

RatingsDirect®

Summary:

Kentucky Asset/Liability Commission; Federal or State Grant Programs

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Credit Profile

US\$54.58 mil project notes 2023 fed hwy trust fd 1st rfdg ser 2023 A due 09/01/2025

<i>Long Term Rating</i>	AA/Stable	New
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Kentucky Asset Liability Commission

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Kentucky Asset Liability Comm proj nts 2014 fed hwy trust fd

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Credit Highlights

- S&P Global Ratings assigned its 'AA' rating to the Kentucky Asset/Liability Commission's proposed \$54.6 million project notes, 2023 federal Highway Trust Fund (HTF) first refunding series A.
- At the same time, we affirmed our 'AA' rating on the commission's federal HTF grant anticipation revenue vehicle (GARVEE) debt outstanding.
- The outlook is stable.

Security

The notes are special obligations of the commission secured solely by receipts from Title 23 federal aid transportation reimbursements allocated by the Federal Highway Administration (FHWA) and designated for project-specific debt service under a memorandum of agreement (MOA) with the cabinet. The agency pledges these federal funds to the commission under a separate financing and lease agreement. Kentucky has a direct GARVEE program whereby FHWA reimburses the state for debt service on specifically approved, federally eligible projects. In practice, the state converts only a portion of the total federally approved funding in an amount equal to principal and interest payments.

Under the MOA, FHWA has agreed to make payments to the Transportation Cabinet, which has agreed, subject to appropriation, to remit to the trustee, when due, an amount equal to the debt service on all GARVEE bonds outstanding. The Transportation Cabinet has also agreed to convert the amount of advance construction funds necessary to pay such debt service as the first authorizations in that federal fiscal year.

The financing agreement is by and among the commission, Finance and Administration Cabinet of the Commonwealth of Kentucky, and the Transportation Cabinet. Under the provisions of the Constitution of the Commonwealth, state agencies are prohibited from entering into financing obligations extending beyond the adopted budget. However, the financing agreement is automatically renewed unless written notice of the election by the state agency not to renew is given to the commission by the last business day of May prior to the beginning of the next succeeding renewal term.

We view the bond provisions as strong for a stand-alone GARVEE structure. Provisions include a supportive legal framework provided by the enabling legislation, the MOA, the financing and pledge agreement, and the master trust agreement.

The 2023 series A project notes are being issued to refund certain notes outstanding of the commission. There is no extension of maturities and the refunding is being undertaken for interest savings. The notes mature Sept. 1, 2025. Post issuance, the commission will have approximately \$264 million of GARVEE debt outstanding.

Credit overview

The rating reflects our view of very strong future debt service coverage (DSC) based on historical federal grant receipts, and a sound bond structure. Federal grants the state receives are the only security for bondholders--there is no additional pledge of state general fund or road fund revenues. Over the past three audited fiscal years (2020-2022), maximum annual debt service (MADS) coverage ranged from 11.1x-12.4x and pro forma MADS coverage, incorporating the proposed 2023 series A refunding, was 13.7x in 2022 based on federal reimbursements. Kentucky estimates a modest 9.5% decline in obligation authority to \$1.09 billion in fiscal 2023 from \$1.21 billion in fiscal 2022. Nevertheless, we expect DSC will remain very strong, including the potential for an additional \$150 million of authorized GARVEE bonds by the commonwealth for the Brent Spence Bridge project, given significant excess capacity at very strong coverage levels and a step-down in debt service requirements in fiscal 2023 to \$71.8 million from \$79.4 million in fiscal 2022. The commonwealth indicates the timing for the additional debt is indeterminate at this time.

The rating also reflects our opinion of the following credit strengths:

- Very strong pro forma MADS of approximately 13.7x based on actual fiscal 2022 federal reimbursements and about 16.8x based on obligation authority following the proposed refinancing;
- Sound bond provisions, including an additional bonds test requiring the most recent year's actual federal aid receipts to provide at least 4x MADS coverage on existing and proposed GARVEE debt;
- A well-defined process for assuring annual deposits of pledged receipts into the note payment fund, as per the financing and lease agreement between the state agency and the commission and the MOA with the FHWA, which details approval of each bond project as authorized for federal reimbursement of debt service payments; and
- A long history of Kentucky maximizing its share of Title 23 federal aid transportation grants. The commission typically uses all of its obligation authority in each federal fiscal year, receives additional obligation authority that the FHWA has redistributed from other states, and effectively manages the reimbursement process.

