



New Issue: Iowa Finance Authority State Revolving Fund

MOODY'S ASSIGNS Aaa RATING TO IOWA FINANCE AUTHORITY'S \$139.9 MILLION OF IOWA STATE REVOLVING FUND REVENUE BONDS, SERIES 2008; OUTLOOK IS STABLE

IOWA FINANCE AUTHORITY HAS A TOTAL OF \$376 MILLION STATE REVOLVING FUND DEBT OUTSTANDING

State Revolving Funds
IA

Moody's Rating

ISSUE	RATING
State Revolving Fund Revenue Bonds, Series 2008	Aaa
Sale Amount	\$139,900,000
Expected Sale Date	12/04/08
Rating Description	State Revolving Fund

Opinion

NEW YORK, Nov 25, 2008 -- Moody's Investors Service has assigned a Aaa rating to Iowa Finance Authority's \$139.9 million of Iowa State Revolving Fund (SRF) Revenue Bonds, Series 2008. The outlook is stable. We have also affirmed our outstanding ratings on the Iowa Finance Authority's state revolving fund revenue bonds.

LEGAL SECURITY: State Match bonds, which provide the state matching funds required to access federal capitalization grants, are secured by loan interest payments made from borrowers pursuant to participant agreements, investment earnings and debt service reserve funds; leverage bonds are secured by loan principal payments and excess interest payments and investment earnings not needed for state match bond debt service and debt service reserve funds; funds held in the deficiency fund are also pledged pursuant to the Master Trust Agreement.

USE OF PROCEEDS: Fund loans to certain Iowa municipalities for water pollution control projects and drinking water projects. Proceeds will also fund the state matching funds required for federal capitalization grants.

INTEREST RATE DERIVATIVES: None

STRENGTHS:

*Large and diverse pool of borrowers, with average credit quality, nearly all of which are considered to be investment grade

*The loan pool could experience a significant, but highly unlikely, default of 30% of the loan payments securing the bonds through final maturity and debt service payments could still be met.

*Each separately secured series of bonds is linked through the deficiency fund created under the Master Trust Agreement. Interest and principal loan repayments in excess of debt service requirements flow to either the interest or principal sub-account of the deficiency fund. Interest sub-account funds are available to pay any state match bond debt service and all deficiency funds are available to pay debt service on leverage bonds

*Water Pollution Control Works (CW) and Drinking Water Facilities Financing (DW) Programs are cross-collateralized through the deficiency fund created under the Master Trust Agreement

CHALLENGES:

*Surplus funds not needed to cure a deficiency flow to the equity fund, and can be used to make loans which are not pledged to the repayment of the bonds

*De-pledging of loans securing the bonds is allowed upon certification of sufficient coverage of debt service; pre-payments of loans are also allowed, at management's discretion

*There are no minimum coverage requirements provided for in the bond indenture

LARGE, DIVERSE POOL OF BORROWERS EXHIBITS AVERAGE CREDIT QUALITY

The program's size and diversity is an important factor supporting the Aaa rating. Approximately 94% of the pledged loans are secured with a first lien on net revenues of the borrower's utility system. The bonds issued by program participants to evidence their loans include rate covenants requiring net revenues to cover senior lien debt service by 1.10x (for senior lien loan pledge) or to cover aggregate debt service by 1.05x (for subordinate lien loan pledge). A general obligation pledge is provided by a limited number of borrowers and make up about 6% of the loans outstanding.

Each separately-secured series of bonds is linked through the deficiency fund created under the Master Trust Agreement. When considering this link through the Master Trust Agreement, the combined loan pool includes a sizable 314 borrowers, with no significant concentration in one single borrower. The portfolio has been growing and its diversity is an important credit factor. The top 5 borrowers represent 29% of the outstanding loans, however 296 of the 314 borrowers (51% of the total loans outstanding) have loans comprising less than 1% of the total loan portfolio. Moody's internal assessment of the borrowers' credit quality indicates that the combined CW and DW loan pool is average, with 52% of the loans outstanding made to borrowers considered to be at or above the A3 rating level. Nearly 44% of outstanding loans would be rated in the Baa category, and more than 3% are below Baa3. This is somewhat balanced by the credit quality of the top five borrowers. The largest borrower, Sioux City (water revenue bonds rated A1/GO rated Aa2) holds about 10.1% of the loans outstanding. Fort Dodge (GO rated A1) and Cedar Rapids (GO rated Aaa), the second and third largest borrowers, comprise 7.5% and 6.2% of outstanding loans, respectively. While Cedar Rapids experienced substantial flooding and infrastructure damage in June 2008, the city's credit quality remains strong. For additional detail, refer to Moody's Update Report dated September 24, 2008. The fourth and fifth largest borrowers, the Wastewater Reclamation Authority (A1 with a positive outlook) and the City of Des Moines (GO rated Aa2) represent 2.6% and 2.5% of the portfolio, respectively.

