

# S&P Global Credit Trends and Criteria Discussion

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# Today's Speaker



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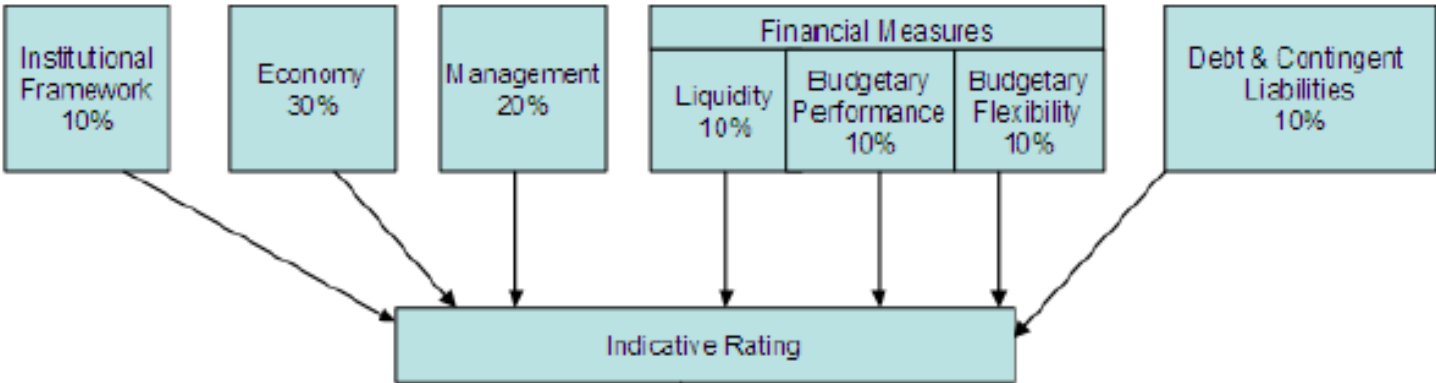
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**S&P Global**  
Ratings

- Local Government Criteria Discussion
- Ratings Linked to the Obligor
- Priority Lien Ratings
- Pension Views
- Direct Purchase Debt

# Local Government Criteria

# S&P Global's Local Government GO Criteria



# Overriding Factors

- **Positive Overriding Factors**
  - High income levels (>225% or >300%)
  - Sustained high fund balances (>75% of general fund expenditures)
- **Negative Overriding Factors**
  - Low market value per capita (<\$30,000)
  - Low nominal fund balance (<\$500,000)
  - Weak liquidity (caps at BBB+ or BB+)
  - Weak management (caps at A or BBB-)
  - Lack of willingness to pay obligations (caps at BBB- for leases and B for debt)
  - Large chronic negative fund balances (caps at A+, A-, or BBB)
  - Budgetary flexibility score of 5 (caps at A+)
  - Structural imbalance (caps at BBB+)
- **Potential one-notch adjustment**
  - The final rating assigned to the GO issue will be within one notch of the indicative rating, with one-notch differentials determined based on trends and comparisons with similarly rated peers

# Linkage to General Creditworthiness

# Ratings linked to issuer credit

S&P Global Ratings recently published methodology for assigning issue credit ratings on obligations which are linked to the creditworthiness of U.S. Public Finance obligors.

