General Obligation Ratings Methodology and Assumptions

An Overview of S&P's Local GO Criteria

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Topics

Å Overview of Criteria and Analytic Framework

Å Summary of Factors

Å Putting it all Together

Local GO Criteria: The Basics

What: **All local GO ratings**

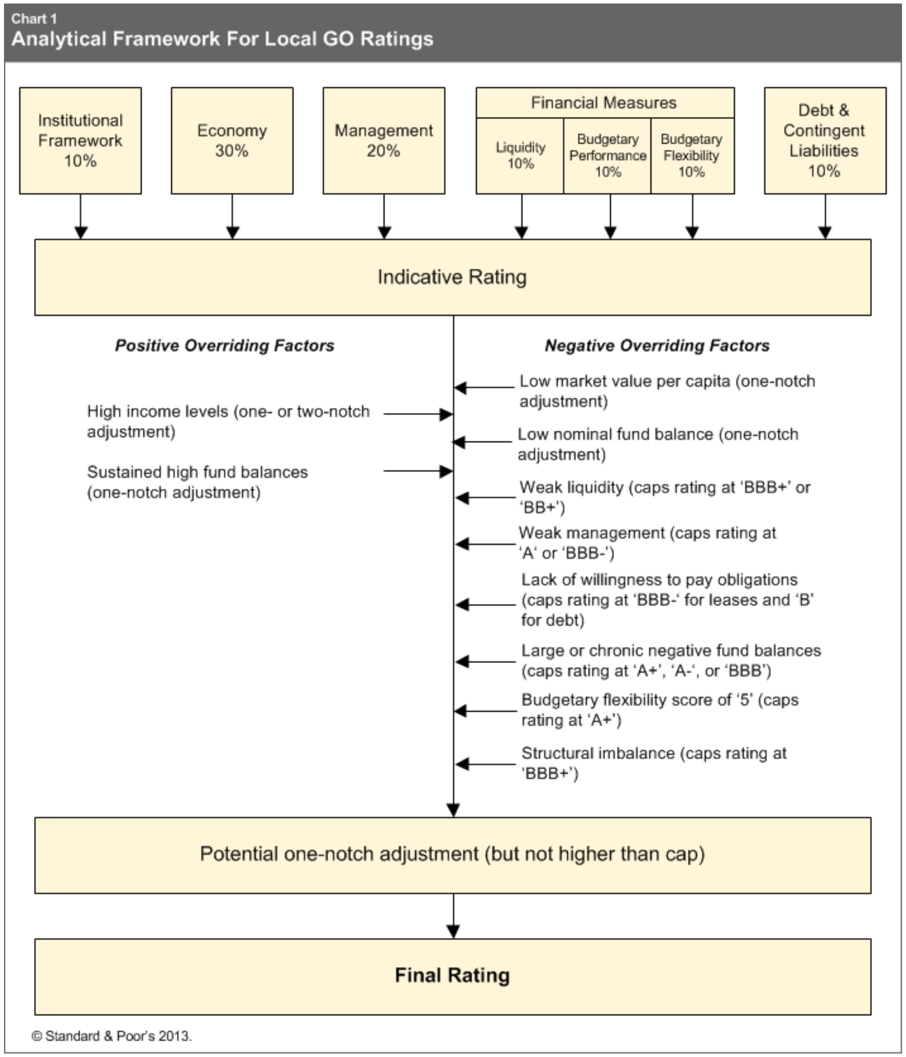
When: **Implemented September 12, 2013**

How: **Reviewed all credits within one year**

Why: **Improved clarity on ratings process, more transparency, comparability and more forward looking components**

Rating change results!

Analytical Framework



Summary of the Factors

Local GO Criteria Factors

Institutional Framework (1 of 7 Factors)

Institutional Framework 10%

Assesses the legal and practical environment in which the local government operates

The score is based on the average of four discretely scored areas

- *Predictability*: the extent to which a local government can forecast its revenues and expenditures on an ongoing basis (Table 4)
- *Revenue and expenditure balance*: the extent to which a local governments have the ability to finance the services they provide (Table 5)
- *Transparency and accountability*: the overall institutional framework's role in encouraging the transparency and comparability of relative financial information (Table 6)
- *System support*: the extent to which local governments receive extraordinary support from a state government when the local government is under extreme stress (Table 7)

Institutional Framework (1 of 7 Factors)

Institutional Framework 10%

All governments of the same type within the same state receive the same score

Å Cities and counties can differ

- Municipalities of the same type can differ based on home rule status, population, etc.

The institutional framework scores will be reviewed and maintained on an ongoing basis

Table 3: Institutional Framework Score Outcomes

Score Range	Institutional Framework Score
1 ï 1.5	1 (very strong)
1.75 ï 2.75	2 (strong)
3.0 ï 3.75	3 (adequate)
4 ï 4.5	4 (weak)
4.75 ï 5	5 (very weak)

The institutional framework score results from the average of the scores for predictability, revenue and expenditure balance, transparency and accountability, and systemic support (see paragraphs 37-40). Each score receives equal weight in the average.

