FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Indiana Finance Authority's Ser. 2022B SRF Bonds 'AAA'; Outlook Stable

Fri 12 Aug, 2022 - 3:24 PM ET

Fitch Ratings - Austin - 12 Aug 2022: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the Indiana Finance Authority (IFA):

--Approximately $250.0 million state revolving fund (SRF) program bonds, series 2022B (green bonds).

Issued under the authority's primary indenture, the series 2022B bond proceeds will be used to fund loans to municipal utilities for certain eligible water and wastewater system projects within the state and pay costs of issuance. The bonds are expected to price via negotiation the week of Aug. 22.

In addition, Fitch has affirmed the 'AAA' rating on the following IFA bonds:

--Approximately $1.55 billion outstanding parity SRF bonds.

The Rating Outlook is Stable.

SECURITY

Bonds issued under the IFA's primary indenture (the primary bonds) are secured by primary loan repayments (loan repayments), debt service reserve funds and/or releases from such funds, permitted transfers from the Water Infrastructure Finance and Innovation Act (WIFIA) pool program, and other pledged accounts related to the general program.

KEY RATING DRIVERS

SOUND FINANCIAL STRUCTURE: Fitch's cash flow modeling demonstrates that IFA's combined clean water (CW) SRF and drinking water (DW) SRF general programs can continue to pay bond debt service, even with loan defaults in excess of the 'AAA' liability rating stress hurdle, as produced by Fitch's Portfolio Stress Model (PSM).

AVERAGE POOL QUALITY: The program's underlying obligor credit quality is largely in line with its peers, as 61% exhibit investment-grade credit characteristics. This translates to an implied pool rating of 'BBB-', one notch lower than the sector's 'AAA' median of 'BBB'.

MODERATE PORTFOLIO DIVERSITY: IFA's combined loan pool is large and moderately diverse. The largest borrower, the city of Fort Wayne (wastewater revenues not rated by Fitch but assessed to be of strong credit quality) represents 16% of the combined pool. The largest 10 borrowers represent approximately 57% of the total pool.

STRONG PROGRAM MANAGEMENT: IFA adheres to consistent, conservative underwriting policies. The program has never experienced a default.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--The ratings are at the highest level on Fitch's scale and cannot be upgraded.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Increased leveraging;

--Significant deterioration in aggregate borrower credit quality;

--Material decreases of cash on hand without a commensurate increase in pledged loans;

--Increased pool concentration, with any of the above resulting in the program's inability to pass Fitch's 'AAA' liability rating stress hurdle.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

IFA's SRF programs were created to provide favorable financing to local entities for wastewater and drinking-water system improvements. IFA is responsible for the administration and management of the

SRFs. Bond proceeds and recycled funds are combined with federal grants and a state matching requirement to provide loans for such projects.

Most of the program's pool metrics, such as credit quality and diversification, have remained stable over the past few years. The program's default tolerance cushion shows some historical volatility typically due to fund and bond proceeds on hand that have not been yet been used to issue additional loans, significant portions of which are expected to provide additional support to bondholders in the form of added enhancement.

In addition to the 'primary' indenture SRF bonds, the IFA also manages the state's WIFIA 'alternative' pool program (AA/Stable). Subject to certain performance tests, surpluses from the alternative program (referred to as permitted transfers) are available on a subordinated basis to primary bondholders, increasing annual coverage margins and thus providing additional loss protection.

SOUND FINANCIAL STRUCTURE

Cash flow modeling demonstrates that the program can continue to pay bond debt service even with hypothetical loan defaults of about 36% in the first four years of the program's life, and 100% in middle and last four years (per Fitch criteria, a 90% recovery is also applied in its cash flow model when determining default tolerance). This is in excess of the IFA's 'AAA' liability rating stress hurdle of 35%, as produced by Fitch's PSM. The rating stress hurdle is calculated based on overall program credit quality as measured by the ratings of underlying borrowers, borrower size, loan term, and concentration.

The program has approximately $266 million in additional reserves that are available to bondholders immediately if needed; a portion of these funds are also expected to be converted to new loans that will then be pledged to bondholders. Inclusion of these funds in Fitch's cash flow model results in a 96% default tolerance rate in the first four-year scenario and 100% in the middle and last four-years.