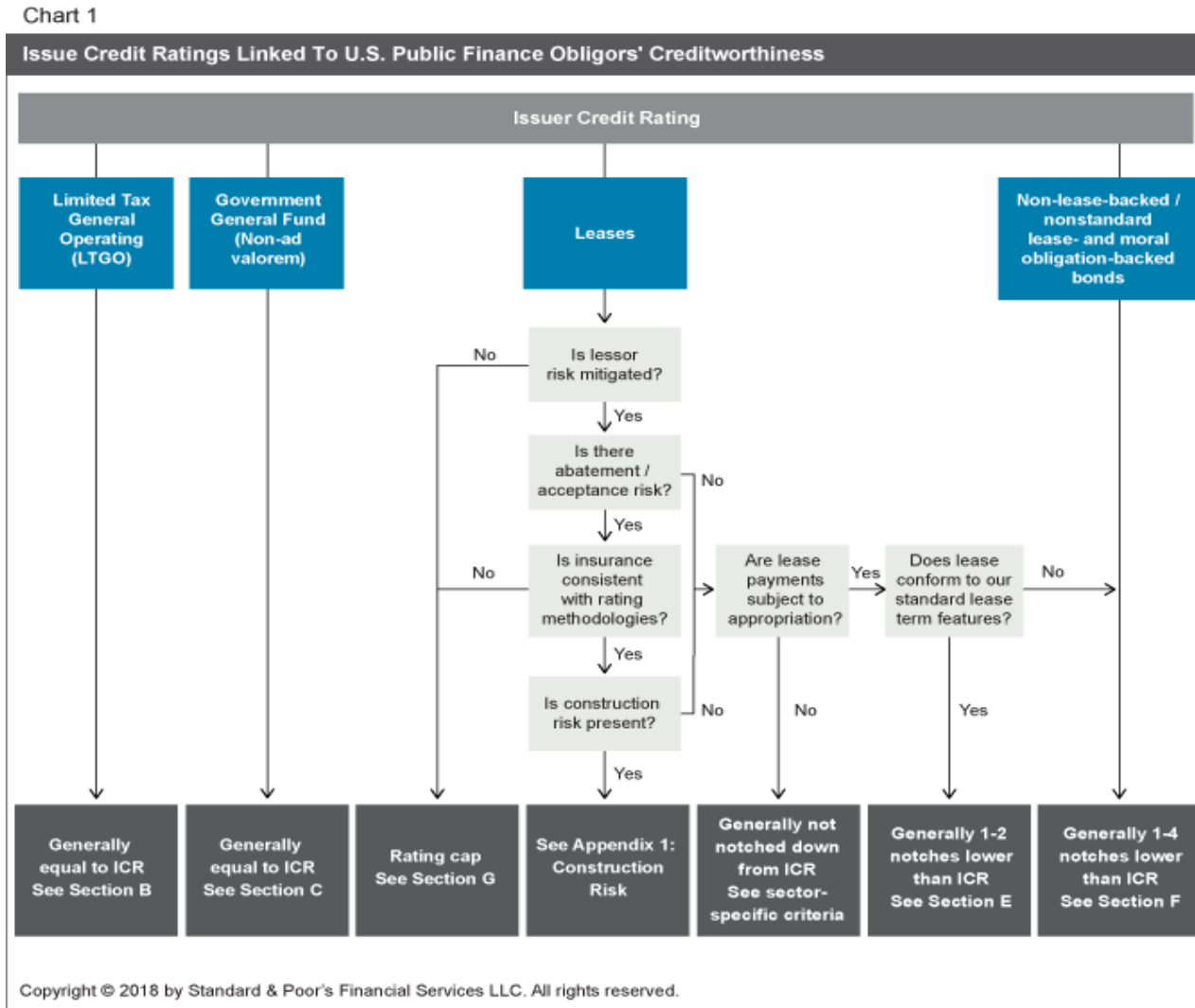
This includes:

- **Limited ad valorem tax or limited general obligation,**
- **Government general fund or legally available fund pledges (sometimes called non-ad valorem pledges),**
- **Revenues derived from underlying lease payments,**
- **Revenues subject to appropriation, and**
- **Moral obligation pledges.**

These obligations may lack the additional security provided by a government's full faith and credit pledge, however we believe the likelihood of payment is strongly linked to an obligor's general creditworthiness.

Generally for obligations that fall under scope of this criteria, we may notch the issue credit rating down from our view of the obligor's general creditworthiness, expressed by a general obligation (GO) or issuer credit rating (ICR) of the obligor (collectively referred to as ICR in this criteria).