Source: Standard & Poorôs Ratings Services.

Institutional Framework

- Only new factor that is now part of the rating
  - Formalizes what we were already doing
- IFs are assigned in advance
  - Does not need a conversation during the rating call

Economic Score (2 of 7 Factors)

Economy 30%

- Assess both the health of the asset base relied upon to provide both current and future locally derived revenues as well as the likelihood of additional service demands resulting from economic deterioration
- The initial score (1 through 5) is based on market value per capita and projected per capita income as a % of U.S. (Table 8)
- Per capita income is based on a 5-year projection
- Especially high income will lead to a positive override and especially low market value per capita will lead to a negative override

	Total Market Value Per Capita				
Projected Per Capita EBI as a % of U.S. Projected Per Capita EBI	>$195,000	$100,000 to $195,000	$80,000 to $100,000	$55,000 to $80,000	≤$55,000
>150	1	1.5	2	2.5	3
110 to150	1.5	2	2.5	3	3.5
85 to110	2	2.5	3	3.5	4
70 to 85	2.5	3	3.5	4	4.5
≤70	3	3.5	4	4.5	5

Source: Standard & Poor's Ratings Services.

Economic Score Adjustments

Economy
30%

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
Participation in a larger broad and diversified economy.	Negative budget impact from demographic profile: population decrease and/or high share of dependent population (>55%) have a material negative impact on future revenue growth and expenditure needs.
A stabilizing institutional influence with a longstanding role as a major employer, such as higher education, health care, military, or large and stable corporate presence.	High county unemployment rate (>10%).
	If employment concentration where an individual sector (excluding education/health, government, and transportation, trade and utilities) represents more than 30% of the nonfarm work base, or tax base concentration where the top 10 taxpayers represent more than 35% of the tax base, the score worsens by one point. If the top 10 taxpayers exceed 45% of the tax base, the score worsens by two points.

Source: Standard & Poor's Ratings Services.

Economy

- **The initial score is entirely data-driven,**
  - Conversations about what is happening in the economy become less applicable to the rating
- **Notables**
  - Ways to move rating up a notch:
    - High effective buying income levels over 225%
    - High effective buying income levels over 300% (2 notches)
    - Sustained high fund balance of over 75%
  - Ways to move rating down a notch:
    - Low market value per capita of less than $30,000

Management Score (3 of 7 Factors)

Management 20%

Å **Assess the impact of management conditions on the likelihood of repayment**

Å **Financial Management Assessment (FMA) is based upon our current methodology**

Table 9: Assessing the Management Score	
Rounded Score	**Characteristics**
1 (Very strong)	FMA score of ñstrongò and none of the factors in score ô4ó or ô5ô is present.
2 (Strong)	FMA score of ñgoodò and none of the factors in score ô4ó or ô5ô is present.
3 (Adequate)	FMA score of ñstandardò and none of the factors in score ô4ó or ô5ô is present.
4 (Weak)	FMA score of ñvulnerableò or any of the following is present: there is a financial reporting restatement that has a material negative impact; any of the conditions in score ô5ô existed in the past three years; the structural imbalance override condition exists or existed within the past three years; or a very high debt, pension and OPEB burden.
5 (Very weak)	Regardless of the FMA score, any of the following is present: a management team that lacks relevant skills resulting in a weak capacity for planning, monitoring, and management; an auditor has delivered a going concern opinion; the government appears unwilling to support a debt or capital lease obligation; or the government is actively considering bankruptcy in the near term

Source: Standard & Poorõs Ratings Services.

Management Score Adjustments

Management
20%

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
Consistent ability to maintain balanced operations.	Frequent management turnover inhibiting a current understanding of the governmentôs financial position and its ability to adjust, or political gridlock, or instability that brings the same results.
Government service levels are limited.	Consistent inability to execute approved structural reforms for two consecutive years.

 Source: Standard & Poorôs Ratings Services.

