S&P Global Ratings

RatingsDirect®

Summary:

California Infrastructure & Economic Development Bank; State Revolving Funds/Pools

Primary Credit Analyst:
Ladunni M Okolo, Farmers Branch + 1 (212) 438 1208; ladunni.okolo@spglobal.com

Secondary Contact:
Malcolm N D'Silva, Centennial + 1 (303) 721 4526; malcolm.dsilva@spglobal.com

Table Of Contents

Summary:

California Infrastructure & Economic Development Bank; State Revolving Funds/Pools

Credit Profile		
US$325.125 mil infrastructure st revolving fd bnds ser 2020A due 10/01/2045		
Long Term Rating	AAA/Stable	New
California Infrastructure & Econ Dev Bnk SRFPOOL		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to California Infrastructure & Economic Development Bank's (I-Bank) 2014 master indenture infrastructure state revolving fund (ISRF) revenue refunding bonds, series 2020A. At the same time, we affirmed our 'AAA' long-term rating on the I-Bank's previously issued bonds under the master indenture. The outlook on all the bonds is stable.

The 2020A bonds are secured by revenues received from the repayment of pledged loans, plus certain funds created under the indenture. There is no debt service reserve (DSR) fund for the 2020A bonds.

Credit overview

The rating reflects, in our opinion, the combination of:

- A very strong enterprise risk score based on low industry risk and a strong market position; and
- An extremely strong financial risk score based on an extremely strong loss coverage score (LCS) and strong financial policies.

We have applied a positive adjustment resulting in a final rating of 'AAA', reflecting our view that the program can withstand a stress scenario with default rates well above the level required for the rating, as well as a history of no defaults or delinquent payments. The positive adjustment also reflects the I-Bank's historical use of the funds held in the equity account to support the program through additional pledged loans instead of transfer funds out for any legal purpose. According to management, the intent of these balances is to fund new pledged loans over time and then issue additional debt to reimburse itself for new loans to further support the program.

Given mobility restrictions, closure of large segments of the economy as a result of COVID-19, and the subsequent economic contraction, all of S&P Global Ratings' sector outlooks in U.S. public finance are now negative. This means that although state and local government bond programs, such as the I-Bank's program (used to provide debt market access at favorable rates), benefit from borrower diversity, the ratings on these programs could face downward pressure if borrower delinquencies occur. An instance of loan delinquency could affect several areas of our criteria scoring:

- If we view a single delinquent payment as significant in size or arising a borrower's diminished capacity to manage timely repayments, then the one-notch positive adjuster could be removed and the rating or outlook would likely face downward pressure.
- Based on our criteria scoring, the program begins to observe a borrower delinquency rate of at least 6% or an occurrence of actual loan defaults of at least 2%, then there would likely be downward pressure on the rating because our operating performance scoring would be negatively affected.

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 in this situation, because the rating on the U.S. is 'AA+'.

The stable outlook reflects our anticipation that loan portfolio credit quality will be generally stable and any delinquencies in repayments will be manageable and absorbed by the excess coverage and reserves. The rating also reflects our view of the I-Bank's intention to use funds held in the equity account to support the program through additional pledged loans. The outlook also reflects our expectation that the level of over-collateralization will be consistent with the rating, and that other program features will not deviate from historical trends and practices.

Stable Outlook

Downside scenario

If the I-Bank were to transfer significant funds out of the program, issue variable-rate debt obligations that change our view of the credit risks, or remove pledged loans in the future--as permitted under the indenture--we could take a negative rating action.

The rating could also face downward pressure if the annual debt service coverage (DSC) margins decline significantly, if management decides to use surplus balances for any legal purpose other than making additional pledged loans, or if reserves decline in the absence of an alternative form of support for bondholders.

Credit Opinion

We consider the program's enterprise risk score to be very strong. It is the result of a low industry risk score and a strong market position. The ISRF program was initially capitalized with state appropriations in fiscal years 1999 and 2000, with no additional appropriations received since that time. We view the program as geographically diverse, because loans are made to entities across the state and therefore, we do not further adjust the initial enterprise risk score to determine the final enterprise risk score.

Administered by the I-Bank, the ISRF program provides loans to local governments throughout California for public infrastructure and economic expansion projects. The I-Bank was initially capitalized with appropriations from the state in fiscal years 1999 and 2000. Loan funding comes from the program's equity, loan repayments, investment earnings, some fee income, and proceeds from bond issuances.

We consider the program's financial risk score to be extremely strong. It is the result of an extremely strong LCS, extremely low delinquencies, and financial policies that we view as generally strong. Formal credit criteria are incorporated in the program's loan origination policies. Program staff review each borrower's financial statements and loan covenant certifications annually. In addition, the program has loan-payment-collection procedures that include 30-day advance notices to borrowers for upcoming payments and formal guidelines in the event of delinquencies.

Under the flow of funds, pledged loan repayment revenues are first used to pay principal and interest on the bonds. After curing any reserve fund deficiencies and covering certain bond-related administrative expenses, revenues accumulate in a supplemental revenue fund if DSC falls below 1.2x, as projected by the I-Bank. If projected coverage exceeds this amount, as it will on issuance of the bonds, revenues flow to the unrestricted assets account in the equity fund held by the trustee to fund 1.5 years of projected I-Bank operating expenses, then to the restricted assets account in the equity fund. The restricted assets account is pledged to the bonds while the unrestricted assets account is not. Funds can be transferred from the restricted assets account to the unrestricted assets account if the 1.2x coverage test is met. Funds in the unrestricted asset account can be used by the I-Bank for any lawful purpose, including uses unrelated to the program.

The repayment schedule for existing loans pledged to the bonds and interest earnings on program funds provides DSC of no less than about 1.3x through the final maturity of the bonds in 2045. We do not include any coverage from potential future loans in our analysis. The high coverage level in combination with funds held in equity provides loss absorption consistent with the 'AAA' rating, in our view. The DSR for the bonds outstanding to be refunded is currently $21.1 million, which will become available to be transferred to the restricted assets account on defeasance. An additional $32.6 million is currently available in ISRF equity, of which $23.6 million will be transferred to the restricted assets account.

The I-Bank intends to use the proceeds from the 2020A bonds to refund all or a portion of the 2014A, 2015A, and 2016A bonds outstanding. The I-Bank has proposed amendments to the 2014 master indenture which, in our view, does not change our view of the risk profile of the program. At defeasance of all bonds outstanding, the amendments to the indenture become effective and 2020A bonds will be the only bonds under the amended indenture. The I-Bank also intends to use available funds in its restricted account to make new loans, although legally they can be moved out of the program if projected coverage of at least 1.2x is maintained. Given the I-Bank's intention of keeping these funds within the program--primarily by making new, pledged loans--we applied a one-notch positive override, leading to the 'AAA' rating. This reflects our assessment that the program should continue to withstand a stressed default rate that is at least 1.5x higher than the rate required for the current rating.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020