# Issue Credit Ratings Linked to Obligor





# Priority Lien

# Priority Lien Debt Scope

## **WHAT IT COVERS**

Approximately 1,300 credit ratings

Bonds with a specific claim on revenues that occurs prior to other claims

Pledged revenue is typically limited

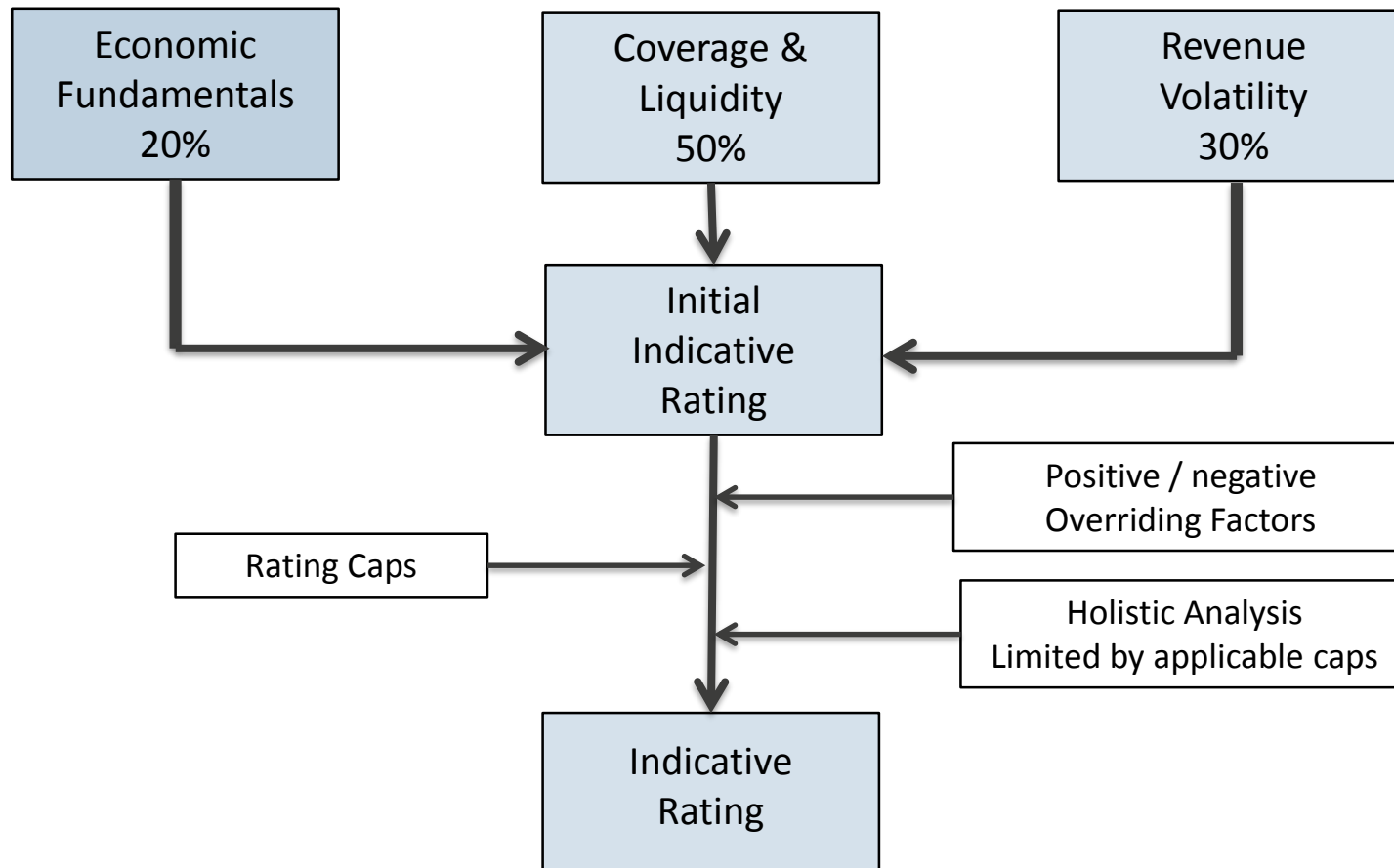
Pledged revenue is not derived from the operations of a municipal enterprise, and could include certain fees and assessments.

