AAA: Making the Grade in State Credit Ratings
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Please see the disclosure appendix of this publication for certification and disclosure information.
All estimates/forecasts are as of 8/4/16 unless otherwise stated.
Credit Rating Factors

- **Infrastructure borrowing has been down since 2010**

  - Borrowing from 2001-2008 was used to expand infrastructure in new locations as housing markets grew; however, there was less attention to basic maintenance and upkeep; 2009-2010 reflects the post crisis Build America Bond program.

  - Ratings are rarely downgraded because of low infrastructure investment.

  - Electoral uncertainty, tax policy uncertainty, lack of budget-making consensus in some states and economic uncertainty are not conducive to long-term infrastructure investment nor corporate capital investment.
    - For several years, anticipation that rates would be rising dominated investor thinking and volatile markets made placing bond issues more tricky.
    - With rates continuing so low for so long, refunding activity has been robust (a good factor for relieving government balance sheets).

- **The Good News: New project borrowing is picking up modestly in 2016**
The Shape of Municipal Bond Volume 2001-2008 Resembles the Housing Boom...and Was Propelled by Low Rates

- New issue volume from 2006-2010 (excluding $181 billion BABS 2009-2010) supports continued high levels of refunding in 2016. Flatter yield curve benefits advanced refunding (less negative arbitrage) and elevated new issue in 2006-2007 benefits current refundings.
- Note slight uptick in bond insurance (which has flattened in 2015/2016)

New Issue Volume (1980-2016) and the Percentage of Bond Insurance

As of July 29, 2016
Source: Bond Buyer, Assured Guaranty, Thomson Reuters and Wells Fargo Securities
New Issue Borrowing Relative to Total Issuance Has Been Down Since 2010

- However, new money issuance YTD is up about $11 billion through June, compared with H1 2015.
- New money in H1 2016 is 40% of the market total, whereas it was 34% of last year’s total for H1 2015.
- Refunding activity is down 9.1% over last year despite low rates (and a flatter yield curve).
- AMT issuance (attractive to crossover/foreign investors) is up nearly 50% over last year.

As of July 29, 2016
Source: Bond Buyer and Wells Fargo Securities
Credit Rating Factors, continued

- **Ratings have been lowered due to factors other than too much debt**
  - Underfunded pensions (Illinois, New Jersey, Pennsylvania)
  - Changes in rating agency criteria and methodologies (mainly local); for example, Moody’s change in pension criteria resulted in several cities losing their Aaa ratings: Minneapolis, Omaha
  - **Late budgets** – e.g., Illinois late budget resulted in short term default on Met Pier bonds
    - This event concerned many investors about appropriation debt
    - Illinois’ inability to resolve budget issues; Pennsylvania school program downgrades
  - April-June six state ratings/outlooks were lowered
    - Kansas, April 25 S&P put rating on negative watch; downgraded July 26
  - **Budget shortfalls** due to persistently lower receipts than forecast (Kansas) or overly ambitious estimates (New Jersey)
  - **Federal gridlock**, particularly in the transportation sector; Moody’s lowered 26 stand-alone GARVEE ratings
  - **Changing economic circumstances, i.e., oil patch states**, coupled with reluctance of policy-makers to come to decision: e.g., Alaska’s tax structure; other commodity dependent states that need to manage spending and tax policy to maintain budget balance

- **Some ratings have increased**
  - South Dakota, Tennessee and Minnesota between February 2015 and July 2016
State Rating Category Map

Moody's/S&P/Fitch/Kroll
NR = Not Rated
*No GO debt- Issuer Rating
**Appropriation backed debt rating
Last updated on 7/26/2016
Data Sources: Moody’s, Standard and Poor’s, Fitch Ratings and Kroll Bond Ratings

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Investor Reaction

- **Has there been a change in the security of municipal debt? Has willingness to pay eroded?**
  - Detroit – general obligation is unsecured and investors had to fight to protect the GO unlimited tax security
  - Illinois (Met Pier) – is appropriation debt secure? What about moral obligation debt?
  - Puerto Rico failed to pay GO bonds but made other payments. Retirees continue to be paid. This has loosened confidence in leadership and on the rule of law.
  - Investors are concerned that severely underfunded pensions will lead to cash being taken from bondholders and elsewhere in the budget to support retirement promises.

