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Summary:

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

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Credit Profile

US\$16.06 mil pub proj rfdg rev bnds (Flexible Term Prog) ser 2022A due 02/01/2050

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 \$16.1 million series 2022A public projects refunding revenue bonds (flexible term program). At the same time, S&P Global Ratings affirmed its '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 revenue, all support 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 2022A issuance, there will be approximately \$225 million in bonds outstanding, \$201.5 million in pledged loans, and 101 program participants.

Credit overview

The 'A+' rating reflects our view of the corporation's:

- 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
- Very strong financial risk profile, reflected by the loss coverage score (LCS), operating performance, and financial policies.

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, that are used to provide debt market access at favorable rates benefit from borrower diversity and overcollateralization, we believe that ratings on these programs could come under pressure 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 see a borrower delinquency rate of at least 6% or an occurrence of actual loan defaults of at least 2%, the rating would likely come under pressure.

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

Stable 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 rating within the two-year outlook horizon. As mentioned, we are also focused more on loan delinquencies as a downside risk, particularly if reserves are not large enough to absorb losses during this stress point.

Upside scenario

Conversely, if our view of the financial or enterprise risk profiles become more positive, we could raise the rating. Absent changes to program operations or structure, the factor most likely to contribute to a higher rating, in our view, would be increased overcollateralization stemming from non-debt-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 given that 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 Assn. (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. Overcollateralization available to cure loan defaults includes annual revenue from pledged administrative fees, excess cash held in miscellaneous funds, and approximately \$23 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. Overcollateralization 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 revenue over a five-year period. 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 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 to less than '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 through 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 reports no loan defaults or delinquent payments since the program's 2001 inception, and we view this as favorable based on our criteria scoring. In addition, KRWA has been offering lending programs to members since 1995, with total originations in excess of \$500 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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