

An aerial night view of a city skyline, likely Dubai, featuring numerous illuminated skyscrapers and a complex multi-level highway interchange in the foreground. The scene is lit with a mix of warm yellow and cool blue lights, creating a vibrant urban atmosphere.

# Approach to State Revolving Funds

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# Agenda

1. Overview of Public Sector Pools
2. Overview of Key Factors Outlined in Current SRF Methodology and Scorecards

# Overview of Public Sector Pools

- » Issuers of debt secured by obligations from multiple entities, typically public sector entities
- 1. State Revolving Funds** programs are rated **Aaa**
  - Benefit from active management of loan portfolio, the composition of which generally changes over time
  - Are typically very highly over-collateralized by loans and reserves
- 2. Pool Programs** are rated relatively high but not as high as the State Revolving Funds
  - Provide loans for infrastructure improvements - may be administered at the state or local level
  - They are actively managed and have less significant over-collateralization
- 3. Pool Financings** are debt obligations secured by payments from a small group of participants
  - Generally do not benefit from active management and are often static, i.e., participant composition does not change significantly



# Overview of Key Factors Outlined in Current Methodology and Scorecards

# Current SRF Scorecard

SRF Characteristic	Very Strong (1)	Strong (2)	Medium (3)	Low (4)	Below Investment Grade (5)	Score	Weighting	Sub Score
<b>Quality and Default Score (50%)</b>								
Q&D Score	1	2	3	4	5		50.00%	0.00
<b>Portfolio Size and Diversity (15%)</b>								
Size of Pool	100 or more	50-99	30-49	20-29	Less than 20		5.00%	0.00
% of Borrowers with Less than 1% of the Pool	More than 35%	20-34%	10-19%	Less than 10%			5.00%	0.00
% of Loans to the Top 5 Borrowers	Less than 20%	20-29%	30-39%	40-49%	More than 50%		5.00%	0.00
<b>Debt Structure and Investments (20%)</b>								
Counterparties and Investments	Counterparties and investments rated at and above A1/P-1 (Aa3 if no short-term rating); program financial resources can mitigate funds invested at lower levels; funds not in GICs are in permitted investments	Counterparties and investments rated at and above A2/P-1 (Aa3 if no short-term rating); program financial resources can mitigate funds invested at lower levels; funds not in GICs are in permitted investments	Counterparties and investments rated at and above A3; program financial resources can mitigate funds invested at lower levels; funds not in GICs are in permitted investments	Counterparties and investments rated at and above Baa3; program financial resources may be able to mitigate funds invested at lower levels; funds not in GICs are in permitted investments	Counterparty and investments rated below Baa3; program financial resources are unable to mitigate funds invested at lower levels; funds not in GICs are not in permitted investments		10.00%	0.00
Cash Flows	Meets default stress scenarios and variable rate stress tests; asset revenues demonstrate ability to pay scheduled debt service			Meets default scenarios and variable rate stress tests in the near-medium term	Cash flows demonstrate that in the near term, program is unable to withstand stresses		10.00%	0.00
<b>Management and Governance (15%)</b>								
Management and Governance Score	Superior management; excellent understanding of program's financial strengths and challenges and regulatory environment; ability to act swiftly and appropriately to address challenges; excellent ability to underwrite, manage and monitor portfolio		Satisfactory management; financial strengths and challenges and regulatory environment understood, but may be dependent on financial advisors/professionals; ability to act appropriately to address challenges; satisfactory ability to underwrite, manage and monitor portfolio		Management is able to address SRF financial challenges and regulatory requirements when limited, but lacks the expertise to address more difficult situations; unsatisfactory underwriting, management and monitoring of portfolio		15.00%	0.00
								<b>0.00</b>



# Factor 1: Portfolio Credit Quality and Default Tolerance Score – 50% weight

- » Default tolerance is compared against the weighted average rating of the pool participants to determine the factor score
- » **Default Tolerance**
  - Assesses over-collateralization by measuring the level of borrower defaults a program could endure for the life of the bonds without loss to bondholders
  - Assumes a pro-rata default of loan revenue across all borrowers with no recovery
  - Provides an important demonstration of the relative strength of various programs, as it ensures comparability across programs with portfolios of varying credit quality
  - Median default tolerance of outstanding programs is **42%**, a key credit strength

# Factor 1: Portfolio Credit Quality and Default Tolerance Score – 50% weight

## » Portfolio Credit Quality

- Determined by weighted average probability of default of the pool participants using our Pool Rating Estimator
- Rated borrowers receive the underlying rating on their pledged security
- Unrated borrowers:
  - For unrated borrowers that represent less than 3% of pool loan principal, we typically use a model generated credit estimates
  - For unrated borrowers that represent more than 3% of pool loan principal, we generally convene a committee to assign a non-public assessment based on the most recent financial and operational disclosures
  - Insufficient borrower information will result in below investment grade assigned to that borrower

