Local & State Government Credit Update & Outlook

Geoff Buswick, Managing Director, U.S. Public Finance, S&P Global Ratings

Robin Prunty, S&P Global Ratings
Agenda – U. S. Public Finance

U.S. Public Finance Ratings Performance

- S&P’s Global Ratings Scale
- U. S. Public Finance default performance

State and Local Government Credit Overview

- State Rating and Outlook Distribution
- U. S. State Outlook and credit trends
- U.S. Local Government Outlook and credit trends

Q&A

- Q&A
U.S. State Ratings and Outlook Distribution
U.S. States Ratings Distribution

- **AAA**: 28%
- **AA**: 30%
- **AA+**: 10%
- **AA-**: 6%
- **A+**: 2%
- **A-**: 2%
- **BBB-**: 2%
- **CA, KA, LA, MI, WV**: 22%
- **CT, KY, PA**: 28%
- **NJ**: 30%
- **IL**: 22%

Source: S&P Global Ratings U.S. State Ratings And Outlooks: Current List 10/13/17
U.S. States Outlook Distribution

Source: S&P Global Ratings U.S. State Ratings And Outlooks: Current List 10/13/17

S&P Global Ratings
Ratings Movements For U.S. States

Source: S&P Global Ratings History of U.S. State Ratings 10/13/17. *As of 10/13/17. Includes multiple rating changes for same state within a year

S&P Global Ratings
Analytical Framework – U.S. States

Chart 1
Standard & Poor’s Analytic Framework For Rating U.S. States

Government framework
• Fiscal policy framework
• System support
• Intergovernmental funding

Financial management
• FMA
• Budget management

Economy
• Demographic profile
• Economic structure
• Wealth and income indicators
• Economic development

Budgetary performance
• Budget reserves
• Liquidity
• Tax/revenue structure
• Revenue forecasting
• Service levels
• Structural performance

Debt and liability profile
• Debt burden
• Pension liabilities
• OPEB risk assessment

Indicative credit level

Holistic analysis
(one-notch adjustment, subject to any applicable rating cap)

Overriding factors:
• System support
• Willingness to support debt
• Liquidity and capital market access
• High level of expected future debt/ liabilities
• Weak structural budget performance
• High level of contingent liquidity risk

State rating

© 2016 Standard & Poor’s Financial Services LLC. All rights reserved.
U.S State Budget Outlook and Themes
## Key themes for 2017

<table>
<thead>
<tr>
<th>Tax Revenue Performance</th>
<th>Narrow Fiscal Margins</th>
<th>Diminished Recession Preparedness</th>
<th>Trade Headwinds</th>
<th>Federal Fiscal Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of early calendar 2017, 60% of states that report collections relative to budget were experiencing revenue collection shortfalls.</td>
<td>Rising expenditures in a range of less discretionary areas</td>
<td>Rising costs related to pensions, OPEB, and debt service reduce flexibility</td>
<td>Ongoing speculation as to trade agreements and the current administration</td>
<td>The federal government may provide less fiscal aid in the event of a downturn</td>
</tr>
<tr>
<td>Potential for slight revenue rebound in fiscal 2018 - accumulation of unrealized gains, continued job growth</td>
<td>As of May 2017, 20 states began the fiscal 2018 budget process projecting deficits</td>
<td>In a 2016 stress scenario analysis, 7 of 10 largest debt portfolio states had insufficient reserves</td>
<td>Although export improvement in early 2017 with firmer global demand and fading effects of strong dollar</td>
<td>Adjustment in Medicaid funding could transform federal-state fiscal relationships</td>
</tr>
<tr>
<td>State finances will remain challenged by large unfunded pension and retiree health care liabilities</td>
<td>State finances will remain challenged by large unfunded pension and retiree health care liabilities</td>
<td>Increases in real consumer spending growth may ease burden</td>
<td>Exports equaled 3.5% or more of state GDP in CA, IL, FL, LA, MI, NY, WA in 2015</td>
<td>Prospect of federal tax reform and revenue deferrals</td>
</tr>
</tbody>
</table>
Revenue Recovery Has Lagged Prior Economic Expansions

