STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Arizona Water Infrastructure Finance Authority; State Revolving Funds/Pools

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Summary:

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Credit Profile		
US$357.03 mil wtr qlty rev rfdg bnds ser 2014A due 10/01/2030		
Long Term Rating	AAA/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AAA' rating to the Arizona Water Infrastructure Finance Authority's (WIFA) series 2014A water quality revenue refunding bonds. We have also affirmed our 'AAA' rating on WIFA's outstanding water quality revenue bonds. The outlook is stable.

The rating reflects the following characteristics:

- An extremely strong enterprise risk profile, given that the program has ongoing support from multiple levels of government and a governmental entity manages the program; and
- An extremely strong financial risk profile, with loss coverage score (LSC), operating performance, and financial policies consistent with this profile.

Various pledged accounts under the authority's master trust indenture secure debt service. These accounts include:

- A financial assistance account (FAA), into which pledged loan revenues and investment earnings are ultimately deposited;
- A reserve account available to cure bond debt service deficiencies if revenues in the FAA are not sufficient; and
- A bond account, into which revenues from the FAA are transferred to pay debt service on the authority's bonds.

Pledged as payment on $716 million of bonds are $1.1 billion of pledged loans and about $300 million of combined pledged debt service reserve (DSR) and FAA investments. DSR investments total $62 million of guaranteed investment contracts (GICs) with various counterparties and $22 million of federal home loan bank obligations, while FAA investments include $216 million of cash equivalents and $28 million of GICs.

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+'.

We view the enterprise risk profile of the program as extremely strong. This is due to a combination of the low industry risk profile for municipal pools and the program's market position, which we consider extremely strong. WIFA was established by statute and is managed by a 12-member board. State statutes authorized the clean and drinking water programs, which receive both federal and state equity support through capitalization grants and state match, respectively. Because WIFA serves the entire state, we have not applied the geographic concentration adjustment to the enterprise risk profile.

We view the financial risk profile of the program as extremely strong, reflecting the combination of the LCS, historical operating performance, and management policies.

Debt service coverage (DSC) from all sources is sufficient to meet our default tolerance for 'AAA' rated municipal pools. Including just loan revenues and interest earnings, annual DSC is no less than 1.3x for all years of debt service. This is combined coverage for clean water, drinking water, state match (of which there are none outstanding), and leveraged bonds.

All of WIFA's bonds have access to a cross-collateralization mechanism. Provisions in the master indenture allow for clean and drinking water funds to advance to one another revenues if an insufficiency arises. The obligation of the deficient account to repay the lending account is subordinate to bond debt service.

These cash flow characteristics lead to an extremely strong LCS under our default tolerance tests; this includes the effect of the largest obligor test, which the program passes.

Averaging all of the financial policies and practices, we view the corpus of these as strong. On receipt of a loan application from a local borrower, WIFA conducts an assessment and internal review of the applicant's legal, managerial, technical, and financial capability. Priority is given to potential borrowers based on both fiscal capacity and project priority. Borrowers are charged a combined interest and fee rate, serving as a subsidized interest rate and determined by WIFA, based on an assessment of the borrower's various economic, financial, operational, and existing debt characteristics. Annual surveillance is performed on all of the program's borrowers. Loan repayments are due no less than 90 days before debt service payments, and there are corrective action policies in place for delinquent loans. WIFA management develops the intended use plan and a project priority list; both are updated annually. Management also receives monthly investment reports; investments are made pursuant to the master trust indenture.

Even though management has indicated that there is one delinquent loan, it is not pledged to the bonds.

Given these enterprise and financial risk profiles, the final rating is 'AAA' because we did not make any negative overriding adjustments.

WIFA revolving fund

WIFA's loan portfolio is large and several of the larger borrowers have outstanding credit ratings. The largest borrower is Lake Havasu (security of system revenues and general obligation (GO), comprising 20% of pledged loans, revenue bonds rated 'A-/Stable' and GO bonds rated 'AA-/Stable'); other large borrowers include Peoria (security of system revenues, comprising 8% of pledged loans, revenue bonds rated 'AA/Stable') and Prescott (security of system revenues, comprising 7% of pledged loans, revenue bonds not rated). Borrowers' utility system revenues secure about 80% of the loans, and other security types include GO, special assessments, and excise taxes.

Bonds are designated as state-match or leveraged bonds and then further allocated between the clean water and drinking water revolving funds. State-match bonds can only be secured with loan and investment interest (in compliance with federal legislation), whereas leveraged bonds are secured with loan principal payments and residual interest revenues after state-match bonds are paid.

Policies are in place that guide management decisions to originate loans pledged or unpledged to repayment on the bonds. Loans considered "qualified" are typically pledged as security on WIFA's outstanding bonds and have what the authority considers strong credit qualities. Loans considered "not qualified" may be made to borrowers that may not have met WIFA's revenue coverage test, loan origination analysis (financial and system capability), or the annual certification requirement, which entails WIFA's review of the status of the outstanding loan. "Qualified-not pledged" loans may have similar characteristics as the qualified and pledged loans, but are not pledged as security on WIFA's bonds.

Outlook

The stable outlook reflects our expectation that cash flow generated from the pledged assets will remain sufficient to meet our default tolerance criteria for a 'AAA' rating. Supporting this view are the strong management practices in place. We do not expect the rating to change within the two-year outlook horizon.

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. 30, 2014

Ratings Detail (As Of October 24, 2014)		
Arizona Wtr Infrastructure Fin Auth wtr qlty rev bnds		
Long Term Rating	AAA/Stable	Affirmed
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