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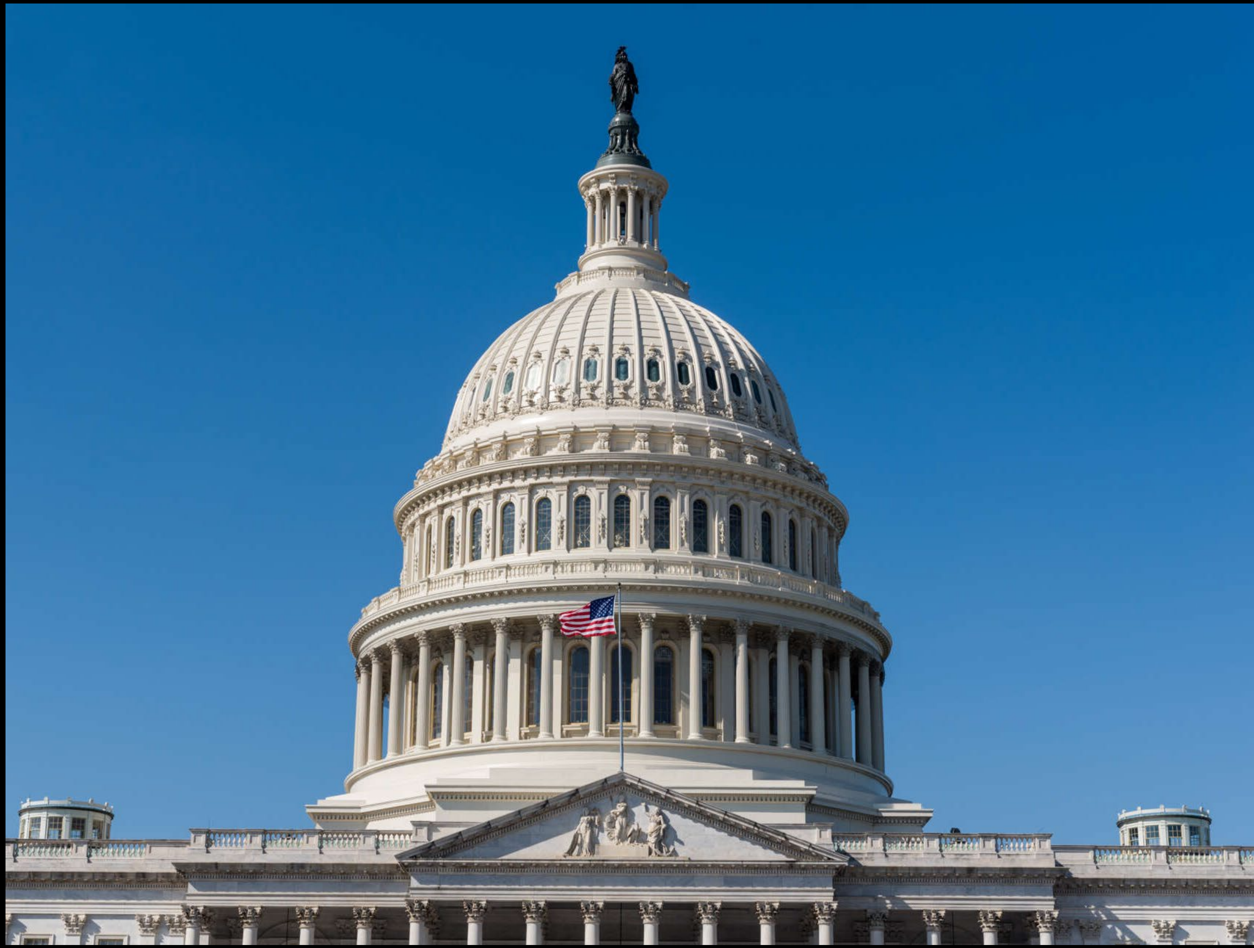

Methodology For Rating U.S. Governments
Request For Comment

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Jan. 22, 2024

This report does not constitute a rating action

U.S. Governments Request for Comment | Speakers

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RFC Feedback Process

Requesting Market Feedback

We encourage interested market participants to submit **written** comments to https://disclosure.spglobal.com/ratings/en/regulatory/ratings-criteria

Comments may also be sent to CriteriaComments@spglobal.com should participants encounter technical difficulties

The RFC webcast replay is the best source of information on the RFC and proposed criteria changes. However, we can schedule a follow-up discussion upon request

RFC comment period is 60 days

Once the RFC period closes, we will review the comments and assess whether these comments warrant changes to the proposed criteria. Therefore, we cannot give exact timing on the final criteria issuance, but we will proceed as promptly as possible.

