

Credit Enhancement and Rating Process – Florida Bonds from the Perspective of a Bond Insurer and Rating Agency



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What Is A Credit Rating?

Key Features

- A forward-looking opinion about the capacity and willingness of an issuer, such as a corporation or government, to meet its financial obligations in full and on time
- Incorporates views on relative likelihood of default that are applied to entities (issuers) and securities (issues)
- Strives to be globally comparable across sectors
- One of many inputs available to investors and other market participants

And What It Is *Not*

- A guarantee of credit quality
- A measure of absolute default probability
- Investment advice or recommendation (buy, sell or hold)
- A measure of liquidity or price
- A way of defining “good” or “bad”
- An audit

- **The key objective of our credit ratings is a rank ordering the relative creditworthiness of issuers and obligations**
- **Our ratings provide comparability and transparency**
- **Endeavor to consistently apply criteria regardless of sector**

Source: “Understanding Standard & Poor’s Rating Definitions”, June 3, 2009

S&P's Global Ratings Scale

Investment Grade*	AAA	Extremely strong capacity to meet financial commitments. Highest rating.
	AA	Very strong capacity to meet financial commitments.
	A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.
	BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
Speculative Grade*	BB	Less vulnerable in the near term, but faces major ongoing uncertainties or exposure to adverse business, financial and economic conditions
	B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
	CCC	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments.
	CC	Highly vulnerable ; default has not yet occurred, but is expected to be a virtual certainty.
	C	Currently highly vulnerable to non-payment, and ultimate recovery is expected to be lower than that of higher rated obligations.
	D	Payment default on a financial commitment or breach of an imputed promise; also used when a bankruptcy petition has been filed or similar action taken.

