

RatingsDirect®

Summary:

South Dakota Conservancy District; State Revolving Funds/Pools

Primary Credit Analyst:

Scott D Garrigan, New York (1) 312-233-7014; scott.garrigan@spglobal.com

Secondary Contact:

Gregory Dziubinski, Chicago + 1 (312) 233 7085; gregory.dziubinski@spglobal.com

Table Of Contents

Rationale

Outlook

Summary:

South Dakota Conservancy District; State Revolving Funds/ Pools

Credit Profile

US\$97.975 mil state revolving fd prog bnds ser 2018 due 08/01/2038

Long Term Rating AAA/Stable New

South Dakota Conserv Dist (State Revolving Fd Prog)

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' rating to the South Dakota Conservancy District's series 2018 state revolving fund (SRF) program bonds, and affirmed its 'AAA' rating on various series of the district's outstanding SRF program bonds. The outlook is stable.

The 'AAA' rating reflects the combination of extremely strong enterprise risk and financial risk scores, resulting from:

- A market position reflecting support from multiple levels of government that creates a growing equity position;
- Collateralization levels that enable the program to absorb a very high level of borrower defaults, resulting in an extremely strong loss coverage score;
- Extremely low historical levels of borrower defaults and delinquencies; and
- Generally strong financial management policies and practices.

Because we view securitizations backed by pools of public-sector assets as highly sensitive to country risk, the rating on the securitization is capped at two notches above the sovereign. However, no specific sovereign default stress is applied, given the U.S. sovereign rating is 'AA+'.

The bonds are secured by repayments made under the pledged loan agreements and other various funds pledged under the master indenture. Separate state match and leveraged series bonds for each program are not issued, but each series is separated into a state match and leveraged portion for each program as applicable. The principal and interest payments from the loan agreements are segregated: The interest payments secure the state match portion of the bonds, with principal payments and excess interest payments (after state match debt service is paid) securing the leveraged portion of the bonds.

We consider the district's enterprise risk score extremely strong, given the combination of a low industry risk score and an extremely strong market position ranking. Ongoing support from state and federal sources leads to a growing equity position available for additional loan activity.

The state created the South Dakota Conservancy District in 1959 for planning, developing, and managing the use and

conservation of the water resources of the state. The district is governed by the seven-member Board of Water and Natural Resources, which sets certain policies for the state Department of Environment and Natural Resources (DENR), including water policy and the state water plan. Board members are appointed by the governor. Employees of the state DENR serve as the staff of the district and perform its administrative functions.

Details of the extremely strong financial risk profile

Over-collateralization is achieved through annual revenues structured to be well in excess of annual debt service costs, as well as surplus revenues generated from prior-year cash flows. For both clean and drinking water, minimum annual debt service (MADS) coverage just from loan revenues exceeds 1.3x in all years, and generally grows stronger over the course of the debt amortization schedule. The district currently has about \$234 million of available cash and investments in various funds. If it can't draw cash out of its various investments to pay debt service in a timely manner, the available cash flow from annual loan repayments provides enough of a cushion, in our view, that bond payments would not necessarily be impaired. Portions of these funds are used to make additional loans, so the loan revenues are designed to recycle back into the program to provide additional debt service coverage (DSC).

The pool's cross-collateralization mechanism helps to further cushion the pool from risks associated with loan defaults. If loan interest payments are insufficient to pay debt service on the state match portion of bonds, excess interest payments from the clean- or drinking-water program can be used. If loan principal payments are insufficient to pay debt service on the leveraged portion of the bonds, excess principal and interest payments from either the clean- or drinking-water program can be used. Federal law does not allow the use of loan principal payments for payment on any state match portion of bonds, which is why the cross-collateralization mechanism does not permit excess loan principal payments to be used for payment of debt service on the state match portion of bonds.

Including the 2018 bonds, there are currently \$331 million of SRF bonds outstanding. Supporting these are about 570 loans either outstanding or pending, with more than \$800 million of principal due on those loans. The borrower portfolio consists of loans to 296 separate entities, though some entities have loans with different pledges. The largest borrower is Sioux Falls, with \$140 million of existing and future loans payable, representing 17% of all loans. There have been no loan defaults or delinquencies for the past 12 months. The loan agreements require the borrowers using utility revenue pledges to maintain 1.1x DSC and a 1.1x rate covenant. Sales tax pledges require 1.2x coverage.

District management prepares and updates its intended use plan annually, including the project priority list. Projects are ranked and funded in order of priority. The creditworthiness of potential borrowers is evaluated by district staff and there are minimum coverage levels that must be met depending on the security provided. Once loans are funded, there are annual reporting requirements that include financial statement and coverage certificates. The district also just incorporated a new investment policy into its master trust indenture by way of a fifth restated and amended master trust indenture. Allowable investment obligations are generally restricted to U.S. Treasuries and agencies, certificates of deposit, money market funds, and other investments that are either collateralized or with investment-grade counterparties.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the district's strong management of the loan portfolio will continue, and that collateralization levels will sustain coverage of a very high level of potential defaults and delinquencies.

Downward scenario

Currently, we do not anticipate downward pressure on the rating given that DSC solely from loan revenues provides a strong cushion for any potential defaults, in our opinion.

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.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.