RESERVES AND CASH FLOW FROM LOANS PROVIDE SUBSIDY AND SECURITY

The solid reserve levels along with the cash flow from participant loans are critical to the rating. The amount of loans outstanding substantially exceeds the amount of bonds outstanding, which together with investment earnings and reserves, provide security to bondholders. Total pledged reserves for both WPC and DW programs are \$88.1 million after this issuance, or 22% of outstanding bonds. Including reserves held in the Equity Fund, which is available to pay debt service, but not pledged, reserves comprise 75% of post-issue outstanding bonds. Reserves for bonds issued prior to 2004 were sized at 50% of bond principal (DW) or 30% of bond principal (CW) and were funded through federal capitalization grants, generating investment earnings which subsidize a portion of the participants' loan interest rate. Since 2004, reserves have been sized at the lesser of MADS, 125% of average annual debt service, or 10% of outstanding par and funded by bond proceeds. The reserves are also available to pay debt service on the bonds if a borrower defaults on its loan repayment. In addition, bonds are secured by an oversized pool of loans; after the current issue, \$636 million of loans will be pledged to \$397 million of bonds. The lowest combined debt service coverage from both loan repayments and investment earnings is expected to be 1.21 times.

Each series of bonds is separately secured and there is no minimum reserve requirement, or debt service coverage requirements. Each series of bonds is linked through a Master Trust Indenture: as reserves are de-allocated in proportion to bond principal amortization, the freed up reserves are available to cure a default in any leverage bond issued under the indenture. Excess loan repayments not needed for debt service flow to either the interest or principal sub-account of the deficiency fund. Interest sub-account funds are available to pay state match bond debt service and all deficiency funds are available to pay debt service on leverage bonds. Amounts not needed to cure a deficiency flow to the Equity Fund and are available to make new loans. Additionally, while the drinking water and water pollution control programs are also separate, de-

allocated reserves not needed to cover deficiencies for one program are available to cure a default in the other program (cross-collateralization).

The authority's investment criteria require that providers maintain a minimum long-term credit rating of Aa3. The reserves are currently invested in a repurchase agreement with Societe Generale (rated Aa2) and a guaranteed investment contract (GIC) with CDC Funding Corporation (guaranteed by CDC Ixis, rated Aaa). The repurchase agreement holds a sizeable \$45.7 million of investments (52% of pledged reserves), however interest earnings represent a modest 5% of annual revenues and the authority has the flexibility to terminate the investment if the provider is downgraded. The GIC holds \$21.8 million of investments (25% of pledged reserves), and if the bank is downgraded below Aa3, the authority has the option to find a replacement counterparty, find a guarantor or request collateralization within 10 days.

The very large reserves along with the cash flow from loan repayments would allow for a significant, but highly unlikely 30.6% of the loan repayments to be in default for the life of the bonds and the programs would still be able to meet all debt service obligations. This default tolerance is a key element of the Aaa rating. Moody's notes that the default tolerance has decreased to current levels from 40% at the time of the last issue (2007), reflecting management's decision to increase new loan capacity to meet a significant increase in demand over the past year. There has never been a participant default in either program in its nearly 20 year history. Also, 94% of the participants in the program include a rate covenant in the loan agreement requiring net revenues to cover debt service by 1.1 times.

ESTABLISHED AUTHORITY MANAGEMENT JOINTLY ADMINISTERS PROGRAM WITH DEPARTMENT OF NATURAL RESOURCES

The CW was established in 1988 pursuant to the federal Clean Water Act and the DW program was established in 1997 pursuant the federal Safe Drinking Water Act. The authority administers the Water Pollution Control Works and Drinking Water Facilities Financing Program in cooperation with the Iowa Department of Natural Resources (DNR). The authority is responsible for underwriting loans, issuing debt and disbursing funds to borrowers, while the DNR concentrates on technical support, and construction monitoring of projects funded through the SRF programs. Loan repayments are due two months prior to debt service payment dates, providing the authority with ample timing to address any delinquencies. The authority recently amended its Master Trust Indenture to shift financial management responsibility solely to itself (previously the authority shared these responsibilities with DNR). This change is expected to streamline operations allowing DNR to concentrate on environmental management and the authority to focus on financial management of the SRF programs.

Outlook

The stable outlook is based on the expectation that the sizable reserves and cash flows, and average credit quality and substantial diversity of borrowers will be maintained.

What Could Change the Rating -- DOWN

Increased leveraging of the programs, resulting in a decrease in the available reserves and/or a decrease in default tolerances below current levels could place downward pressure on the rating. A material change in the credit quality of the pool participants could also cause a rating downgrade.

KEY INDICATORS:

Revolving Fund Structure: Hybrid - Reserve and Cash Flow Model

Indenture Requirements: No minimum debt service coverage requirements; de-pledging and pre-payments allowed.

Lowest Projected Coverage: State Match bonds, 2.23x; leverage bonds, 1.21x

Number of Borrowers (combined programs): 314

Outstanding Loan Value: \$636 million

Debt Service Reserve: \$88.2 million

Default Tolerance: 30.6% (combined CW & DW programs)

Portfolio Credit Quality: aggregate portfolio carries an A3-equivalent average rating

Loan Pledge: primarily net revenues of utility system with 1.1x rate covenant; limited number of GO pledges provided.

Largest Borrowers in Combined CW and DW Funds:

Sioux City - 10.1% (A1 water revenue/Aa2 GO)

Fort Dodge - 4.7% (unrated revenue/A1 GO)

Cedar Rapids - 6.2% (Aaa GO)

Metropolitan Des Moines Water Resources Authority - 2.6% (A1 with a Positive Outlook)

City of Des Moines - 2.5% (Aa2 GO)

RATED DEBT:

Series 2001: \$124,825,000, Aaa

Series 2003: \$ 45,545,000, Aaa

Series 2005: \$10,600,000, Aaa

Series 2007: \$55,395,000, Aaa

Series 2008: \$139,000,000, Aaa

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