Management

- **Still based on FMA**
- **Topics for additional focus**
  - Turnover, political gridlock, etc.
  - Management capability regarding planning, monitoring and execution
  - Very high pension/OPEB burden
  - Any news stories or other conversations related to potential bankruptcy
- **Notables**
  - More rating caps under management than other scores

Financial Measures

- **Three components factor into our assessment of a municipality's financial credit characteristics**
- **Budgetary flexibility, budgetary performance, and liquidity**
- **Each factor is weighted 10% — all financial measures together are 30%**

Financial Measures		
Budgetary Flexibility 10%	Budgetary Performance 10%	Liquidity 10%

Financial Measures: Budgetary Flexibility Score (4 of 7 Factors)

Budgetary Flexibility 10%

The budgetary flexibility initial score measures the degree to which the government can create additional financial flexibility in times of stress

- Available fund balance as a % of general fund expenditures: for the most recently reported fiscal year
- When other fund balances outside of the government's general fund are available beyond the current fiscal year, they are included in the calculation
- This measure can cap a rating or it can be a positive override if extremely strong

Table 10: Assessing The Budgetary Flexibility Score					
	Available Fund Balance as a percentage of expenditures				
%	>15	8 to15	4 to 8	1 to 4	≤1
Score	1	2	3	4	5

 Source: Standard & Poor's Ratings Services.

Budgetary Flexibility Score Adjustments

Budgetary Flexibility 10%

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
If projections for the current year and the following year suggest a better initial score.	If projections for the current year and the following year suggest a worse initial score.
Ability to avoid financial imbalances with demonstrated capacity and willingness to cut operational spending (by more than 2%), resulting from a flexible cost structure, flexible legislation, and/or widespread political support.	High levels of questionable receivables or amounts due from other funds with deficit balances.
Existing state tax caps do not apply to the government, or the government retains substantial flexibility under the caps.	Limited capacity to cut expenditures due to infrastructure or operational needs or political resistance.
Demonstrated ability and willingness to raise taxes when needed (and voter support is usually obtained when such approval is required).	Limited capacity to raise revenues due to consistent and ongoing political resistance which can include self-imposed restrictions through charter or local initiative processes.
Timing of fiscal year and tax billing dates result in high cash with abnormally low fund balance levels.	Where cash accounting is used, the criteria use cash balances instead of fund balances and the score is worsened by one point.
Maintenance of an available fund balance exceeding 30% of general fund expenditures for the most recently reported year, the current year and the next year.	

Source: Standard & Poor's Ratings Services.

Budgetary Flexibility

- **Want to know all sources of reserves**
  - Highlight all accounts where óavailableôreserves are kept, including those outside the general fund
  - Can be last audited year plus most recent unaudited numbers
- **Notables**
  - Fund balance over 75% improves rating by one notch
  - Fund balance less than $500,000 worsens rating by one notch
  - Score of 5 caps the rating at óA+ô
  - Fund balance caps:
    - óA+ô: < - 10%
    - óA-ô: < - 5%
    - óBBBô: < - 5% for the past three years

Financial Measures: Budgetary Performance Score (5 of 7 Factors)

Budgetary Performance 10%

The budgetary performance initial score measures the current fiscal balance of the government

- Total governmental funds net result: the most recent yearØs net total governmental funds on a budgetary basis as a percent of expenditures
- General fund net result: the most recent yearØs general fund operational balance as a percent of expenditures

Table 11: Assessing The Budgetary Performance Score					
	Total Governmental Funds Net Result (%)				
General fund net result (%)	> -1	-1 to -5	-5 to -10%	-10 to -15	≤ -15
(> 5)	1	2	3	3	4
(-1 to 5)	2	3	3	4	5
(≤ -1)	3	4	4	5	5

Source: Standard & PoorØs Ratings Services.

Budgetary Performance Score Adjustments

Budgetary Performance 10%

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
Expected structural improvement: if projections for the current year and following year suggested a better initial score, the score would improve by one point. The score would improve by two points only if required adjustments to revenues or expenditures to produce the result were already approved.	Expected structural deterioration: if projections for the current year and following year suggested a worse initial score, the score would worsen by one or two points. To worsen by two points, expected performance must fall to the commensurate level within the current year.
	Deferred payments on a cash basis: in cases where good ratios hide significant underspending due to deferred payments, the deferral produces a better score.
	Significant historic volatility in performance because of very cyclical revenues (e.g., oil & gas or sales tax on luxury goods and/or dependence on volatile state transfers) or exposure to event-related risks, the sources of volatility remain.

Source: Standard & Poor's Ratings Services.

Budgetary Performance

- **Calls/meeting with analysts will include:**
  - More discussion of transfers in/out of general fund
  - More detailed conversations regarding capital expenditures and any one-time revenues, including bond proceeds
  - Existence/changes to deferred payments
  - Structural imbalance: existence of such and plans to remedy
- **Notables**
  - Structural imbalance caps final rating at BBB+

Financial Measures: Liquidity Score (6 of 7 Factors)

Liquidity
10%

The initial score measures the availability of cash and cash equivalents to service both debt and other expenditures

Initial liquidity score: combination of two measures (table 12)

Å Total government cash as % of total governmental funds debt service

Å Total cash % of total governmental funds expenditures

Table 12: Assessing The Liquidity Score					
	Total Government Available Cash As % Of Total Governmental Funds Debt Service				
Total Government Available Cash As % Of Total Governmental Funds Expenditures	>120	100 to120	80 to100	40 to 80	≤40
>15	1	2	3	4	5
8 to15	2	2	3	4	5
4 to 8	3	3	3	4	5
1 to 4	4	4	4	4	5
≤1	5	5	5	5	5

Source: Standard & Poorõs Ratings Services.