A key credit weakness, in our opinion, is the possibility of declines in pledged revenue resulting from reduced distributions to states from the Highway Trust Fund (HTF) or from the amounts that Congress appropriates, or modifications in the rules governing distribution of federal aid.

The rating on the GARVEE bonds, like those on all other GARVEE ratings, assumes that the supportive legislative framework and congressional appropriations will continue through the enactment of multiyear authorizations or temporary extensions. We base our assumption on historical precedent, our view of the political and economic importance of national highway and mass transit systems, the broad historical bipartisan political support for

transportation spending programs at all levels of government, and Congress' track record of continuing appropriations and extensions to budget authorizations when they expire. For additional information, see "Reliable Funding Continues To Support Stable GARVEE Sector View Amid Stubborn Construction Cost Inflation," published April 27, 2023, on RatingsDirect.

In addition to applying our "U.S. Federal Transportation Grant-Secured Obligations" criteria (May 29, 2009), we also applied our "U.S. Federal Future Flow Securitization" criteria (March 12, 2012) to determine the maximum possible rating level relative to the U.S. debt rating because Kentucky's GARVEE bonds are solely secured by federal aid cash flows. Our application of these criteria to Kentucky's GARVEE program resulted in an overall score of 1.2, indicating that the maximum possible rating level is 'AA', one notch below the U.S. debt rating. If we lower the U.S. rating or revise the U.S. outlook to negative, it would result in a corresponding action on the GARVEE rating, which is capped at one notch below the U.S. rating.

Outlook

The stable outlook reflects our expectation that Kentucky will receive its historical share of annual Title 23 distributions under the longstanding Federal Aid Highway program and that federal reimbursement revenue will continue to provide very strong MADS coverage on the state's GARVEE debt.

Downside scenario

Although unlikely, we could lower the rating if MADS coverage weakens materially due to significant additional debt beyond our expectations or substantially reduced federal reimbursements to states.

Upside scenario

Given the current rating on the U.S. and linkage under our "U.S. Federal Future Flow Securitization" criteria, we do not expect to raise the rating. Although unlikely, we could consider raising the rating if we were to raise the U.S. rating.

Credit Opinion

In 2022, the commonwealth authorized \$150 million of additional GARVEE bonds, supported by Transportation Cabinet Federal Highway Trust funds for the Brent Spence Bridge project. However, the current timing for issuance is indeterminate.

Kentucky has a stable history of receiving federal receipts with actual receipts averaging approximately \$876.6 million from state fiscal year 2018 to 2022. The commission's fiscal 2022 MADS coverage is very strong, in our view, at 13.7x based on a pro forma debt service schedule, incorporating the 2023 series A refinancing and actual 2022 receipts. MADS is estimated to occur in state fiscal year 2023 at about \$71.8 million, then decline to about \$71 million until the final maturity in federal fiscal year 2027.

While there is no debt service reserve, the Transportation Cabinet has adopted a policy statement to the effect that, if new obligation authority is insufficient to pay debt service on GARVEE bonds, it will evaluate the balances of existing federally funded projects and take action to de-obligate funds from those projects and re-program those funds to pay

debt service, when due.

The Commonwealth of Kentucky's pipeline of highway projects is identified within its Highway Plan, as enacted by the Kentucky General Assembly and signed into law by the governor. Kentucky's highway plan is updated every two years by the submission of the Kentucky recommended highway plan by the governor in January of even number of years to the Kentucky General Assembly, outlining projects in the next two-year biennium and the out four years, which provide a list of projects for six fiscal years.

The state transportation improvement plan (STIP) is updated every two years. The STIP contains the list of projects scheduled to use federal-aid highway funding over the next four federal fiscal years. The most recent plan update for fiscal years 2021-2024 totals \$6 billion in STIP apportionments for highway funding for those fiscal years. Of that amount, \$3.2 billion is estimated from federal funds and \$2.8 billion from state funds.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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