The challenge: using these descriptions to promote global rating comparability

* As considered by market participants

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

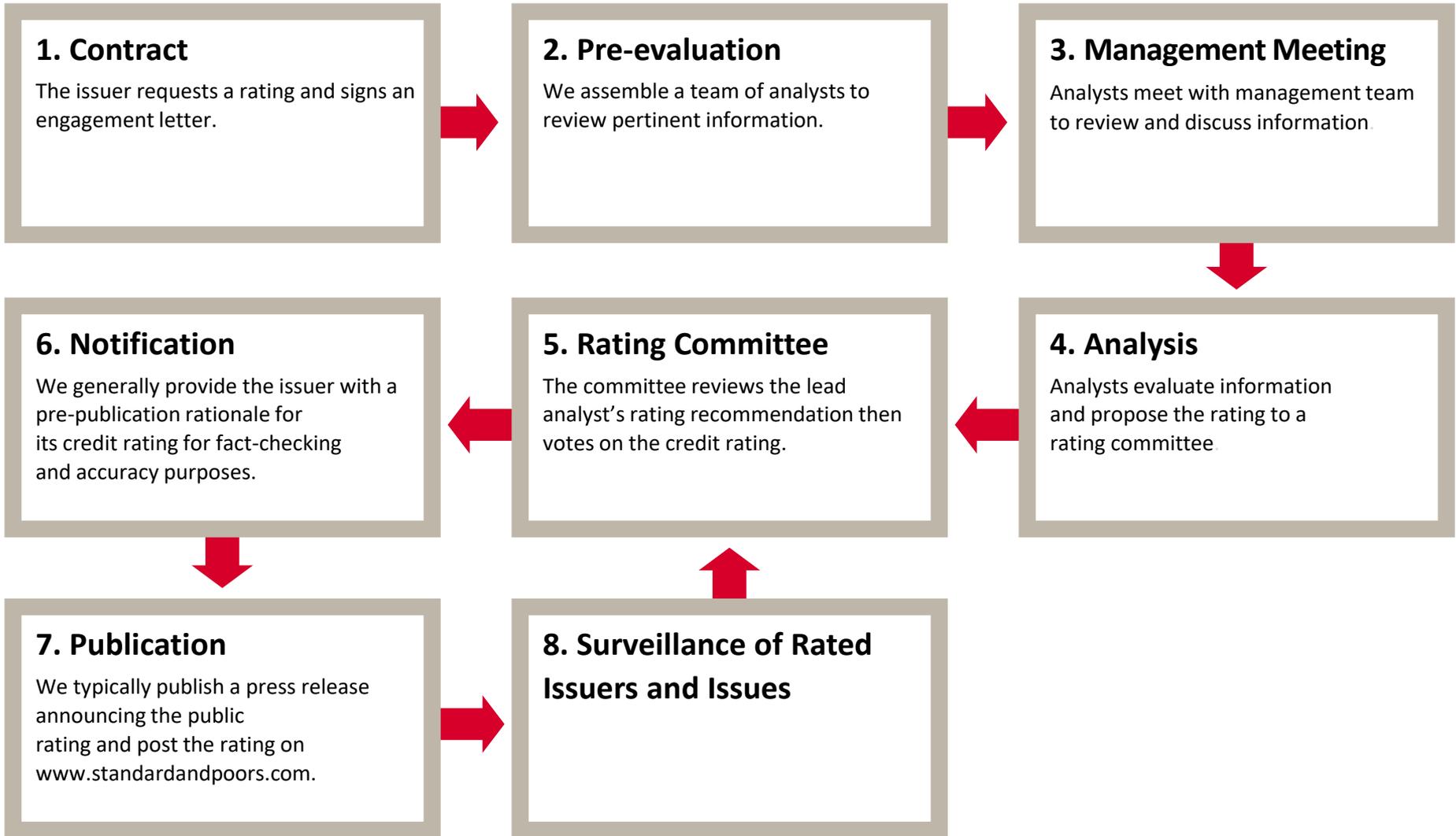
The Time Horizon of Rating Outlooks

- **Time horizon:** Generally, up to 2 years for investment grade ratings, up to one year for speculative
- **Likelihood of rating change:** Generally, if we believe there is at least a 1-in-3 chance of a rating change, we'll signal that change with the outlook
- **Information availability:** If we have information that changes our view of the rating today, we don't change the outlook, we change the rating!
- **Criteria:** Generally, sector-specific and asset class criteria address the determination of ratings but not outlooks. We use the criteria "Use of CreditWatch and Outlooks" to guide the application of outlooks.

Our Rating Process



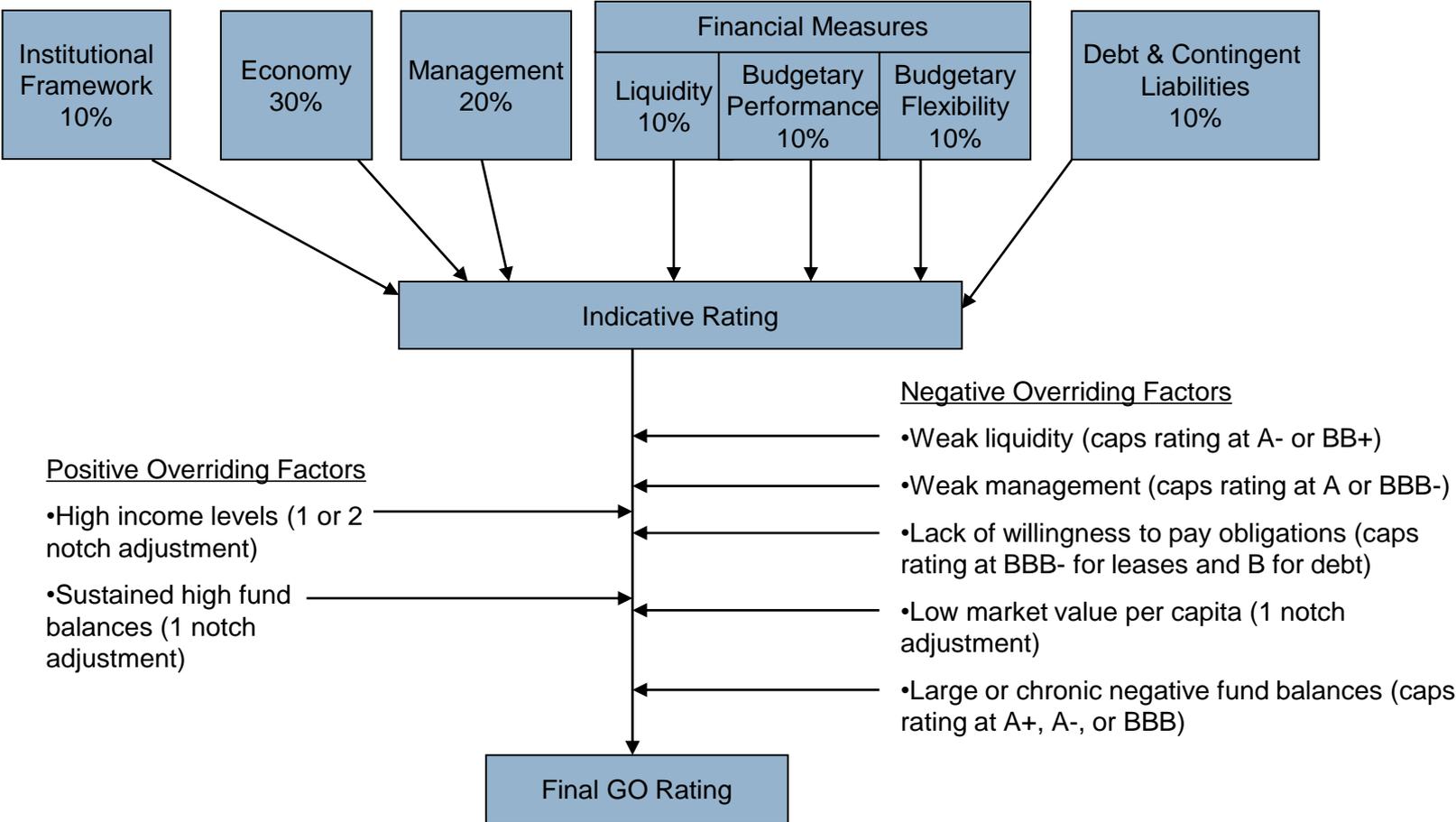
S&P Global Ratings Process



Local Government Criteria



Analytical Framework For Local GO Ratings



Institutional Framework

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
- *Revenue and expenditure balance*: the extent to which a local governments have the ability to finance the services they provide
- *Transparency and accountability*: the overall institutional framework's role in encouraging the transparency and comparability of relative financial information
- *System support*: the extent to which local governments receive extraordinary support from a state government when the local government is under extreme stress