Liquidity Score Adjustments

Liquidity
10%

Qualitative factors with a positive impact on the initial score	Qualitative factors with a negative impact on the initial score
If projections for the current year (and the following year) suggest a better score, the score improves by one point.	If projections for the current year (and the following year) suggest a worse initial score, the score worsens by one point.
If access to external liquidity is óexceptionalô as defined in table 13, the score improves by two points; if óstrongô, the score improves by one point.	If access to external liquidity is óuncertainô as defined in table 13, the score worsens by two points; if ólimitedô, the score worsens by one point.
Very robust and stable internal cash flow generation capacity compared with peers in this category.	High refinancing risk over the next 24 months.
	Aggressive use of investments.
	Exposure to non-remote contingent liability risk that could come due within 12 months.

Source: Standard & Poorôs Ratings Services.

Liquidity

Å **Topics to highlight**

- Å Highly liquid investments that are not included as cash?
- Å Contingent liabilities due in the next year?
- Å Details of existing short term liquidity facilities
- Å Direct purchase debt?
- Å Frequency of non-GO debt issuance?
- Å BANs outstanding that will need to be refinanced

Å **Notables**

- Å Liquidity score of 4 caps the rating at óBBB+ô
- Å Liquidity score of 5 caps the rating at óBB+ô
- Å Non-remote contingent liabilities that reach certain levels without a credible plan to finance will trigger these caps

Debt and Contingent Liability (7 of 7 Factors)

Debt & Contingent Liabilities
10%

Initial debt score: combination of two measures (table 14)

- Total governmental funds debt service as a percentage of expenditures
  - Measures the annual fixed cost burden that debt places on the government
- Net direct debt as a percentage of total governmental funds revenue
  - Measures the total debt burden on the government's revenue position rather than the annual cost of the debt, which can be manipulated by amortization structures

Table 14: Assessing The Debt And Contingent Liabilities Score

	Net Direct Debt As % Of Total Governmental Funds Revenue				
Total Governmental Funds Debt Service As A % of Total Governmental Funds Expenditures	<30	30 to 60	60 to 120	120 to 180	≥180
< 8	1	2	3	4	5
8 to 15	2	3	4	4	5
15 to 25	3	4	5	5	5
25 to 35	4	4	5	5	5
≥35	4	5	5	5	5

 Source: Standard & Poor's Ratings Services.

Debt and Contingent Liability Adjustments

Debt & Contingent Liabilities 10%

Qualitative factors with a positive impact on the initial score:	Qualitative factors with a negative impact on the initial score:
Overall net debt as a percentage of market value below 3%.	Overall net debt as a percentage of market value exceeding 10%.
Overall rapid annual debt amortization, with more than 65% coming due in10 years.	Significant medium-term debt plans produce a higher score when included.
	Exposure to interest-rate risk or instrument provisions that could increase annual payment requirements by at least 20%.
	Unaddressed exposure to large unfunded pension or OPEB obligations leading to accelerating payment obligations over the medium term that represent significant budget pressure (see paragraph 82). If there is a plan to address the obligations, the final score worsens by one point; otherwise the score worsens by two points.
	Speculative contingent liabilities or those otherwise likely to be funded on an ongoing basis by the government representing more than 10% of total governmental revenue.

 Source: Standard & Poor's Ratings Services.

Debt and Contingent Liabilities

- **Debt plans for the next two years**
- **Amortization schedule**
- **Pension or OPEB information not in audit?**
  - Specific list includes contributions and valuation of assets
  - Any plans to make significant adjustments that would affect costs?
  - Expectation of increases to annual pension costs in next 2-3 years?
- **Contingent liabilities outstanding?**
- **Notables**
  - Includes pension and OPEB

Putting it all Together

Indicative Rating

Positive Overriding Factors

Å High income levels (1 or 2 notch adjustment)

Å Sustained high fund balances (1 notch adj)

Negative Overriding Factors

Å Low market value per capita (1 notch adjustment)

Å Low nominal fund balance (1 notch adjustment)

Rating Caps

Å Weak liquidity (BBB+ or BB+)

Å Weak management (A or BBB-)

Å Lack of willingness to pay obligations (BBB- for leases and B for debt)

Å Large or chronic negative fund balances (A+, A-, or BBB)

Å Budgetary flexibility score of 5 (A+)

Å Structural imbalance (BBB+)

*** ONE NOTCH FLEXIBILITY ***

FINAL RATING!

 Source: Standard & Poorõs Ratings Services.

Q&A