As an additional measure of financial strength, Fitch calculates the program asset strength ratio (PASR). The PASR, an asset-to-liability ratio, includes total scheduled primary loan repayments and any additional pledged funds divided by total scheduled primary bond debt service. The authority's PASR is 1.7x, which is slightly lower than Fitch's 2021 'AAA' rating-category median of 2.0x but still well supportive of Fitch's 'AAA' rating. The model inputs used to calculate the default tolerance and PASR are based on forecasted cash flows provided by the issuer's financial advisor.

LOSS PROTECTION PROVIDED BY OVERCOLLATERALIZATION AND RESERVES

Under the program structure, each bond series is protected from losses by borrower loan repayments made in excess of bond debt service (overcollateralization) and, in certain prior series, approximately $33.1 million in separately secured debt service reserves. As bonds amortize, released reserves, excess loan repayments and interest earnings are deposited into a deficiency fund, which is available to make debt service payments on any bonds issued before being released to program equity.

The method by which excess amounts are deposited into the deficiency fund allows for cross-collateralization between the CWSRF and DWSRF, increasing pool diversity and potentially lowering aggregate loss amounts. Due to the cross-collateralization feature, Fitch combines the programs in its cash flow modeling.

Inclusive of the permitted transfers from the WIFIA program, minimum annual debt service coverage (DSC) is calculated to be about 1.1x, which is less than Fitch's equivalent median of about 1.6x. Modeled annual coverage tends to improve over time as debt service reserves from prior bonds amortize and the structure transitions from a reserve-fund model to a surplus cash-flow enhanced model.

AVERAGE LOAN POOL WITH MODERATE DIVERSITY

The combined primary loan pool is composed of 329 obligors. The city of Fort Wayne's wastewater system is the largest participant, representing about 16% of the pool. At 13.7% and 9.6%, respectively, the second and third largest obligors are the Citizens Water Authority (CWA, A+/stable) and the City of Evansville's wastewater system (unrated by Fitch but assessed to be of strong credit quality).

Each remaining program participant accounts for 5% or less of the total pool. In aggregate, the top-10 borrowers represent approximately 57% of the primary loan pool, which is on par with Fitch's 'AAA' median level of 55%. Based on these attributes, Fitch views the loan pool as having moderate diversity compared with similar 'AAA' programs.

Approximately 61% of the rated pool is 'BBB+' or better, and about 51% at least 'A+'. The remaining 39% of the pool does not carry a public rating. In accordance with Fitch criteria, the unrated portion of the pool was conservatively estimated to be of speculative-grade credit quality (BB) in the analysis.

Credit quality is slightly weaker than that of similar municipal pools rated by Fitch, as reflected by an 'AAA' PSM liability stress hurdle of 35% versus Fitch's 'AAA' median level of 31% (lower liability stresses correlate to stronger credit quality), but is still considered sound overall. The pool's loan security pledges are considered to be strong, consisting of primarily water/wastewater net system revenues.

STRONG PROGRAM MANAGEMENT

IFA manages both the CWSRF, DWSRF and WIFIA programs using strong underwriting practices. Among other factors, IFA takes into consideration in its borrower assessment the creditworthiness of the borrower and environmental goals of the SRF program. Primary loans secured by system revenue pledges (the primary source of loan security) must demonstrate minimum coverage of 1.25x annual debt service coverage and are also required to create a local debt service reserve fund equal to 1.0x maximum annual debt service.

Annual loan monitoring is conducted on outstanding borrowers and includes verification of local reserves and a review of financial statements. No primary loan defaults have occurred within the IFA SRFs to date.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Indiana Finance Authority (IN) [State Revolving Fund]				
Indiana Finance Authority (IN) /Revolving Fund Revenues/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Major Parkhurst
Director
Primary Rating Analyst
+1 512 215 3724
major.parkhurst@fitchratings.com
Fitch Ratings, Inc.
2600 Via Fortuna, Suite 330 Austin, TX 78746

Vicky Raso
Analyst
Secondary Rating Analyst
+1 646 582 3649
vicky.raso@fitchratings.com

Dennis Pidherny
Managing Director
Committee Chairperson
+1 212 908 0738
dennis.pidherny@fitchratings.com

MEDIA CONTACTS

Eleis Brennan
New York
+1 646 582 3666
eleis.brennan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

State Revolving Fund and Municipal Finance Pool Program Rating Criteria (pub. 27 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Stress Model, v1.11.1 (1)

State Revolving Fund Cash Flow Model, v1.18.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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