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

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

Economy

- 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.
- Per capita income is based on a 5-year projection

Table 8 Assessing The Economic Score (see paragraphs 41-47)					
	Total Market Value Per Capita				
Projected per capita effective buying income as a % of U.S. projected per capita E BI	>\$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 to 150	1.5	2	2.5	3	3.5
85 to 110	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

A score of '1', '2', '3', '4', and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Management

- Assess the impact of management conditions on the likelihood of repayment
- Financial Management Assessment (FMA) is based upon our current methodology

Management – Adjustments

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 government's 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.
For each relevant qualitative factor, the score changes by one point. The final management score equals the initial score adjusted up or down based on the net effect of the qualitative adjustments. Qualitative adjustments cannot improve an initial management score of '5' or, in certain cases, a score of '4' (see paragraph 57).	

Financial Measures

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

Flexibility

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 (see paragraphs 59-64)					
	Available Fund Balance As A % Of Expenditures				
%	>15	8-15	4-8	1-4	≤1
Score	1	2	3	4	5

A score of '1', '2', '3', '4', and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Budgetary Performance

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

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

Table 11

Assessing The Budgetary Performance Score (see paragraphs 65-68)

	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

A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Liquidity

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

- Total government cash as % of total governmental funds debt service
- Total cash % of total governmental funds expenditures

Table 12 Assessing The Liquidity Score (see paragraphs 69-77)					
	Total Government Available Cash As % Of Total Governmental Funds Debt Service				
Total Government Available Cash As % Of Total Governmental Funds Expenditures	>120	100 to 120	80 to 100	40 to 80	≤40
>15	1	2	3	4	5
8 to 15	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

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

Debt and Contingent Liabilities

Initial debt score: combination of two measures

- 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 (see paragraphs 78-84)					
	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

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

Putting it All Together

Indicative Rating

Positive Overriding Factors

- High income levels (1 or 2 notch adjustment)
- Sustained high fund balances (1 notch adj)

Negative Overriding Factors

- Low market value per capita (1 notch adjustment)
- Low nominal fund balance (1 notch adjustment)

Rating Caps

- Weak liquidity (BBB+ or BB+)
- Weak management (A or BBB-)
- Lack of willingness to pay obligations (BBB- for leases and B for debt)
 - Large or chronic negative fund balances (A+, A-, or BBB)
- Budgetary flexibility score of 5 (A+)
 - Structural imbalance (BBB+)

***** ONE NOTCH FLEXIBILITY *****

FINAL RATING!

The Top 10 Management Characteristics Of Highly Rated State And Local Borrowers



Top 10 List

Management Characteristics of Highly Rated Issuers

- 1) Focus on structural balance
- 2) Strong liquidity management
- 3) Regular economic and revenue updates to identify shortfalls early
- 4) An established rainy day/budget stabilization reserve
- 5) Prioritized spending plans and established contingency plans for operating budgets

Top 10 List

Management Characteristics of Highly Rated Issuers

- 6) Strong long-term and contingent liability management
- 7) A multiyear financial plan in place that considers the affordability of actions or plans before they are part of the annual budget
- 8) A formal debt management policy in place to evaluate future debt profile
- 9) A capital planning process
- 10) A well-defined and coordinated economic development strategy

Additional Info & Questions

www.spratings.com (select SECTOR: U.S. Public Finance)

This has our “Meet the Team” hand-out

This also has our Request for Comments:

- Limited-Tax General Operating Debt
- Issues Linked to Obligors’ Creditworthiness

Bio

Geoffrey E. Buswick

Geoffrey Buswick is a Managing Director and Sector Leader in the U.S. Public Finance - Governments team at S&P Global Ratings in Boston. Geoff focuses on developing research and educating the market about S&P Global's approach to rating municipal entities and our views on emerging risks in the public finance sector. He speaks regularly on the topics of cybersecurity, sustainability, direct purchase bank loans, distressed credits, and specific aspects of the local government criteria. Geoff also serves as a committee chair for local government ratings. Much of his work aims at improving transparency and external understanding of S&P Global's public finance rating process.

Geoff has held various senior analytical and management roles in Ratings. From October 2010 to February 2015, Geoff was the Lead Analytical Manager for the Public Finance Infrastructure Group and, beginning in January 2014, he led the Housing team as well. for the City of Gloucester, Mass. In addition, he spent three years as the Administrative Officer for the City of North Adams, Mass.

Geoff served on the board of governors of the National Federation of Municipal Analysts (NFMA) from 2010-2013, and was the co-chair for the 2012 and 2013 NFMA Annual Conferences. Geoff also served on his town's Finance Committee from 2008-2015. Geoff holds both a B.A. in Political Science and a Masters of Public Administration from the University of Massachusetts at Amherst.

Thank you

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