Source: National Association of State Budget Officers (Fiscal Survey of the States)
Downside Volatility of State Tax Revenues Has Increased

Source: US Census Bureau (Quarterly Summary of State and Local Tax Revenues)

S&P Global Ratings
States Are Institutionally Ill-Suited To Fund Entitlements

Annual Percent Change in State Tax Revenue and Medicaid Enrollment

- Change in Medicaid Enrollment
- % Change in State Tax Revenue

Source: U.S. Census Bureau, Center for Medicare and Medicaid Services
Debt Profile
State and local government debt trends are sustainable

• The state and local government sector has long exhibited sustainable debt trends.

• Debt levels had increased overall with recovery post-recession, but has trailed economic growth.

• Generally, debt service as a percentage of general spending remains manageable and small compared to other fixed costs.
Growth in new money municipal bond issuance relative to GDP

Source: S&P Global Ratings  U.S. State Debt Levels Continue to Flatline Despite State Efforts To Raise Transportation Revenues, July 17, 2017

Source: SIFMA
State Tax-Supported Debt

Source: S&P Global Ratings  U.S. State Debt Levels Continue to Flatline Despite State Efforts To Raise Transportation Revenues, July 17, 2017
U.S. State Debt Service Costs

Source: S&P Global Ratings  U.S. State Debt Levels Continue to Flatline Despite State Efforts To Raise Transportation Revenues, July 17, 2017

S&P Global
Ratings
U.S Local Government Outlook and Themes
Analytical Framework For Local GO Ratings

Institutional Framework 10%
Economy 30%
Management 20%

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

Debt & Contingent Liabilities 10%

Indicative Rating

Positive Overriding Factors
- High income levels (1 or 2 notch adjustment)
- Sustained high fund balances (1 notch adjustment)

Negative Overriding Factors
- Weak liquidity (caps rating at A- or BB+)
- Weak management (caps rating at A or BBB-)
- Lack of willingness to pay obligations (caps rating at BBB- for leases and B for debt)
- Low market value per capita (1 notch adjustment)
- Large or chronic negative fund balances (caps rating at A+, A-, or BBB)

Final GO Rating
Georgia County & Muni Rating Distributions
As of 10/31/17

Counts

- AAA: 37%
- AA+: 10%
- AA: 21%
- AA-: 10%
- A+: 3%
- A: 3%
- BBB: 3%

Municipalities

- AAA: 17%
- AA+: 17%
- AA: 31%
- AA-: 9%
- A+: 6%
- A: 20%
Hot Topics in the Southeast and Local Government More Broadly

- Hurricane/Natural Disaster Risks
- Nuclear Projects
- Changing Institutional Framework
- Continued Credit Pressures
- Bankruptcy Views

“It’s The Dawn Of A New And Less-Forgiving Era For U.S. States” April 4, 2017

“For Some U.S. State Budgets, Eleventh-Hour Negotiations Prevail” June 22, 2017

“Credit Conditions: For U.S. State And Local Governments, The Resilient But Shallow Expansion Complicates Budget Management” July 24, 2017

“Cyberattacks Pose A Real, If Varying, Credit Risk Across U.S. Public Finance Sectors” September 20, 2017

“U.S. Local Government Sector 2017 Outlook: Stable And Resilient” January 9, 2017

“The Top 10 Management Characteristics Of Highly Rated State And Local Borrowers” May 23, 2017

“U.S. State Debt Levels Continue To Flatline Despite Efforts To Raise Transportation Revenues” July 17, 2017

“How Long ‘Til We Get There? Major Post-Hurricane Recoveries In Recent Years” September 7, 2017

“Credit FAQ: Understanding Climate Change Risk And U.S. Municipal Ratings” October 17, 2017

As of November 1st, 2017
Thank you

Robin Prunty
robin.prunty@spglobal.com
212.438.2081

Geoff Buswick
geoff.buswick@spglobal.com
617.530.8311