

## **FITCH RATES ILLINOIS FINANCE AUTHORITY'S STATE OF IL CLEAN WATER INITIATIVE SRF REVS 'AAA'**

Fitch Ratings-Austin-22 August 2017: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the Illinois Finance Authority (IFA) under its 2013 Master Trust Agreement (MTA):

--Approximately \$558.5 million State of Illinois clean water initiative revolving fund revenue bonds, series 2017.

The series 2017 bond proceeds will be used to fund loans to local governments for eligible clean water and drinking water projects and to pay for the costs of issuance. The bonds are scheduled to price via negotiation the week of Aug. 28.

In addition, Fitch affirms its 'AAA' rating on the following outstanding clean water initiative revolving fund revenue bonds:

--\$67.3 million series 2013;  
--\$489.4 million series 2016.

The Rating Outlook is Stable.

### **SECURITY**

The bonds are secured by pledged loan repayments and certain account interest earnings.

### **KEY RATING DRIVERS**

**STRONG FINANCIAL STRUCTURE:** Fitch's cash flow modeling demonstrates that the clean water initiative revolving fund (CWIRF) program (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).

**LARGELY UNRATED POOL:** At least 64% of the CWIRF's combined loan pool is considered to be investment grade (versus a 'AAA' median of 80%), inclusive of internal credit opinions previously assigned by Fitch. The remaining portion does not carry a public rating. The portion of investment grade borrowers is low in comparison to similar pools rated by Fitch.

**MODERATE POOL DIVERSITY:** The CWIRF loan portfolio pool is larger and more diverse than similar programs rated by Fitch, and is growing with the issuance of the 2017 bonds. After this issuance, the pool is projected to include loans to approximately 402 individual obligors, the top 10 of which represent 54% of the pool total. This is lower than Fitch's median level of 55%, which is indicative of better-than-average pool diversity.

**SOUND PROGRAM MANAGEMENT:** Program management adheres to a formal underwriting policy which includes, among other things, minimum coverage requirements for most borrowers and reserve requirements for subordinate lien pledges. To date, there have been no pledged loan defaults in any of the Illinois Environmental Protection Agency (IEPA) state revolving fund (SRF) programs.

## RATING SENSITIVITIES

**REDUCTION IN MODELED STRESS CUSHION:** Significant deterioration in aggregate borrower credit quality, increased pool concentration, or increased leveraging resulting in the State of Illinois Clean Water Initiative Revolving Fund's inability to pass Fitch's 'AAA' liability rating stress hurdle would likely put downward pressure on the rating.

## CREDIT PROFILE

The CWIRF was announced in February 2012 as part of the state's initiative to provide \$1 billion of affordable loans to local governments for qualified water and wastewater capital projects. The CWIRF is operated by the IEPA under the state's Water Revolving Fund, which includes both the state's clean water program (CWSRF) and drinking water program (DWSRF).

The series 2017 bonds are the third series to be issued under the 2013 MTA. With this issue, the total program size will be expanded significantly which, in turn, will lead to improved diversity.

## STRONG FINANCIAL STRUCTURE

Fitch measures financial strength SRFs by calculating the program asset strength ratio (PASR). The PASR includes total scheduled pledged loan repayments divided by total scheduled bond debt service. Reflective of the strength of its financial structure, the CWIRF's PASR is 1.7x, which is just slightly below Fitch's 2016 'AAA' median PASR of 1.9x.

Also as a measure of the strength of the program's financial structure, cash flow modeling demonstrates that it can continue to pay bond debt service even with hypothetical loan defaults of 100% over the first, middle and last four years of the program's 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 28% as produced by the PSC. The rating 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

The bonds' primary form of loss protection is provided by the program's surplus loan repayments made in excess of bond debt service (overcollateralization). On an annualized basis, such surplus loan repayments overcollateralize aggregate 2013 MTI bond debt service by a minimum of 1.5x, which is better than Fitch's 2016 median level of 1.4x.

The CWIRF program includes a cross-collateralization feature wherein excess funds from the CWSRF are available to cover deficiencies in the DWSRF and vice versa. The ability for the two funds to cross-collateralize helps to minimize losses if defaults were to occur. Because of this feature, Fitch combines both programs in its models.

## LOAN POOL MODERATELY DIVERSIFIED YET LARGELY UNRATED

The combined CWSRF and DWSRF loan pool is projected to include about 402 individually secured obligors. The Metropolitan Water Reclamation District of Greater Chicago (MWRD; general obligation debt rated 'AAA' with a Stable Outlook) is the largest participant, representing about 25% of the pool. While significant, MWRD's high rating mitigates the single-obligor concentration risk it would otherwise present.

In aggregate, the top-10 borrowers will represent approximately 54% of the loan pool versus Fitch's 2016 'AAA' median level of 55%. Excluding MWRD, each remaining program participant

accounts for 11.9% or less of the total pool. Overall, Fitch views the loan pool as having above-average diversity in comparison to similar 'AAA' programs.

Based on this composition, the pool's 'AAA' liability rating stress hurdle is calculated to be approximately 28%, while Fitch's comparable median is 32%. The lower-than-average hurdle is primarily due to the pool's below-average weighted-average life. Loan security is strong with 72% of the pool backed by water or wastewater pledges and the remaining 28% backed by general obligation pledges or other sources; these pledge types are considered to be among the strongest by Fitch and, generally speaking, historically demonstrate high recoveries upon default.

## STRONG PROGRAM MANAGEMENT AND UNDERWRITING

The Illinois SRF programs, including the CWIRF, are jointly managed by the IFA and the IEPA through a memorandum of agreement. Program loans are chosen by the IEPA following an established set of administrative policies and procedures to evaluate loan applications.

Favorably, loan reserves may be required for subordinate revenue liens as are minimum coverage requirements, which are set at the same level as senior obligations. Additionally, the IEPA has payment intercept authority and the ability to require borrowers to raise rates to meet coverage requirements. Reflecting the strength of management and underwriting, there have been no pledged loan defaults to date.

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### Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)

<https://www.fitchratings.com/site/re/898969>

State Revolving Fund and Leveraged Municipal Loan Pool Criteria (pub. 20 Oct 2016)

<https://www.fitchratings.com/site/re/888966>

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