# Factor 1: Portfolio Credit Quality and Default Tolerance Score – 50% weight

## Rating Level Associated with Portfolio Credit Quality and Default Tolerance Score

SRF Characteristic	Very Strong (Aaa)	Strong (Aa)	Medium (A)	Low (Baa)	Weak (Below IG)
Portfolio Credit Quality and Default Tolerance Score	1	2	3	4	5

## Portfolio Credit Quality and Default Tolerance Scorecard

		25% And Higher	20%	15%	10%	5% And Lower
Weighted Average Portfolio Rating	Aaa	1	1	1	1	2
	Aa	1	1	2	2	3
	A	1	2	3	3	4
	Baa	2	3	4	4	5
	Below IG	3 or below	4 or below	5	5	5



# Factor 2: Portfolio Size and Diversity – 15% weight

- » Meant to capture what the weighted average credit quality cannot
- » A large and diverse portfolio is better able to absorb idiosyncratic credit issues at the individual borrower level

## » **Sub-factor: Portfolio Size (number of borrowers) – 5% weight**

- Large number of borrowers serves to mitigate event risk or specific credit deterioration associated with a single borrower

SRF Characteristic	Very Strong (Aaa)	Strong (Aa)	Medium (A)	Low (Baa)	Weak (Below IG)
Size of Portfolio	100 or more	50-99	30-49	20-29	Less than 20

- SRFs like most pools start small and grow over time
- Median size of outstanding portfolios is **260** unique borrowers

# Factor 2: Portfolio Size and Diversity – 15% weight

## » Sub-factor: Percent of Borrowers with Less than 1% of the Portfolio - 5% weight

- The greater this number, the lower the likelihood that a single borrower will have impact on the program

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SRF Characteristic	Very Strong (Aaa)	Strong (Aa)	Medium (A)	Low (Baa)	Weak (Below IG)
% of Borrowers with Less than 1% of the Portfolio	More than 35%	20-34%	10-19%	5-9%	Less than 5%

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- Median share of borrowers accounting for less than 1% is currently **29%**

# Factor 2: Portfolio Size and Diversity – 15% weight

## » Sub-factor: Percent of Loans to the Top 5 Borrowers – 5% weight

- Determines the program vulnerability to the performance of few borrowers because the largest ones can have a disproportionate affect on the program
- Concentration in highly-rated borrowers is viewed more favorable than that in average or lower-rated borrower

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Srf Characteristic	Very Strong (Aaa)	Strong (Aa)	Medium (A)	Low (Baa)	Weak (Below IG)
% of Loans to the Top 5 Borrowers	Less than 20%	20-29%	30-39%	40-49%	More than 50%

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- Median share of top 5 borrowers stands at **42%**

# Factor 3: Debt Structure, Investments and Cash Flows – 20% weight

## » **Sub-factor: Counterparties and Investments – 10% weight**

- Assesses long- and short-term ratings of investments in portfolio; ability of resources to mitigate of risk of lower-rated securities; diversity of counterparty risk

## » **Sub-factor: Cash Flows - 10% weight**

- Assesses to what extent the program can withstand cash flow stress scenarios
- Debt Structure: includes also a review of the assets pledged to bondholders, the contractual flow of funds, additional bonds test, etc.

# Factor 4: Management and Governance – 15% weight

- » Assesses management's understanding of the program as well as ability and willingness to address challenges facing it, including interest rate risk, counterparty risk, and compliance with federal and state regulations
- » Staff stability, experience, track record, and succession plans
- » Active management of program
  - Ability and willingness to take action when necessary to meet debt service
  - Regular monitoring of pool participants
  - Ability to refund, restructure and otherwise modify pool composition
  - Ability to exercise remedies to obtain delinquent payments
- » Helps differentiate credit quality in certain cases

# Other Considerations

- » Assessment of credit strength may include additional factors not captured by the scorecard because they are difficult to quantify or only have a meaningful effect in differentiating credit quality in certain cases
  - Additional assets at the borrowers level or outside of the program that may be available, but not legally pledged, to the program to cover any shortfalls
    - Pledged reserves at the borrower level
    - Presence of a state intercept or moral obligation of the state
    - Rate covenants at the borrower level
  - Default tolerance significantly in excess of 25%
  - A substantial amount of borrowers with very high or very low ratings
  - Nontraditional debt structure (e.g. short-term borrowing and variable rate debt), which introduces additional potential risks to the program



# SRF Default History



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