Examples: sales taxes, hotel taxes, vehicle registration fees, court docket fees

## **WHAT IT DOES NOT COVER**

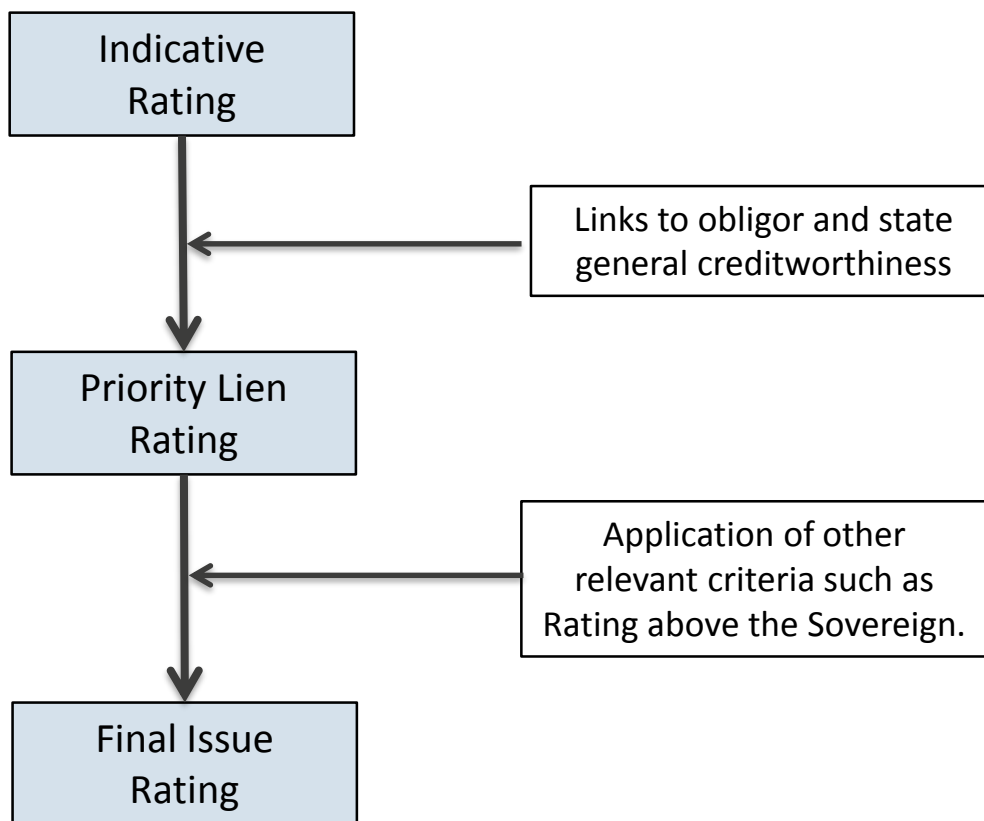
- **Bonds secured by ad-valorem property taxes**
- Tax increment revenue bonds
- Revenues from municipal enterprise (liquor, casino, tribal, etc).
- General obligation pledges

# Analytical Framework – Chart 1



**Continued next slide**

# Analytical Framework – Chart 1 continued



Key economic drivers:  
population within the  
...taxing boundaries,  
income levels, &  
participation in a large,  
broad and diverse  
MSA.

The assessment first looks at **expected** coverage and then **may** make an adjustment for liquidity.

