

Kansas Development Finance Authority

Kansas Revolving Funds Revenue Bonds (Kansas Department of Health and Environment)

New Issue Summary

Sale Date: The bonds are expected to sell via competitive bid on Jan. 25, 2023.

Series: Approximately \$170,100,000 Kansas Revolving Funds Revenue Bonds (Kansas Department of Health and Environment) Series 2023SRF

Purpose: Bond proceeds will be used to finance loans to certain municipalities for eligible drinking water projects, reimburse the Kansas Department of Health and Environment (KDHE) for funds used in loan advances and pay the costs of issuance.

Security: The bonds are secured by the trust estate pledged by the Kansas Development Finance Authority (KDFA, or the authority) and KDHE under the master finance indenture (MFI), consisting of pledged clean water state revolving fund (CWSRF) and drinking water state revolving fund (DWSRF) loan repayment revenue, and amounts held in certain pledged funds and accounts, including interest earnings.

Key Rating Drivers

Programs Surpass Fitch Ratings' 'AAA' Rating Threshold: Fitch's cash flow modeling demonstrates that the CWSRF and DWSRF programs (collectively, the program) can continue to pay bond debt service, even with hypothetical loan defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's Portfolio Stress Model (PSM).

Above Average Pool Diversity: The aggregate CWSRF and DWSRF pool consists of 338 obligors, with the top 10 participants representing approximately 48% of the total portfolio (versus Fitch's 'AAA' median of 57%). Single-borrower concentration is also relatively low. Thus, overall, the pool is more diverse and less concentrated than comparable municipal finance pool programs rated by Fitch.

Sound Pool Credit Quality: Approximately 72% of the aggregate programs' portfolio consists of obligors exhibiting investment grade (IG) credit quality, in line with the 'AAA' median (73%) of other municipal programs. Obligor security is very strong as all are secured by either a combination of general fund and utility revenue pledges or utility system revenue pledges.

Effective Management: KDFA's loan underwriting and administration have proven effective as its revolving funds have never experienced a loan payment default.

Rating Sensitivities

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

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

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

- An inability to pass Fitch's 'AAA' liability rating stress hurdle due to material increases in leveraging, increases in pool concentration and/or significant deterioration in aggregate borrower credit quality.

Ratings

New Issue

Approximately \$170,100,000 Kansas Revolving Funds Revenue Bonds (Kansas Department of Health and Environment) Series 2023SRF AAA

Outstanding Debt

Environmental Infrastructure Bonds AAA

Rating Outlook

Stable

Applicable Criteria

State Revolving Fund and Municipal Finance Pool Program Rating Criteria (September 2021)

Related Research

Fitch Rates Kansas Development Finance Auth's Series 2023 SRF Revenue Bonds 'AAA' (January 2023)

U.S. Public Finance State Revolving Fund and Municipal Finance Pool – 2022 Peer Review (November 2022)

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Credit Profile

Acting in conjunction with KDHE, the authority provides below market financing to municipalities in the State of Kansas for water supply and wastewater projects. Bond proceeds are combined with recycled funds from prior loans, federal grants and an EPA requirement for the state to provide matching funds for such projects.

The series 2023 bonds are issued on parity with other outstanding MFI bonds, including the series 2019, 2020 and 2022 bonds. The previously issued bonds are not rated by Fitch. However, program metrics are generally similar to those as of Fitch's prior review of the program in August 2020. (The prior bonds rated by Fitch have since been refunded or repaid.)

Funds and assets of the CWSRF and the DWSRF are cross-collateralized with one another, providing common security for any bonds issued or outstanding under the indenture. For this reason, Fitch combines the CWSRF and DWSRF programs in its modeling analyses.

Bondholders Protected from Losses by Surplus Funds, Equity

Pursuant to the MFI, the programs use a cashflow-based program structure wherein program bonds are primarily protected from losses by overcollateralization or annual loan repayments made in excess of bond debt service. On an annualized basis, minimum debt service coverage (DSC) is 1.9x, which bests Fitch's 'AAA' median of 1.6x.

