



Recalibration of U.S. Public Finance Ratings

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Rating Recalibration – Key Issues

- Meaning of ratings
 - Default
 - Stability
 - Recovery
- Purpose of Recalibration
 - Increased comparability of credit risk with other sectors
 - Recalibration is not at an indication of improved credit quality



Background of Recalibration Process

- > Part of continuous effort to ensure comparability of Fitch's opinion on relative ability of entities in all sectors to meet financial commitments.
- > Recalibration effort is not unique -
 - > Fitch conducted inaugural study of municipal defaults in 1999
 - > Sector rating revisions have been made in other sectors – Banks, CDOs, RMBS, Non-Investment Grade Corporates



Key Considerations in Municipal Ratings Uplift

- > Favorable credit characteristics
- > Low overall default experience
- > Existing rating distribution
- > Outlook for credit quality with special emphasis on current environment and long-term factors
 - > Prolonged recession
 - > Continued weakness of the housing market, and more recent declines in commercial real estate
 - > Delayed impact of real estate declines on governmental revenues
 - > Increased Pension and OPEB funding requirements



Timeline

Background

- > 1999 - Fitch published “Municipal Default Risk”, which reviewed industry data on municipal defaults since 1980, and reported very low default rates.
- > 2000 – To enhance comparability with ratings in other sectors, Fitch upgraded by one-to-two notches about 25% of its tax-supported and half of its water/sewer ratings (approximately 300 ratings in total), based on findings from “Municipal Default Risk”.
- > 2003 – Fitch published “Municipal Default Risk Revisited”, which updated the 1999 study, finding no significant changes in default rates previously noted.



Timeline

Recent Recalibration Efforts

- > March 2008 – Fitch initiated a new review of its US Public Finance ratings, comparing Fitch-rated US municipal securities to other sectors, including corporations and sovereigns. Fitch also held a series of roundtable discussions with 44 issuers, investors, and intermediaries active in public finance.
- > July 31, 2008 – Fitch published “Exposure Draft: Reassessment of Municipal Ratings Framework”, which explained the findings of its review, proposed an upward revision of most tax-supported and water/sewer ratings by one-to-two notches, and solicited market feedback and commentary.
- > October 7, 2008 – Fitch announced it was deferring final determination of municipal ratings recalibration due to extraordinary turmoil in the global financial markets and the potential impact on the credit quality of U.S. municipal issuers.



Timeline

Recent Recalibration Efforts (continued)

- > March 3, 2009 - Fitch issued an update on the recalibration study, further deferring the final determination until economic and market conditions were sufficiently stabilized.
- > March 25, 2010 – Fitch announced its final determination on recalibrations (“Recalibration of US Public Finance Ratings”), identifying which ratings would be affected, how they would be changed, and the dates on which the changes would be implemented.
- > April 5, 2010 – Fitch recalibrated its ratings on the states, District of Columbia, Commonwealth of Puerto Rico, and New York City.
- > April 30, 2010 – Fitch recalibrated ratings in remaining sectors: local government tax-supported, water/sewer, public higher education, and public power (distribution-only).



Impact of Rating Recalibration

- > Broad-based upward rating adjustments subject to certain constraints
- > Upward revisions for tax-supported, water/sewer, public power (distribution only) and public higher education bonds
 - > Typically 2 notches for 'BBB-' to 'A' ratings
 - > Typically 1 notch for 'A+' to 'AA+' ratings
 - > 1 notch for special tax bonds
- > Below investment grade credits were reviewed on a case-by-case basis
- > With few exceptions, Rating Outlook and Watch designations were maintained



Ratings affected by April 2010 Recalibrations:

- > Approximately 2,100 out of 3,600 Fitch-rated US public finance ratings, on a securities basis (140,000 out of 191,000 on a CUSIP basis).
- > State and local government tax-supported debt and water/sewer, public higher education, and public power (distribution-only) revenue bonds are being recalibrated upward by one-to-two notches.
- > Sectors not affected include public power generating systems, nonprofit healthcare, private higher education, tax-exempt housing, transportation, and state revolving funds.



Final Recalibration Map

Current Rating	GO, Water Sewer, Public Power (distribution-only)	Special Tax	Public Higher Education
AAA	AAA	AAA	AAA
AA+	AAA	AAA	AA+
AA	AA+	AA+	AA
AA-	AA	AA	AA
A+	AA-	AA-	AA-
A	AA-	A+	A+
A-	A+	A	A
BBB+	A	A-	A-
BBB	A-	BBB+	BBB+
BBB-	BBB+	BBB	BBB
Below BBB-	case by case	case by case	case by case



Impact on Affected US Public Finance Rating Sectors (%)¹

	AAA	AA	A	BBB	BIG ²
Current Ratings	6	46	40	7	1
Post-Recalibration³	15	67	15	2	1

> Based on number of issuers.

(1) includes tax-supported and essential service enterprise ratings only

(2) below investment grade

(3) estimated



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