# Prospective View of Coverage

The assessment of coverage is based on our expectation of **future** coverage levels, which may be informed by:

- The Additional Bonds Test;
- Maximum Annual Debt Service Coverage;
- Our view on the likelihood of economic stress
- Our expectation of the likelihood of additional debt
- The entity's reliance on excess pledged revenues for operations
- Volatility of the pledged revenue stream and
- The ability of the obligor to affect coverage (for instance by changing tax rates)

# Liquidity Adjustment

- We may adjust the Coverage and Liquidity Assessment down in certain circumstances
- Focuses on liquidity required in the bond documents
- Generally does not consider other sources of liquidity if they are not legally pledged and required to be maintained
- Based on the principle that liquidity becomes more important when coverage is low and volatility is high



We consider historical  
volatility of the  
**economic activity**  
being taxed

# Macro-Level Volatility Assessment

Our analysis of macro-level volatility risk takes into account both

- Historical volatility of the economic activity being taxed as well as
- Our forward-looking view of societal, demographic, political, and other factors that could potentially affect the economic activities being taxed

We assign an assessment score of 1 (very low) to 5 (very high) to the overall macro-level volatility based on general characteristics of the economic activity being taxed.

# Volatility Assessment: Methodology

For revenue types that are commonly observed, we have published a criteria-related commentary (see Related Research) that provides our assessment of macro-economic revenue volatility by revenue type



For revenue types that are less commonly observed or composed of mixed revenue streams.... our macro-level assessment reflects the proportion of expected revenues attributable to each stream, as well as whether we believe there is any additional stability provided by the inclusion of revenue streams that we believe have low or negative correlation.

# Capping PL ratings relative to obligor credit

## Rating caps above obligor general creditworthiness

### 4 notches

- We view operating risk as remote
- We believe pledged revenues are **legally and practically** separated from operations
- Examples: Special purpose entity securitization (Assignment/sale), Operating lease **[I don't see this distinction in the criteria.]**

### 2 notches

- Operating risk is present, but mitigated by revenue collection **and distribution** mechanisms that limit obligor control until after priority lien obligations are paid
- Example: Intercept and lockbox (pre-default)

### 1 notch

- Operating risk is present and unmitigated, but we believe priority lien obligations are likely to be paid before other, non-priority lien obligations

# When do the caps relative to general credit NOT apply?

## 1. Obligor is an independent entity....

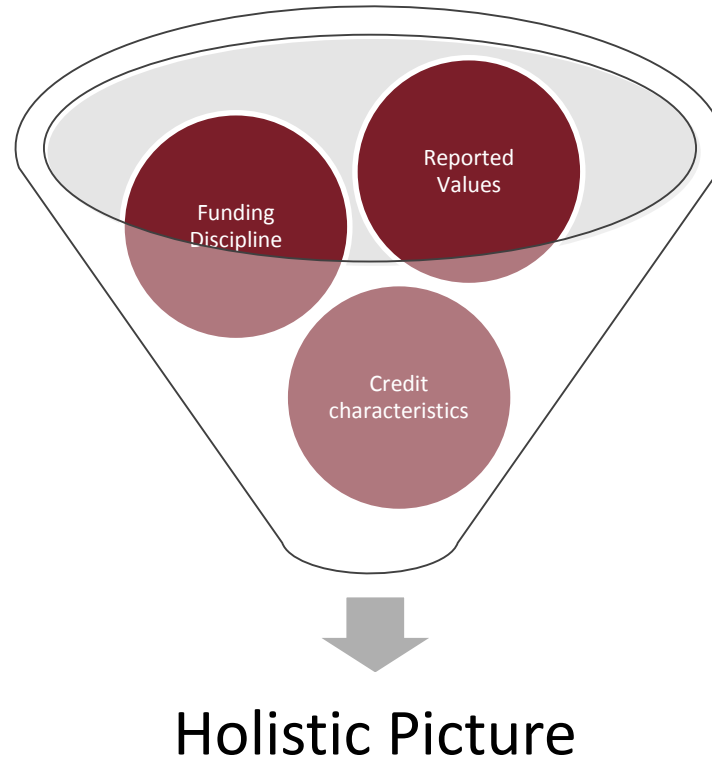
- To what extent is issuer exposed to the operating risk of a parent entity, or the one that originates the revenue stream?
- Does the issuer have **independent taxing authority**, and does it retain revenues after debt service is paid?
- Examples that would likely not be considered independent:
  - Issuer/obligor is a limited purpose entity set up by a municipality or a state to attempt a separation of revenue (through transfer, assignment, or sale)
  - Issuer/obligor is a component unit of or subdivision of a larger entity