Surplus amounts are released to the pledged equity fund at the end of each year. Although equity funds can be used to make additional loans, to the extent they are not spent they are available to provide additional loss protection in the case of any hypothetical obligor shortfall. Combined equity amounts total about \$243 million, which is nearly equivalent to the outstanding debt and the series 2023 bonds. However, amounts in the equity funds are subject to release to the nonpledged general fund after meeting a 1.2x release test. Additionally, it is expected that some of the equity funds will be drawn down for the purposes of making additional loans.

Robust Financial Structure

Benefiting from the aforementioned loss protection, cashflow modeling demonstrates that the program can continue to pay bond debt service even with hypothetical pool defaults of 100% in the first, middle and final four years of the program's life (as per Fitch criteria, a 90% recovery is also applied in its cashflow model when determining default tolerance). This is in excess of Fitch's 'AAA' liability rating stress hurdle of 29% as produced by the PSM, indicating a passing result.

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 repayments plus any additional pledged funds divided by total scheduled bond debt service. The MFI's PASR is 3.2x, which is stronger than Fitch's 2022 'AAA' median PASR of 1.9x. As of Fitch's prior reviews of the program, the PASR trended around a still sound 2.0x; it is possible that the PASR will revert to this level with future leveraging and/or prepayments.

Above Average Obligor Diversity, Sound Credit Quality

The combined pool comprises 338 obligors. Overall credit quality is in line with other SRFs rated by Fitch, as reflected by a 'AAA' PSM liability stress hurdle of 29% versus Fitch's 'AAA' median level of 31% (lower hurdles are indicative of higher credit quality).

In aggregate, the top 10 obligors represent about 48% of the pool versus Fitch's 'AAA' median level of 57%. The City of Wichita's water system (water revenue bonds not rated by Fitch but assessed to be of very strong credit quality), the Kansas City Board of Public Utilities (revenue bonds rated 'A' by Fitch) and the City of Salina (bonds not rated by Fitch but assessed to be of very high credit quality) are the three largest participants, accounting for approximately 13%, 7% and 5% of the pool, respectively. The remaining top 10 obligors range from around 3% to 4% of the pool in total. Based on the characteristics described above, Fitch views the pool as having slightly above average diversity in comparison to similar 'AAA' rated programs.

The estimated pool weighted average rating is 'BBB', which is in line with the median (BBB) for similar 'AAA' rated programs. At least 71% of the portfolio is considered to be IG compared to Fitch's 'AAA' median of about 73% (IG obligors measured by publicly available ratings of the

Rating History

Rating	Action	Outlook/ Watch	Date
AAA	Assigned	Stable	1/6/22

same security and lien). Obligor security is very strong as all are secured by either a combination of general fund and utility revenue pledges or utility system revenue pledges.

Largest Borrowers

Borrower	Outstanding (\$)	% of Portfolio
City of Wichita	115,000,000	12.7
Kansas City Board of Public Utilities	60,925,138	6.7
City of Salina	41,523,352	4.6
City of Liberal	37,063,763	4.1
Miami County Regional Water District	36,265,903	4.0
City of Salina	32,552,392	3.6
City of Bonner Springs	30,591,308	3.4
City of Emporia	27,125,261	3.0
City of Junction City	24,944,888	2.8
City of Hays	24,284,996	2.7
Total	430,277,001	47.5

Source: Fitch Ratings, K DFA.

Strong Program Management and Underwriting

KDHE, the Kansas Department of Administration (KDOA) and K DFA work together on the programs under a joint financing arrangement. KDHE is responsible for the application of (and is the recipient of) federal capitalization grants from the EPA on behalf of the state; execution and administration of EPA capitalization grant agreements; the administration of the programs, including the selection of projects to be financed; and the making of loans to eligible borrowers. KDHE also selects projects to be financed. KDOA assists KDHE in monitoring compliance with federal requirements and provides accounting and reporting services for the revolving funds.

