Research Update:

National Rural Utilities CFC Outlook Revised To Stable On Receding Texas Utility Risks; 'A-' Ratings Affirmed

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Overview

- National Rural Utilities Cooperative Finance Corp. (CFC) has posted modest provisions for loan losses since some of its Texas borrowers incurred large power costs in February.
- Senate Bill 1580 provides a path for Texas electric cooperatives to meet their obligations related to the storm cost, including repayment of their borrowings from CFC.
- We believe that the risk of CFC experiencing substantial further losses has diminished and are revising our outlook to stable from negative.
- The stable outlook reflects our expectations that CFC will maintain a RAC ratio of 7.0% or better with adequate funding and liquidity over the next 12-24 months.

Rating Action

On Aug. 6, 2021, S&P Global Ratings revised its outlook on National Rural Utilities Cooperative Finance Corp. (CFC) to stable from negative. At the same time, we affirmed our 'A-' long-term issuer credit, senior secured debt, and senior unsecured debt ratings and our 'A-2' short-term issuer credit and commercial paper ratings, as well as our 'BBB' subordinated debt rating on CFC.

Rationale

The outlook revision mainly reflects our view that the risk of CFC experiencing substantial further losses stemming from Winter Storm Uri has diminished. CFC is exposed to utilities that had elevated credit stress, in large part due to settlements of Electric Reliability Council of Texas (ERCOT) transactions that occurred during the extreme weather conditions in February. Texas accounted for approximately 17% of CFC's total loans outstanding as of May 31, 2021, including loans to Brazos Electric Power Cooperative Inc. ('D', Brazos) and Rayburn Country Electric Cooperative Inc. ('CCC/Positive', Rayburn), which faced enormous settlements due to ERCOT.

As of May 31, 2021, CFC had $85 million of loans outstanding to Brazos ($64 million unsecured and $21 million secured) and $379 million of loans outstanding to Rayburn ($212 million unsecured and $167 million secured). Despite these exposures, CFC's provision for credit losses was just $29 million for the fiscal year ended May 31, 2021, primarily attributable to Brazos and Rayburn. While we believe losses could exceed this amount, we believe CFC has sufficient capital cushion to absorb the potential losses. CFC had an S&P Global Ratings' risk-adjusted capital (RAC) ratio of 8.5% and total adjusted capital of $2.5 billion as of May 2021. We generally consider a RAC ratio of 7%-10% to be indicative of adequate capital.

Furthermore, on June 18, the Texas governor signed into law Senate Bill 1580, which allows electric cooperatives to use securitization financing to cover extraordinary costs and expenses owed to ERCOT. While it is uncertain whether Brazos, Rayburn, or others will execute such securitizations, the legislation provides a path for Texas electric cooperatives to meet their obligations, including repayment of their borrowings from CFC.

Our ratings on CFC are based on, in our view, its unique business position in financing its rural electric utility members, adequate capitalization, historically strong asset quality, adequate funding and liquidity, and access to funding from the Federal Financing Bank, Farmer Mac, and member subordinated debt, which is subordinate to all other debt issues. The company's concentrated business model and large single borrower exposures partially offset some of these strengths.

Notwithstanding the extreme winter weather events, CFC had strong results for the fiscal year ended May 2021, with adjusted net income of $192 million, an increase of $47 million from the prior fiscal year, while its adjusted times interested earned ratio (TIER) improved to 1.23x from 1.17x at May 31, 2020.

Outlook

The stable outlook reflects our expectations that CFC, over the next 12-24 months, will maintain a RAC ratio of 7.0% or better with adequate funding and liquidity, while maintaining its role as an important source of financing for the rural electric utility industry.

Downside scenario

We could lower our ratings if the company's RAC ratio declines below 7.0% on a consistent basis, perhaps due to unexpectedly large credit losses, or if, in our view, the company's unique business position erodes or its liquidity weakens.

Upside scenario

We could raise our ratings if the company's RAC ratio rises well above 10.0% while maintaining minimal credit losses with continued access to funding from the Federal Financing Bank, Farmer Mac, and its members. The company's concentrated business model and use of short-term debt limit the probability of a higher rating.

Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/A-2

Stand-alone credit profile: a-

- Anchor: bb+
- Entity-specific anchor adjustment: +1
- Business position: Very strong (+2)
- Capital, leverage, and earnings: Adequate (0)
- Risk position: Adequate (0)
- Funding and liquidity: Adequate and Adequate (0)
- Comparable ratings adjustment: +1

External influence: 0

- Government influence: 0
- Group influence: 0
- Rating above the sovereign: 0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004
- Criteria | Financial Institutions | Finance Companies: Commercial Paper II: Finance Companies, March 22, 2004

Related Research

- National Rural Utilities Cooperative Finance Corp. Downgraded to ‘A-’ On Exposure To Texas Utilities; Outlook Negative, March 5, 2021

Ratings List

Ratings Affirmed		
National Rural Utilities Cooperative Finance Corp.		
Senior Secured	A-	
Senior Unsecured	A-	
Senior Unsecured	A-p	
Subordinated	BBB	
Commercial Paper	A-2	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
National Rural Utilities Cooperative Finance Corp.		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2