Deadline

March 11, 2024

S&P Global Ratings' criteria are always available for free at www.spglobal.com/ratings.

Webcast Replay And Associated Articles

All resources related to the RFC can be found on our dedicated website: S&P Global Ratings U.S. Governments RFC

- A **replay** of today's webcast
- A **short video series** providing more detail on the criteria by government type
- Articles associated with this webcast:
  RFC: Request For Comment: Methodology For Rating U.S. Governments, Jan. 11, 2024
  FAQ: Frequently Asked Questions about the U.S. Governments RFC, Jan. 11, 2024

Current Criteria:

- U.S. State Ratings Methodology, Oct. 17, 2016
- U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, Sept. 12, 2013
- Key General Obligation Ratio Credit Ranges, April 2, 2008
- GO Debt, Oct. 12, 2006
- Debt Statement Analysis, Aug. 22, 2006
- Financial Management Assessment, June 27, 2006

Why are we revising our criteria?

Criteria Objectives

Consolidate criteria

by providing a single scored framework for U.S. governments including states, counties, municipalities, school districts, and special purpose districts

Increase transparency

of our methodology and assumptions to the marketplace

Improve consistency and alignment

of ratings across different U.S. governments

Enhance global comparability

across state, local, and regional governments globally

Potential Rating Impact

Expected Rating Impact

Across the approximately 10,700 public credit ratings in scope, we expect **95% will remain unchanged.** We expect rating changes generally will be **one notch up or down. For U.S. state and territory ratings, we do not expect any to change.**

For the approx. 1,000 **county** ratings:

97% — **No change**

3% — **Could change**

For the approx. 3,900 **municipality** ratings:

95% — **No change**

5% — **Could change**

For the approx. 5,100 **school district** ratings:

94% — **No change**

6% — **Could change**

For the approx. 500 **special district** ratings:

94% — **No change**

6% — **Could change**

Timing And Process For Potential Rating Changes

Timing

- The final criteria publication will depend on market feedback and any potential changes resulting therefrom.
- Once the RFC period closes, we will review the comments and see whether they warrant changes to the proposed criteria.
- We cannot give exact timing on the final criteria issuance, but we will proceed as promptly as possible.

List of potential rating changes

- On the day the final criteria are published, we will publish a list of credits that are "under criteria observation" (UCO) to identify which issuer and issue ratings could be affected by a criteria change.
- The UCO identifier will remain in place until the conclusion of the review under the changed criteria, which we expect to be within six months following the final criteria publication.

Proposed Criteria Framework

The Analytical Framework

Framework for ratings U.S. governments

Institutional framework 1

Individual credit profile (ICP) 2

Economy	20%
Financial performance	20%
Reserves and liquidity	20%
Management	20%
Debt and liabilities	20%

3

Anchor → Stand-alone credit profile (SACP) → Issuer credit rating → Issue credit rating

Modifiers and caps, when relevant

Holistic analysis, when relevant (not subject to caps)

4

Application of rating above the sovereign, when relevant

5

Application of issue criteria, when relevant

We determine the issuer credit rating (ICR) by:

1. Assessing the Institutional Framework (IF)
2. Establishing the individual credit profile (ICP)
3. Combining IF and the ICP to establish the anchor
4. When relevant, adjusting the anchor for credit-specific modifiers and caps
5. When relevant, applying our methodology for rating U.S. governments above the sovereign

Determining The Anchor

- Both the IF and ICP are scored on a ‘1’ to ‘6’ scale.
- The final assessment of the IF is rounded, while the final assessment of the ICP remains unrounded.
- The IF and the ICP are combined to determine the anchor. For instance, if a government is operating with an IF of ‘2’ and an ICP of ‘2.2’, the table outcome would be ‘aa/aa-’.

