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Fitch: Proposed US Budget Cut May Pressure State Revolving Funds.

Fitch Ratings-New York-20 March 2017: The Trump Administration's proposed 2018 budget cuts to the US Department of Agriculture's (USDA) rural water and wastewater grant program would likely result in a partial diversion of funds from the US Environmental Protection Agency's (EPA) State Revolving Fund (SRF) Programs, Fitch Ratings says.

The recommended budget essentially calls the USDA program redundant and eliminates its nearly \$500 million budget. Without any offsetting increases in SRF grant funding, SRF project funding, which is frequently used, would likely be strained.

SRF programs provide valuable financing options for municipalities' water- and sewer-related infrastructure needs. SRFs combine a pool of loan repayments with additional forms of credit enhancement, such as reserve funds, to protect bondholders from losses caused by the default of pool participants.

The combined 2018 budget proposal for clean and drinking water SRFs is approximately \$2.3 billion, which is similar to last year. Therefore, increases in funding needs, or similarly, funding reductions, could eventually lead to further leveraging of the SRF programs.

We do not expect any ratings impact in the near term, as the SRF programs rated by Fitch have substantial reserves and equity positions. However, ratings could be pressured over the long term if there are any substantial increases in program leverage to meet the demands from utilities historically served by the USDA.

Most SRFs are rated 'AAA' by Fitch. Associated costs of financing are passed to SRF program borrowers, many of which may not have affordable access to the capital markets.

Fitch's program asset strength ratio (PASR) is a measure to help market participants distinguish the relative financial strength of Fitch-rated SRFs. The PASR, an asset-to-liability ratio, is calculated by dividing the amount of aggregate pledged assets, including scheduled loan repayments, reserve funds, and account earnings, by aggregate outstanding debt service. The overall median PASR for the sector in 2016 was 1.9x, equivalent to 2015 and up slightly from 1.7x and 1.8x in 2013 and 2014, respectively. The high PASR levels reflect SRF's robust enhancement.

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Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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