Water Infrastructure Finance Authority of Arizona

Water Quality Revenue Refunding Bonds

New Issue Report

Ratings

New Issue

Water Quality Revenue Refunding Bonds, Series 2014A	AAA
Outstanding Debt	
Parity Bonds	AAA

Rating Outlook

Stable

Related Research

Fitch Rates Water Infrastructure Finance Auth of AZ's Series 2014A SRF Bonds 'AAA'; Outlook Stable (October 2014)

State Revolving Fund and Leveraged Municipal Loan Pool 2013 Peer Review (October 2013)

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New Issue Details

Sale Information: Approximately $358,200,000 Water Quality Revenue Refunding Bonds, Series 2014A, scheduled to price via negotiation the week of Oct. 27.

Security: Certain loan repayments payable from local borrowers, pledged account and reserve funds and account investment earnings.

Purpose: To refund portions of the Water Infrastructure Finance Authority of Arizona's (WIFA) outstanding bonds and to pay for the costs of issuance.

Final Maturity: Oct. 1, 2030.

Key Rating Drivers

Strong Financial Structure: Fitch Ratings' cash flow modeling demonstrates that the program can continue to pay bond debt service even with loan defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's Portfolio Stress Calculator (PSC).

Concentrated Pool: WIFA's combined loan pool is somewhat small and somewhat concentrated. On a combined basis, the largest borrower represents approximately 23% of the pool, and the largest 10 borrowers represent an elevated 65% of the total.

Average Pool Credit Quality: Approximately 34% of WIFA's loan portfolio consists of unrated entities, which Fitch conservatively assumes to be of speculative-grade credit quality in its analysis. Overall, pool credit quality is in line with other state revolving funds (SRFs) rated by Fitch.

Effective Program Management: WIFA adheres to consistent, conservative underwriting policies. Management and underwriting strength is demonstrated by the fact that the program has never experienced a default.

Rating Sensitivities

Reduction in Modeled Stress Cushion: Significant deterioration in aggregate borrower credit quality, increased pool concentration or increased leveraging resulting in the program's inability to pass Fitch's 'AAA' liability rating stress hurdle would put downward pressure on the rating. The Stable Rating Outlook reflects Fitch's view that these events are unlikely to occur.

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	10/22/14
AAA	Affirmed	Stable	11/6/12
AAA	Affirmed	Stable	2/10/12
AAA	Affirmed	Stable	6/30/10
AAA	Affirmed	Stable	4/4/08
AAA	Affirmed	Stable	3/2/06
AAA	Affirmed	Stable	3/1/04
AAA	Upgraded	—	11/21/01
AA+	Assigned	—	3/18/99

Related Criteria

Revenue-Supported Rating Criteria (June 2014)

State Revolving Fund and Leveraged Municipal Loan Pool Criteria (October 2014)

Credit Profile

WIFA is an independent agency of the state of Arizona and was established to provide below-market financing for the construction, rehabilitation and improvement of drinking water, wastewater, wastewater reclamation and other water quality facilities/projects within the state.

Solid Financial Structure

The strength of the program's financial structure is exhibited by its sound program asset strength ratio (PASR). Fitch calculates the PASR, which includes the sum of total scheduled loan repayments, debt service reserve account (DSRA) funds and account earnings divided by total scheduled bond debt service, to be solid at approximately 1.5x versus Fitch's 'AAA' median of 1.6x.

Because of this available margin, cash flow modeling demonstrates that the program can continue to pay bond debt service even with hypothetical loan defaults of 100% in the first, middle and last four years of the outstanding bonds' expected life (as per Fitch criteria, a 90% recovery is also applied in its cash flow model when determining default tolerance). This is in excess of Fitch's 'AAA' liability rating stress hurdle of 30% as produced by the PSC. The liability stress hurdle is calculated based on overall pool credit quality as measured by the rating of underlying borrowers, size, loan term and concentration.

Loss Protection Provided by Overcollateralization and Reserves

Under the program's financial structure, each series of bonds is protected from losses by borrower loans made in excess of bond debt service (overcollateralization). On an annual basis, loans overcollateralize bonds by a minimum of 30%, or 1.3x. Also protecting bonds from losses are the DSRA, the financial assistance account (FAA) and the loan acquisition fund.

