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Summary:

Kentucky Rural Water Finance Corp.; State Revolving Funds/Pools

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Table Of Contents

Rating Action

Stable Two-Year Outlook

Credit Opinion

Summary:

Kentucky Rural Water Finance Corp.; State Revolving Funds/ Pools

Credit Profile

US\$6.735 mil pub proj rfdg rev bnds (flexible term prog) taxable ser 2020H due 02/01/2044

Long Term Rating A+/Stable New

Kentucky Rural Wtr Fin Corp (Flexible Term Prog)

Long Term Rating A+/Stable Affirmed

Kentucky Rural Wtr Fin Corp (Flexible Term Prog) (MBIA) (National)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Kentucky Rural Wtr Fin Corp (Flexible Term Prog) (MBIA) (National) (SEC MKT)

Unenhanced Rating A+(SPUR)/Stable Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'A+' long-term rating to Kentucky Rural Water Finance Corp.'s anticipated \$6.7 million series 2020H public projects refunding revenue bonds (flexible term program). At the same time, we affirmed our 'A+' rating on the corporation's previously issued public project debt. The outlook is stable.

Loans to cities, counties, and water districts, as well as pledged reserves, reserve fund investment earnings, and miscellaneous administrative fund revenues, all serve as monetary sources for debt service payments. The program's investment earnings provide a portion of annual debt service payments. As reserve fund investments mature, liquidated investments are used to make debt service payments. Following the 2020H issuance, there will be approximately \$221 million in bonds outstanding, \$199 million in pledged loans, and 106 program participants.

The stable outlook reflects our view that over-collateralization will remain commensurate with the rating and that other program features will not deviate from historical trends and practices.

Credit overview

The 'A+' ratings reflect our view of:

- The strong enterprise risk profile, given that the loan pool is managed by a nonprofit, nonstock public corporation, and the loan program has no geographic concentration; and
- The very strong financial risk profile, reflected by the corporation's loss coverage score (LCS), operating performance, and financial policies.

Following mobility restrictions and closure of large segments of the economy due to COVID-19 and the swift onset of recession, all of S&P Global Ratings' sector outlooks in U.S. public finance are now negative. For long-term municipal pools, the majority of the underlying cash flows that are either pledged for repayment of bonds or guaranteed by the

programs originate from U.S. public finance asset classes. While state and local government bond programs, such as the flexible term program, used to provide debt market access at favorable rates benefit from borrower diversity, we believe that ratings on these programs could be negatively affected if the exceptionally low rate of loan delinquencies at or near 0% that we have typically observed becomes no longer applicable. Based on our criteria scoring, once the flexible term program begins to observe a borrower delinquency rate of at least 6% or an occurrence of actual loan defaults of at least 2%, then there would likely be downward pressure on the rating.

Stable Two-Year Outlook

Downside scenario

If reserves become insufficient for the rating, or if any other program factors hurt enterprise or financial risk profiles, we could lower the ratings within the two-year outlook horizon. As mentioned above, at this time we are also focused more on loan delinquencies as a downside risk.

Upside scenario

Conversely, if our view of the financial or enterprise risk profiles changes, we could raise the ratings. Absent changes to current program operations or structure, the factor most likely to contribute to a higher rating, in our view, would be increased over-collateralization stemming from nondebt-funded reserves or other available resources.

Credit Opinion

Enterprise risk

We view the program's enterprise risk profile as strong. This is due to a combination of a low industry risk profile for municipal pools, our view of the program's market position as adequate, and not applying a geographic concentration adjustment since the program funds loans throughout the state. The finance corporation is a public nonstock and nonprofit corporation governed by a board and formed under Kentucky Revised Statutes chapters 58 and 273. The Kentucky Rural Water Association (KRWA), founded in 1979, acts as the financing program sponsor. KRWA is a statewide association, offering membership to water and wastewater utilities throughout Kentucky. It has more than 300 voting members.

Financial risk

We view the program's financial risk profile as very strong, reflecting a combination of the strong LCS with the corporation's generally strong historical operating performance and management policies. Over-collateralization available to cure loan defaults includes annual revenues from pledged administrative fees, excess cash held in miscellaneous funds, and \$21.7 million of investments in the debt service reserve (DSR). The program's cash flows are structured so that loan repayments match debt service on the portion of bonds used to make loans, while the DSR and its interest earnings are used for debt service on bonds used to fund the DSR. Over-collateralization arising from the DSR, administrative fees, and trustee-held excess cash all provide sufficient revenue, in our view, to make full payments on all bonds, given the level of defaults consistent with an adequate LCS. We allow for 93% recovery of defaulted loan revenues. If a DSR draw occurs, participants must repay the draw amount within one year. As further protection, participants must agree to set rates sufficient to provide 1.2x maximum annual debt service (MADS)

coverage on all system obligations.

Program reserves include municipal bonds rated at least 'AA-', guaranteed investment contracts with Mass Mutual and Wells Fargo Bank as counterparties, and accrued cash balance amounts. Should the rating on an investment provider fall below 'A-', the investment contracts require either a posting of collateral, a guarantee with a provider rated 'AA-' or higher, or a reassignment of the investment contract. In addition, \$600,000 in Federal Deposit Insurance Corp.-insured certificates of deposit in the program's administrative fund are available for any program purpose, including to replenish draws on the reserve fund. However, the program purchased the investments via a loan from KRWA, and since March 1, 2011, KRWA has had the right to demand full loan repayment.

We view the program's financial policies and practices as ranging from strong to adequate. Management has the flexibility to enter into several loan agreements, including general obligations and revenue pledges, but that can involve any governmental agency. Program staff require all participants to submit annual financial statements. Loan payments are made monthly, with funds on hand at least 30 days prior to semiannual debt service payment dates. Management prioritizes projects as loan demand develops, with a credit review process for each new loan. The board undertakes bimonthly investment portfolio reviews, with adjustments as needed, depending on either the program's investment strategy or the credit quality of investment counterparties.

Management indicates that since the program's 2001 inception, no loan defaults or delinquent payments have occurred, which we view as favorable based on our criteria scoring. In addition, KRWA has been offering lending programs to its members since 1995, with total originations in excess of \$600 million. Management reports no payment defaults or loan delinquencies across its programs.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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