--Institutional framework assessment--	--Individual credit profile--										
	1	1.5	2	2.5	3	3.5	4	4.5	5	5.5	6
1	aaa	aaa	aa+	aa	aa-	a+	a	a-	bbb	bb+	bb-
2	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb-	bb	b+
3	aa+	aa	aa-	a+	a	a-	bbb	bbb-	bb+	bb-	b
4	aa-	a+	a	a-	bbb+	bbb	bb+	bb	bb-	b	b-
5	a	a-	bbb+	bbb	bbb-	bb+	bb-	b+	b	b-	b-
6	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-	b-	b-

If the table indicates multiple ratings, we determine the anchor by considering:

- The position within the range (closer to one versus another); and
- The expected future performance of one or several of the five ICP credit factors; or
- Any credit characteristics that may be over or understated in our analysis; or
- A peer comparison.

Institutional Framework

Institutional Framework

- The IF is the set of formal rules and laws, practices, customs, and precedents that shape the environment in which governments operate.
- We assess the IF by state and government type (i.e. states, counties, municipalities, schools).
- When the legal or practical environment for a specific local government differs from the norm in its state (portfolio assessment), we will assess accordingly.

Predictability (25%)	**Revenue/expenditure balance and system support** (50%)	**Transparency and accountability** (25%)
The ability of a government to forecast its revenues and expenditures	The ability of a government to finance the services it provides, and the degree of ongoing and exceptional support from a higher-level government	The comparability of a government's relevant financial information

Institutional Framework – What's Changing

- Relative to the existing U.S. State Ratings Methodology, the IF assessment is broader and incorporates analytical concepts from the existing Government Framework analysis. Under the proposed criteria, we will analyze each state's IF separately based on the specific laws and practices in that state.
- Relative to the existing criteria for counties and municipalities, the IF analysis is very similar. IF assessments for local governments are based on types of government within a state, such as North Carolina counties or Texas municipalities.
- The IF assessment is calibrated on a '1' to '6' scale; however, IF assessments for U.S. governments are generally in the '1' to '3' range.
- We do not expect IF assessments for U.S. governments to change frequently, highlighting the strength and stability of operating environments for U.S. governments.
- We will publish the IF portfolio assessments with the final criteria.

Framework For Establishing The Individual Credit Profile (ICP)

Step 1: Establish initial assessment

Economy 20%	Financial performance 20%	Reserves and liquidity 20%	Management 20%	Debt and liabilities 20%
State GSP % of U.S. (50%) State PCPI % of U.S. (50%)	**State** State budgetary performance over economic cycles	**State** Budget-based reserves	**State and local government** Budgeting practices (35%) Long-term planning (35%) Policies (30%)	**State and local government** Current cost for debt service and liabilities (50%) Net direct debt per capita (25%) Net pension liabilities per capita (25%)
Local government GCP % of U.S. (50%) County PCPI % of U.S. (50%)	**Local government** Three-year average operating result (%)	**Local government** Available reserves (%) of revenues		

Step 2: Apply qualitative adjustments

Economy	Financial performance	Reserves and liquidity	Management	Debt and liabilities
Local economic profile	Under or overstated operating results	Under or overstated reserves	Transparency and reporting	Under or overstated current costs
Economic volatility and concentration	Performance volatility	Projections suggest different assessment	Governance structure	Under or overstated long-term liabilities
Economic growth prospects	Projections suggest different assessment	Liquidity and contingent liability risks	Risk management, credit culture, and oversight	Projections suggest different assessment

Final factor assessments

GSP--Gross state product. GCP--Gross county product. PCPI--Per capita personal income.