Loan repayments are deposited into each respective clean water and drinking water SRF FAA, which are then available to make debt service payments on any bonds issued under the master trust indenture. Once the aforementioned payments are made, excess amounts in each account can be transferred to the other to make up any deficiencies, resulting in cross-collateralization of the two funds. This increases the diversity of the aggregate loan pool and lessens the risk of any one borrower's default eroding reserve balances and threatening bondholder payments. Any such transfer creates a repayment obligation by the deficient account, but the obligation is subordinate to the trust estate's pledge under the bond indenture. Due to the cross-collateralization feature, Fitch combines the programs in its cash flow modeling.

After taking into account all transfers from the FAAs, the DSRA will be used to cure debt service payment shortfalls. The program indenture requires that the DSRA be maintained at the least of 10% of the original balance of all outstanding bond principal, 1.0x maximum annual debt service or 1.25x of the average annual debt service remaining. The DSRA may be funded with cash or a letter of credit, surety bond or other similar arrangement.

The total DSRA balance is projected to be approximately $83.6 million on Jan. 1, 2015, which will equate to 11.7% of bonds outstanding. At the same time, the FAA is expected to be funded at approximately $139.1 million (or 19.4% of outstanding bond principal). The total of all pledged accounts, including the FAA, the DSRA and the loan acquisition fund, is projected to provide an additional 36.5% in loss protection to the bonds.

Concentrated Loan Pool

The combined loan pool is composed of 65 borrowers. At a combined 23%, Lake Havasu is the pool's largest borrower. Loans to Lake Havasu secured by net utility system revenues (senior lien wastewater WIFA loan rated 'A'/Stable by Fitch) represent about 14% of the aggregate pool, and loans secured by a combination general obligation and revenue pledge represent 9% of the pool (Fitch rates Lake Havasu's general obligation debt 'AA–' with a Stable Rating Outlook). In aggregate, the top 10 borrowers represent approximately 65% of the loan pool versus Fitch's 'AAA' median level of 52%.

Largest Borrowers

Borrower	% of Portfolio
Lake Havasu, City of (Utility Revenue)	13.9
Lake Havasu, City of (GO/Utility Revenue)	9.0
Prescott, City of	7.4
Queen Creek, Town of	7.3
Peoria, City of	7.2
Tucson, City of	5.1
Yuma, City of	4.9
Kingman, City of	4.0
Flagstaff, City of	3.4
Cave Creek, Town of	2.9
Total	**65.1**

Note: Numbers may not add due to rounding.

Pool credit quality is in line with similarly rated municipal pools, as reflected by the PSC liability stress hurdle of 30% versus Fitch's 'AAA' median level of 33% (lower liability stresses correlate to stronger credit quality). Loan security provisions are strong, with nearly 90% backed by utility system revenues, general obligation debt or a combination of the two.

Effective Program Management and Underwriting

WIFA's loan underwriting guidelines, evidenced by extensive formalized policies and procedures, are a key credit strength. Prior to loan origination, WIFA staff perform a due diligence review and a financial capability review. The due diligence review includes determination of legal, managerial, technical and financial capability. The financial capability review focuses on a borrower's historical performance over the previous three-year period, with results used to analyze trends and project future performance. To date, as a result of WIFA's underwriting and monitoring policies, there have been no program defaults.

Additional Bonds Test

Additional parity bonds can be issued provided that, after such issuance, debt service coverage relating to leveraged bonds is at least 1.2x. In calculating coverage, only principal and interest from qualified pledged loans are considered.

Investment Guidelines

Per bond covenants, eligible investments include securities such as U.S. guaranteed obligations or U.S. government agencies, fully insured or guaranteed time deposits, commercial paper, municipal debt and investment agreements.

Reserve assets are primarily invested in guaranteed investment contracts, with providers rated at least in the second highest rated category and fully collateralized at 102% by direct U.S. Treasuries or agencies with third-party custodians.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.