Infrastructure Investment and U.S. State Debt

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Credit Ratings: What They Are and Are Not

Are:

• Opinions about relative credit risk
• Opinion about ability & willingness of an issuer to meet financial obligations in full & on time
• Forward looking and regularly evolving
• Intended to be comparable across different sectors and regions

Are not:

• Investment advice
• Indications of market liquidity or price
• Guarantees of future credit risk
• Absolute measures of default probability
• Expected ultimate loss given default
# Standard & Poor’s Ratings Scale

<table>
<thead>
<tr>
<th>Rating</th>
<th>Interpretation</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Extremely Strong</td>
<td>Investment Grade</td>
</tr>
<tr>
<td>AA+</td>
<td>Very Strong</td>
<td></td>
</tr>
<tr>
<td>AA</td>
<td>Strong</td>
<td></td>
</tr>
<tr>
<td>AA-</td>
<td>Adequate</td>
<td></td>
</tr>
<tr>
<td>A+</td>
<td>Strong</td>
<td>Speculative Grade</td>
</tr>
<tr>
<td>A-</td>
<td>Adequate</td>
<td></td>
</tr>
<tr>
<td>BBB+</td>
<td>Vulnerable</td>
<td></td>
</tr>
<tr>
<td>BBB</td>
<td>More Vulnerable</td>
<td></td>
</tr>
<tr>
<td>BBB-</td>
<td>Highly Imminent Vulnerability</td>
<td></td>
</tr>
<tr>
<td>BB+</td>
<td>Imminent Vulnerability</td>
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</tr>
<tr>
<td>BB</td>
<td>Default</td>
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</tr>
</tbody>
</table>

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**Investment Grade**

**Speculative Grade**
U.S. State Ratings Criteria

- Government framework
- Financial management
- Economy
- Budgetary performance
- Debt and liability profile
U.S. State Ratings Criteria

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

Overriding factors
• System support
• Willingness to support debt
• Capital market access constrained
• High level of expected future debt/liabilities
• Weak financial management
• High level of risk relating to derivatives/variable rate debt

State rating

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State Debt
S&P’s View on State Debt

• We believe that state debt levels are moderate overall and that states are not laboring under unbearable debt burdens

• Debt ratios are not significantly higher now than before the Great Recession

• Aggregate tax-supported debt in the 50 states in fiscal 2012 increased by 2.8% from fiscal 2011 to $488 billion

• Median ratio of debt service to general governmental spending was 3.7% in fiscal 2012

• Unlike many sovereign governments, U.S. state debt is almost entirely issued for capital projects, not operations

• U.S. state debt is also nearly all amortizing debt
Significant demands to reinstate services, reduce taxes, and fund pension and healthcare costs should leave limited appetite for additional debt.

Finding an appropriate balance of funding infrastructure and other priorities will remain a challenge in an environment of tepid revenue growth and potential reduced federal funding.

Many states have recently had large proposed infrastructure programs, particularly for transportation, but many were downsized or not enacted.
State Debt and Liability Factors

- Tax-supported debt (TSD) per capita
- TSD as percentage of personal income
- TSD as percentage of gross state product
- Debt service as percentage of general gov. spending
- Debt amortization
- Pension funded ratio
- Pension annual funding levels
- Unfunded pension liability per capita
- Unfunded pension liability to personal income
- OPEB risk assessment
U.S. Infrastructure
U.S. Infrastructure

- The American Society of Civil Engineers’ (ASCE) latest assessment of U.S. infrastructure: D+ grade overall, D grade for highways
  - ASCE reports that 1 in 9 bridges is structurally deficient
  - The Federal Highway Administration indicates that all levels of government would need to invest $170 billion/year to significantly improve highway conditions
  - Only $91 billion per year is being spent now
U.S. Infrastructure (cont.)

• The latest EPA surveys report $384.2 billion of infrastructure needs for drinking water, and $298 billion of needs for sanitary sewer.

• The EPA surveys are used to determine the allocation of state revolving fund money the EPA appropriates to each state.

• Other professional organizations estimate even greater needs.
Overview of Infrastructure Financing

- In many cases, revenues to repay infrastructure investments will be paid by users through user fees, tolls, etc.
- In other cases, investments are funded more generally through taxes on a wider base
- Local governments and states may attempt to shift project risks through P3 structures
Typical Transportation Project Funding Options

- Federal Grant-Secured Obligations (GANs/GARVEEs)
- General Obligation Bonds (GOs)
  - Appropriation debt (Certificates of Participation - COPs)
- Sales Tax Revenue Bonds
- Gas Tax Revenue Bonds
- Motor Vehicle Registration Fee Bonds
- Enterprise Revenue Bonds
  - Airports, Ports, Parking, Toll Roads, Transit Systems
- Public Private Partnerships (P3)
  - With or without TIFIA in the capital structure
Debt analysis is a primary focus on S&P’s credit analysis

S&P’s tax-supported debt calculations include GOs, appropriation debt, and special-tax bonds such as sales, personal income and gas tax bonds

In general, the calculations will not include:

- Debt for true enterprise or self-sustaining purposes, such as toll revenue bonds
- GARVEES, if payable solely from dedicated federal revenues
- Tobacco settlement bonds, if they conform to stress scenarios and are payable exclusively from settlement revenues
- Contingent debt obligations that historically have not needed state support
Public Private Partnerships (P3s)

- Risk-sharing method used globally and becoming more popular in the U.S.
- Includes some private investment and typically a transfer of construction and operating risk to a private party
- Done as either availability or volume-based projects
  - Availability projects: state would make milestone payments and recurring availability payments, often backed by tolls, gas taxes, or appropriations
  - Volume-based projects: government receives upfront payment and allows private entity to collect project revenues
- Political Acceptance of P3s
  - Less political appetite for private concessions of existing assets
  - More appetite for new capacity construction projects, due to increased risk for start-up projects.
TIFIA loans are federal loans sometimes used as part of P3 financing.

The loans are repaid after senior debt in the cash waterfall.

Designed to make the financing more attractive. Upon a “bankruptcy related event” (BRE), TIFIA loan becomes on a parity with senior lien.

A BRE occurs if two consecutive mandatory payments missed or a bankruptcy filing.
Vehicle Miles Traveled
Relevant Recent S&P Publications

- Top 10 Investor Questions For 2013: Global Public Private Partnership Infrastructure Investment, December 5, 2012
- U.S. State Ratings Methodology, January 3, 2011
Thank You

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