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Economy

Step 1: Establish initial assessment

	1	2	3	4	5	6
State						
GSP per capita as a % of U.S. GDP per capita	>110	110-95	95-85	85-75	75-65	<65
State PCPI as a % of U.S. PCPI	>100	100-90	90-80	80-75	75-70	<70
Local government						
GCP per capita as a % of U.S. GDP per capita	>110	110-95	95-85	85-75	75-65	<65
County PCPI as a % of U.S. PCPI	>100	100-90	90-80	80-75	75-70	<70

Step 2: Qualitative adjustments

Local economic profile

Considers local government demographics, wealth, and income characteristics influencing revenue-generating capacity or expenditure demands

Economic volatility and concentration adjustment

Considers the concentration and volatility of state or local government economies over cycles

Economic growth prospects adjustment

Considers the projected economic growth patterns and other economic circumstances that could affect future revenue-generating capacity

Initial assessment:
'1' to '6' scale

- Local governments within the same county receive the same initial score.

See Table 6 in RFC.

Qualitative adjustments:

- Reflect other economic factors not in the initial assessment.
- For municipalities, schools, and special districts, the qualitative adjustments differentiate local economic characteristics that are not represented in the county-level metrics.

See Tables 7-9 in RFC.

Financial Performance

Step 1: Establish initial assessment

	1	2	3	4
State				
State budgetary performance over economic cycles	Surplus performance achieved during Economic expansion and budget balance during economic decline will be less than 50% reliant on one-time measures	Balanced operating results achieved during economic expansion and budget balance during economic decline may be more than 50% reliant on one-time measures	Balanced operating results may be achieved during economic expansion and budget balance during economic decline may be more than 75% reliant on one-time measures	Limited focus on Structural budget balance, regular deficits carried through into future fiscal years
Local government				
Three-year average operating result (%)	>3	3-0	0-(3)	(3)

Step 2: Qualitative adjustments

Adjustment for under or overstated operating results

Considers if financial performance is over or understated and would align with a different initial assessment

Performance volatility adjustment

Considers if financial performance is subject to unpredictability and would align with a worse initial assessment

Adjustment for projections that suggest different assessment

Considers whether prospective changes to current financial performance would result in a better or worse initial assessment

Initial assessment:
'1' to '4' scale

- The states' initial assessment focuses on budgetary performance over economic cycles.
- Local governments' initial assessment focuses on the three-year average operating result as reported in financial statements.

See Table 10 in RFC.

Qualitative adjustments:

- Final assessments of '5' or '6' are reached through the application of qualitative adjustments and typically reflect instances where governments exhibit structural imbalance.

See Tables 11-13 in RFC.

Reserves And Liquidity

Step 1: Establish initial assessment

State	1	2	3	4
Budget-based reserves	There is a formal budget-based reserve target relative to revenue or spending that is above 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is a formal budget-based reserve target relative to revenue or spending that is between 4% and 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is a formal budget-based reserve target relative to revenue or spending that is between 1% and 4%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is no formal budget reserve target, or reserves are funded at less than 1% over time, or there is no process for accumulating reserves. No additional reserve funds are identified or available

Local government	1	2	3	4	5
Available reserves % of revenues	>15	8-15	4-8	1-4	<1

Step 2: Qualitative adjustments

Adjustment for under or overstated reserves

Considers if reserves are over or understated and would align with a different initial assessment

Adjustment for projections that suggest a different assessment

Considers whether prospective changes to reserves would result in a better or worse initial assessment

Liquidity and contingent liability risks adjustment

Considers whether liquidity pressures could worsen initial assessment

Initial assessment:

- **States:** ‘1’ to ‘4’ scale based on a qualitative assessment of a state's budgetary reserve target and track record of replenishing reserves.
- **Local governments:** ‘1’ to ‘5’ scale based on available reserves as a percentage of revenue as reported in its most recent financial statements.

See Tables 14-15 in RFC.

Qualitative adjustments:

- For states, final assessments of ‘5’ or ‘6,’ and for local governments, final assessments of '6' are reached through the application of qualitative adjustments and typically reflect liquidity and contingent liability risks.

See Tables 16-18 in RFC.