- **What to do?**
  - Clear statutory language on liens
  - Established, routine support for local governments in trouble well ahead of financial crisis goes a long way to strong ratings.
General Commentary

Municipal Market Matters: In Light of Brexit
In response to numerous questions about the effects on the municipal market of the successful vote in the UK to exit the EU, we share a few thoughts.

Municipal Market Matters: Foreign Investor Inflows
In addition to following volume and market performance we track inflows from investors outside the United States.

Bond Insurance and Distressed Municipal Credit
With pending defaults, including those “wrapped” by bond insurance, the natural question on investors’ minds is “will the insurers be able to pay?”

Lower for Longer?
We update what longer, lower oil prices mean for states, particularly those that assumed higher prices in their budgets and a temporary price decline.

State Budgets and Looking to FY 2017
As most states look to close their budget year on June 30 and look ahead to FY 2017, many continue to face ongoing challenges.

State Midyear Review: Revenue Slowdown
States overall shown improvement. But for some, there is some uncertainty as revenue is coming in below expectations.

Public Pensions

Public Pension Sleepers
Comment on three less-well-discussed public pension issues: investment allocations, governance and what the growing 80-something population means to funding levels.

State Revenues and Public Pensions
Financial markets volatility affects not only public pension asset returns and funding levels but also state revenues.

Municipal Market Matters: Puerto Rican Pensions
We discuss Puerto Rico’s extreme pension problems

Analyzing Public Pensions
This commentary explains some basic public pension factors to consider when reviewing a borrower's financial condition.

Public Pension Update
We review some important differences among measuring public pensions and other retirement benefits, recognizing assets and liabilities, analyzing and funding.

Public Higher Education Ratings and Retiree Benefits
We discuss differences among public systems of higher education, the quality of their pension funding and highlight California, Pennsylvania, New Jersey, Connecticut and Illinois.
Municipal Research
Select Reports

Infrastructure

Another Page in the U.S. P3 Restructuring Playbook
We discuss ramp up risk, restructuring with TIFIA and recent U.S. P3 concession sales.

Low Energy Prices Accelerating Air Travel Demand
This report examines the effect of lower energy prices on airport passenger growth.

Clean Power Plan Halted
The U.S. Supreme Court granted a stay on the Clean Power Plan (CPP). In this brief note, we discuss what made this decision so unexpected.

California Dreaming Infrastructure
We discuss the key drivers of this capital spending and analyze the operating environment for California’s infrastructure issuers.

Public Power: Strong Returns Medium-Term Challenges
We think the public power sector remains stable there are a number of factors that could affect credit performance within the electric utility space over the medium term.

Health Care

Health Care D.C. Download (7/6/16)
Recent news on the healthcare front.

Hospital News Whiteboard, Vol. 11
We provide brief comments on recent developments in hospital antitrust litigation and on new Republican proposals for healthcare reform.

ACA Cost-Sharing Reduction Subsidies Denied, but Appeals to Defer Impact
The U.S. District Court for the District of Columbia struck down a key aspect of the Affordable Care Act. We briefly discuss the case.

NFP Hospitals 2Q 2016 Update
Observations and a recap on the first quarter of 2016 for the hospital sector.

Long-Term Care Bond Volume Grows
Observations on bond volume in the not-for-profit long-term care space.

Higher Education

Revisiting Endowment Payouts and Taxation
This report explores the recent discussion of taxing higher educational endowments.

Public Private Partnerships in Public Higher Education
Many schools continue a trend toward development through P3s.
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Additional information is available on request.

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