments, along with interest earnings from both unrestricted and restricted reserves, yield an average debt service coverage ratio of 1.53x. The borrower portfolio comprises loans to around 239 distinct entities. The largest borrower, Sioux Falls, has $354.358 million in outstanding loans, accounting for 15.78% of the total loans currently outstanding.

Ratings List	
New Issue Ratings	
US$198.24 mil rev bnds ser 2025A due 08/01/2055	
Long Term Rating	AAA/Stable
Ratings Affirmed	
Water & Sewer	
South Dakota Conservancy Dist, SD State Revolving Fund Clean Water & Drinking Water Program	AAA/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.