Management

Step 1: Establish initial assessment

State and local government	1	2	3	4
Budgeting practices	Budgets are forward-looking with robust monitoring	Budgets are realistic with sufficient monitoring	Budgets are limited in scope with informal monitoring	Budgets are unrealistic and lack monitoring
Long-term planning	Robust culture of long-term planning	Some long-term planning	Informal long-term planning	No long-term planning
Policies	Robust, well-defined policies with thorough reporting	Basic policies with regular reporting	Informal policies exist with little or no reporting	No policies or policies not followed

Step 2: Qualitative adjustments

Transparency and reporting adjustment

Considers if issues with management's timely and effective disclosure of key information could worsen initial assessment

Governance structure adjustment

Considers whether the relationship between management and governing bodies or issues with the processes for making decisions or executing reforms could worsen initial assessment

Adjustment for risk management, credit culture, and oversight

Considers management's risk tolerance, oversight, or track record in adequately planning and monitoring the government's operations

Initial assessment:
'1' to '4' scale

- Each of the subfactors is scored and weighted to arrive at the initial assessment.

See Tables 19-21 in RFC.

Qualitative adjustments:

- A final assessment of '5' or '6' is reached through the application of qualitative adjustments.
- Adjustments may reflect:
  - A challenging management and governance environment,
  - A management team that is understaffed or lacks relevant skills or experience, or
  - Our view of issues related to leadership competency, knowledge, or credit culture.

See Tables 22-24 in RFC.

Debt And Liabilities

Step 1: Establish initial assessment

	1	2	3	4	5	6
State						
Current cost for debt and liabilities % of revenues	<3	3-6	6-9	9-12	12-15	>15
Net direct debt per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,000-4,500	>4,500
Net pension liabilities per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,000-4,500	>4,500
Local government						
Current cost for debt and liabilities % of revenues	<8	8-14	14-20	20-25	25-30	>30
Net direct debt per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,000-4,500	>4,500
Net pension liabilities per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,000-4,500	>4,500

Step 2: Qualitative adjustments

Adjustment for under or overstated current costs

Considers if initial assessment should be adjusted because current costs for debt and liabilities are over or understated and would align with a different initial assessment

Adjustment for under or overstated long-term debt and liabilities

Considers if initial assessment should be adjusted because long-term debt and liabilities are over or understated and would align with a different initial assessment

Adjustment for projections that suggest different assessment

Considers whether prospective changes to current costs and long-term debt and liabilities would result in a different initial assessment

Initial assessment:
'1' to '6' scale

- Current cost includes annual debt service, pension, and OPEB expenditures.
- We typically use pension information as reported under GASB standards. We do not adjust the data, but we may qualitatively adjust our assessment for plan assumptions that increase risk.

See Table 25 in RFC.

Qualitative adjustments:

- Consider whether the initial scores may be under or overstated for various reasons.

See Tables 26-28 in RFC.

Modifiers, Caps, And Holistic Analysis

Factors that generally worsen or improve the anchor	No. of notches
For local governments, effective buying income is greater than 150% of the U.S.	Improve by **1**
For local governments, small population of less than 5,000 without an offsetting economic strength	Worsen by **1**
A management assessment of '5' or worse	Worsen by **1 or more**
An excessive debt or liability burden relative to its economic base or operations	Worsen by **1 or more**
Risk of materialization of large contingent liabilities not reflected in financial information	Worsen by **1 or more**
Rapidly rising or unexpected risks	Worsen by **1 or more**
Factors that generally cap the SACP	**Category capped at**
Management assessment of '6'	**'bbb'**
Management demonstrates a current lack of willingness to pay annual appropriation debt, or support a moral obligation pledge in full or on a timely basis	**'bbb'**
Management and reserves and liquidity assessments of '6'	**'bb'**
There is a perceived change in the willingness to honor unconditional or guarantee debt in full or on a timely basis, or we believe the organization may be actively considering a bankruptcy or receivership filing	**'b'**

- Once we determine the anchor, the next step is to apply any relevant modifiers and caps.
- Individual modifiers typically improve or worsen the anchor by only one level, but for certain modifiers, analysts have more flexibility.
- The final step in the determination of the rating is consideration of a holistic adjustment. The holistic analysis is meant to capture credit nuances not already factored into the anchor.