## 2. ...Without substantive operations

- The definition of substantive operations is being evaluated. Considerations may include:
  - Essentiality of the operations relative to the authority's general purpose
  - Total operational expenses relative to the debt and other functions
  - Nature of operations – single project versus system wide

# Pension Update

# Key Focus for State and Local Government



# S&P Local Ratings Pension Approach

## Direct Assessment

### Large Obligation

- Funded Ratio
- Assumptions

### Accelerating Payments

- Contribution practice
- ADC strength (amortization, etc.)

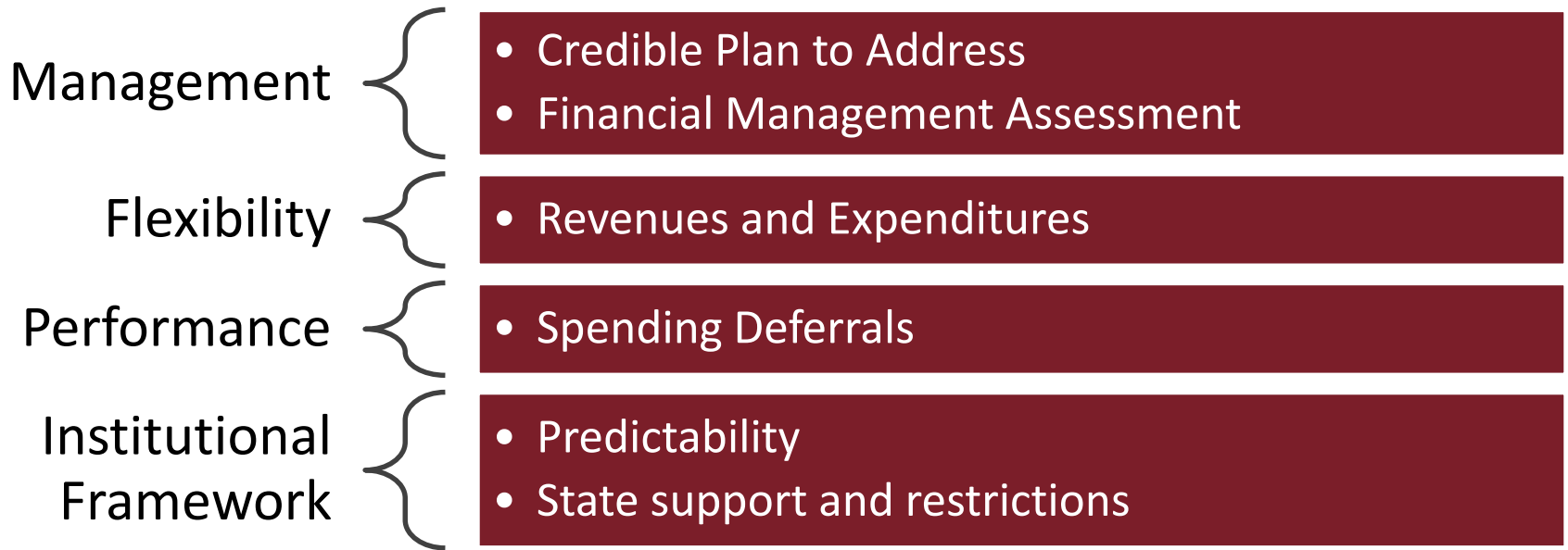
### Impact on Budget Stress

- Carrying charge
- Influence from assumptions and methods



# S&P Local Ratings Pension Approach

## Further Implications



# Credit Fundamentals Matter