KDHE is also responsible for the selection and approval of eligible loans to be financed. DWSRF loans are required to be secured by utility revenues plus an unlimited GO pledge; if it does not pledge a GO, it must purchase bond insurance. For borrowers without taxing authority, loans may be backed by net utility system revenues, additionally secured by: (i) a bond insurer; (ii) revenues sufficient to cover 1.4x debt service; or (iii) revenues sufficient to cover 1.25x debt service combined with a reserve fund equal to 10% of the original loan principal. CWSRF loans are required to be secured by an unlimited GO pledge or a net utility system revenue pledge backed additionally by bond insurance. Due to KDHE’s strong underwriting and management, none of the revolving fund programs have ever experienced a loan default.

Series Comparison

	2022 'AAA' Median ^a	KDFA Series 2023	KDFA (2019-9)	KDFA (2016-9)	KDFA (2014-9)
Revolving Fund Type	—	CWSRF/DWSRF	CWSRF/DWSRF	CWSRF/DWSRF	CWSRF/DWSRF
Purpose	—	Financing	Surveillance	Surveillance	Surveillance
Total New Issuance (\$ Mil.)	—	107.1	N.A.	N.A.	N.A.
Fitch Rating	—	AAA	AAA	AAA	AAA
Rating Date	—	1/5/2023	9/12/2019	9/13/2016	9/25/2014
Fitch Default Tolerance Test (%)					
Minimum Default Tolerance Rate	100.0	100.0	100.0	100.0	100.0
Less: Fitch PSM Stress Hurdle ^b	30.8	29.0	24.0	20.3	19.8
Rating Stress Cushion	69.2	71.0	76.0	79.7	80.2
Financial Structure (\$ Mil.)					
Total Outstanding Program Bonds	345	256	204	293	387
Program Assets (\$ Mil.)					
Total Pledged Revenues Excluding Reserves	1,950	939	821	786	918
Total Pledged Revenues Including Reserves	1,957	1,182	821	821	950
DSRF Balance	5.0	0.0	0.0	35.0	32.0
Program Liabilities (\$ Mil.)					
Total Debt Service	705	371	218	411	528
Financial Ratios					
Projected Minimum Annual DSC (x)	1.6	1.9	2.0	1.4	1.1
Program Asset Strength Ratio (x)	1.9	3.2	3.8	2.0	1.8
DSRF as % of Bonds Outstanding	0.7	0.0	0.0	12.0	8.4
Portfolio Summary					
No. of Borrowers	165	338	293	302	304
Implied WA Pool Rating (PSM)	BBB	BBB	BBB	BBB	BBB-
WA Life (Years)	16.9	17.1	12.6	12.8	12.9
% Investment Grade	73.0	71.6	79.2	77.9	74.2
Top 10 Concentration (%)	57.3	47.5	45.1	48.5	47.1
Largest Single Borrower (%)	15.3	12.7	7.6	9.8	10.6
Largest Borrower Composite Rating	AA-	AA-	AA+	AA+	AA-
Security Pledge Distribution (%)					
Pledge 1	—	GO and Utility (72.4)	GO and Utility (83.4)	GO and Utility (100.0)	GO and Utility (100.0)
Pledge 2	—	Utility Revenues (27.6)	Utility Revenues (16.6)	—	—
Pledge 3	—	—	—	—	—
Pledge 4	—	—	—	—	—

^aBased on data collected for Fitch's peer review (through October 2022). ^bPSM changes that occurred on March 4, 2021 and on Sept. 22, 2021 may result in differences in liability stress hurdles before and after these dates. See Fitch's related criteria for details. DSRF – Debt service reserve fund. N.A. – Not available. WA – Weighted average. Source: Fitch Ratings, Kansas Revolving Funds.

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