Arriving At An Issue Credit Rating

Institutional framework

Individual credit profile (ICP)

Economy	20%
Financial performance	20%
Reserves and liquidity	20%
Management	20%
Debt and liabilities	20%

Anchor → Stand-alone credit profile (SACP) → Issuer credit rating → Issue credit rating

Modifiers and caps, when relevant

Holistic analysis, when relevant (not subject to caps)

Application of rating above the sovereign, when relevant *

Application of issue criteria, when relevant *

*** There is no change to our existing criteria approach to**

- "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions,"
- "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," and
- "Priority-Lien Tax Revenue Debt," which remain unchanged.

Thank You

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Summary Of Key Changes From Current Criteria

Key Changes From Current Criteria

U.S. states and territories	U.S. counties and municipalities	U.S. schools and special districts
Overall methodology		
Adopts a common scored framework to all U.S. governments. Introduces the anchor table, which combines the institutional framework (IF) and individual credit profile (ICP) to arrive at an anchor. Maintains weights of the five key credit factors of the ICP at 20%.	Adopts a common scored framework to all U.S. governments. Introduces the anchor table, which combines the IF and ICP to arrive at an anchor. Updates the weights for the five key credit factors of the ICP to 20%.	Adopts a common scored framework to all U.S. governments. Introduces the anchor table, which combines the IF and ICP to arrive at an anchor. Introduces a scored framework that weights the five key credit factors of the ICP at 20% each.
Institutional framework		
Certain aspects of the prior Government Framework are relocated to the IF while other aspects are included within the ICP to increase analytical consistency with local and regional governments globally.	Separates the IF assessment from the weighted factors of the government's ICP to increase analytical consistency with local and regional governments globally.	Introduces an Institutional Framework assessment for schools and special districts to provide more transparency and increase analytical consistency with local and regional governments globally.
Economy		
Analytical approach and metrics are largely the same but place more emphasis on economic outputs (GSP) and per capita personal incomes (PCPI) in initial assessments to simplify the scoring approach.	Reorients the initial assessment to reflect broader regional indicators, including gross county product (GCP) and county PCPI, rather than specific analysis of market values to improve comparability across governments.	Introduces a scored assessment that reflects broader regional indicators, including GCP and county PCPI, rather than specific analysis of market values to improve comparability across governments.
Financial performance		
Maintains same analytical approach to structural performance but becomes its own ICP factor to highlight the role financial performance plays in maintaining credit quality.	Enhances the analysis by including a three-year trend of operating results in the initial assessment to reflect financial performance over time.	Introduces a scored assessment that includes a three-year trend of operating results to reflect financial performance over time.
Reserves and liquidity		
Relocates budget reserves and liquidity by moving the factor out of budgetary performance to a separate ICP factor. This highlights the role reserves and liquidity play in paying debt service and supporting operations during times of distress.	Consolidates our analysis of reserves and liquidity into one factor of the ICP to highlight the role they play in paying debt service and supporting operations during times of distress.	Introduces a scored assessment of reserves and liquidity to highlight the role they play in paying debt service and supporting operations during times of distress.
Management		
Updates our approach from the prior Financial Management Assessment and introduces new qualitative adjustments to assess emerging risks.	Updates our approach from the prior Financial Management Assessment and introduces new qualitative adjustments to assess emerging risks.	Updates our approach from the prior Financial Management Assessment and introduces new qualitative adjustments to assess emerging risks.
Debt and liabilities		
Maintains similar analytical approach but includes annual OPEB costs in the initial assessment to better reflect the cost of these liabilities. Relies on quantitative metrics for the initial assessments and qualitative adjustments to account for funding discipline and OPEB risk to simplify the scoring approach.	Includes annual pension and OPEB costs and net pension liabilities per capita in the initial assessment. This elevates the importance of pension and OPEB costs in our analysis of a government's fixed costs.	Introduces a scored assessment of debt and liabilities to improve comparability across governments.

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