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Summary:

Massachusetts Clean Water Trust; State Revolving Funds/ Pools

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Summary:

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Credit Profile

US\$231.095 mil st revolving fd bnds ser 18 due 02/01/2045

<i>Long Term Rating</i>	AAA/Stable	New
Massachusetts Clean Wtr Trust (MWRA In prog)		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts Clean Wtr Tr (Pool Ln Prog)		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts Clean Wtr Tr (Sesd In Prog)		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating to Massachusetts Clean Water Trust's series 18 state revolving fund (SRF) refunding bonds. At the same time, Standard & Poor's affirmed its 'AAA' rating on the trust's outstanding debt consisting of pool SRF bonds, Massachusetts Water Resources Authority (MWRA) SRF bonds, and South Essex Sewerage District (SES) SRF bonds. While we incorporate the cash flows from the trust's New Bedford program into our analysis, we do not carry an underlying rating (SPUR) on the bonds issued for that program. The outlook on all issues is stable.

The ratings reflect our view of:

- An extremely strong enterprise risk profile, since the pool has ongoing support from multiple levels of government and was established by state statute; and
- An extremely strong financial risk profile, with a loss coverage score, operating performance, and financial policies consistent with this profile.

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 trust plans to use the series 2014 bond proceeds to finance or refinance loans to pool borrowers. The bonds are being issued pursuant to a new master trust indenture. After the Pool 18 bonds are issued, the lien created for the trust's existing SRF programs will be closed.

Pool SRF bonds are secured with revenues from borrower repayments, commonwealth assistance payments, and earnings and principal on various reserve funds. The commonwealth's general obligation (GO) pledge secures assistance payments. The trust's MWRA, SES, and New Bedford SRF bonds are secured primarily with loan

repayments from those specific entities, series reserve funds, reserve earnings, and a deficiency fund. Series reserve funds are sized between 33% and 50% of the loans' original principal.

Bonds issued under the new master trust indenture will additionally be secured by an equity fund. Revenues within the equity fund can also be used to cure defaults on the trust's other program bonds. Revenues deposited to the equity fund include excess revenues not needed to pay debt service on the trust's aggregate program and pool bonds.

We view the program's enterprise risk profile as extremely strong. This is due to a combination of the low industry risk profile for municipal pools, and the program's market position, which we also consider extremely strong. MWPAT was created by Chapter 29C of the General Laws of the Commonwealth of Massachusetts to administer the state SRF program. The Massachusetts Department of Environmental Protection (DEP) develops the SRF intended-use plan and reviews borrower applications. The SRF program receives support from multiple levels of government, including federal capitalization grants and state matching funds.

We view the program's financial risk profile as extremely strong, reflecting a combination of the loss coverage score, historical operating performance, and management policies.

Aggregate program cash flows (for all four SRF programs) indicate that annual revenues from loan repayments, investment earnings, and commonwealth assistance payments exceed debt service by at least 1.3x in the program's early years, then generally increase over time before settling to about 1.5x.

Pledged to \$3.1 billion of outstanding bonds for all programs are \$4.2 billion in loan principal and commonwealth payments, as well as \$949 million in reserves. Reserve balances are invested primarily in U.S. Treasury obligations and guaranteed investment contracts with various providers. There are about \$280 million of reserves invested with counterparties rated below 'AA-', which do not meet our counterparty criteria for transactions rated 'AAA'. Even when including these reserves as assets in Standard & Poor's CDO (Collateralized Debt Obligation) Evaluator and receiving related reductions in value, our default tolerance analysis indicates cash flows are still strong enough to achieve an extremely strong loss coverage score. Supporting this score is a large corpus of equity funds totaling \$284 million, which management could use to cure defaults in any program if needed. The use of equity funds is restricted to the SRF and cannot be transferred out for general state government purposes.

Averaging all financial policies and practices, we view the corpus of these as adequate. Management works directly with borrowers to manage additional loan payments within their budget constraints, but does not necessarily undertake a formal credit review for all borrowers because many, if not all, loans are with existing borrowers. MWPAT does not perform direct annual surveillance, yet has stated that the commonwealth's Department of Revenue tracks credit ratings. Loan payments are made 15 days before debt service. Management works with the DEP to prioritize projects annually using the intended use plan. Investment guidelines are fairly permissive, but the current portfolio only includes U.S. Treasuries and guaranteed investment contracts.

Management indicates there have been no loan defaults or delinquent payments on any pledged loans since 1993, when it first started providing loans under various SRF programs. The trust has financed roughly \$6 billion in loans since then.

Given the aforementioned enterprise and financial risk profiles, the indicative rating matches the final rating of 'AAA' because we did not make any negative overriding adjustments.

Program and bond characteristics

MWPAT's pool and other program SRFs have about 1,800 outstanding loans involving 293 borrowers. All loans are backed by the participants' GO pledge or with water/sewer revenue pledges. The pool's largest borrower is Massachusetts Water Resources Authority, representing about 30% of all pool loans outstanding. We do not view this as a credit concern given the authority's own credit strength ('AA+' rated senior-lien debt). Cash flow projections from the trust indicate commonwealth assistance payments total about \$458 million for all programs.

In the case of a pool participant defaulting on loan payments, MWPAT is authorized to intercept local aid payable to the participant. A regional entity that provides utility services (such as MWRA or SESD) can also intercept a local government's aid payable if the regional entity defaults on its loan payments to MWPAT because a local government it serves fails to pay assessments or charges due.

Outlook

The stable outlook reflects our expectation that pledged revenues will continue to provide strong debt service coverage consistent with the current rating, given historical trends. Based on those trends, the outlook also reflects our expectation that the trust will maintain a large equity position, and that direct loans comprising equity funds will be amortized in a manner consistent with existing loans. We could lower the rating within the two-year outlook horizon if reserves become insufficient for the rating or if any other program factors weaken the enterprise or financial risk profiles.

Related Criteria And Research

Related Criteria

- USPF Criteria: U.S. Public Finance Long-Term Municipal Pools, March 19, 2012
- Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance, Sept. 19, 2014

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 15, 2014

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