



Signs of Distress in Localities Indirect Linkage to US Rating

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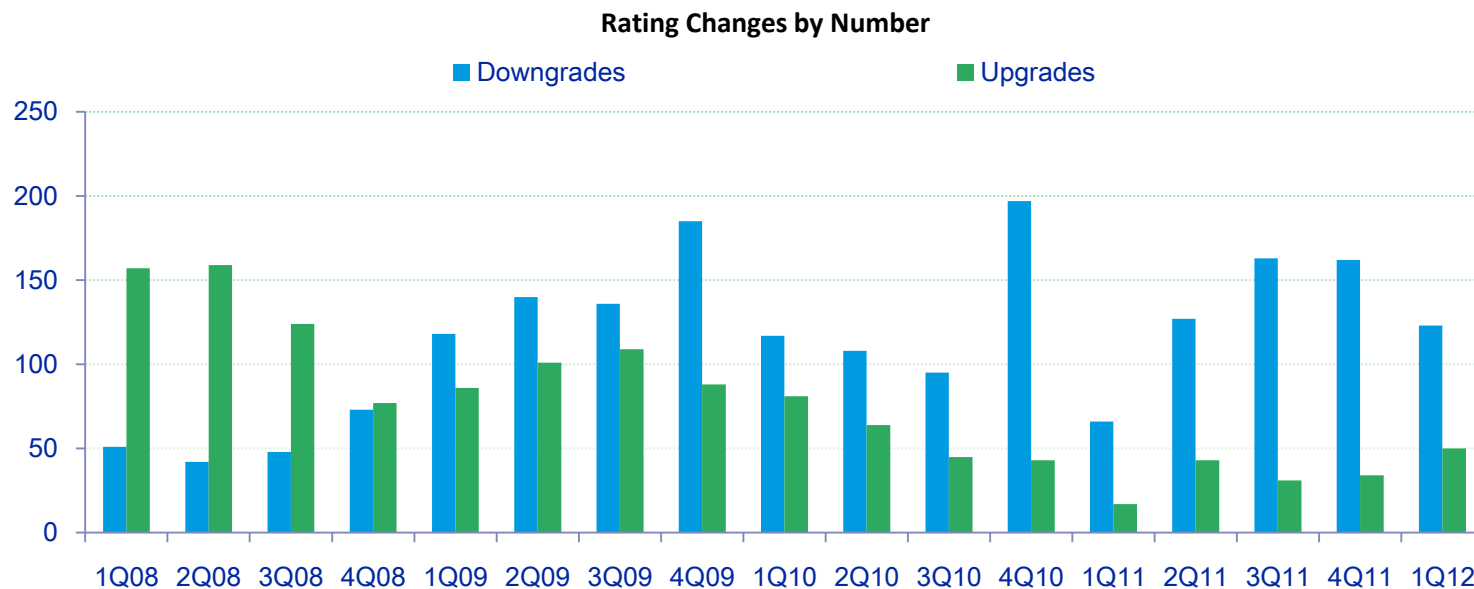
Muni Market Overview

Unprecedented Credit Stress Continues

- » Public sector finances for many issuers are materially weaker than prior to economic downturn
- » Most ratings are unchanged but downgrades are outpacing upgrades
 - This trend will continue
- » State and local defaults are expected to increase but will not be widespread

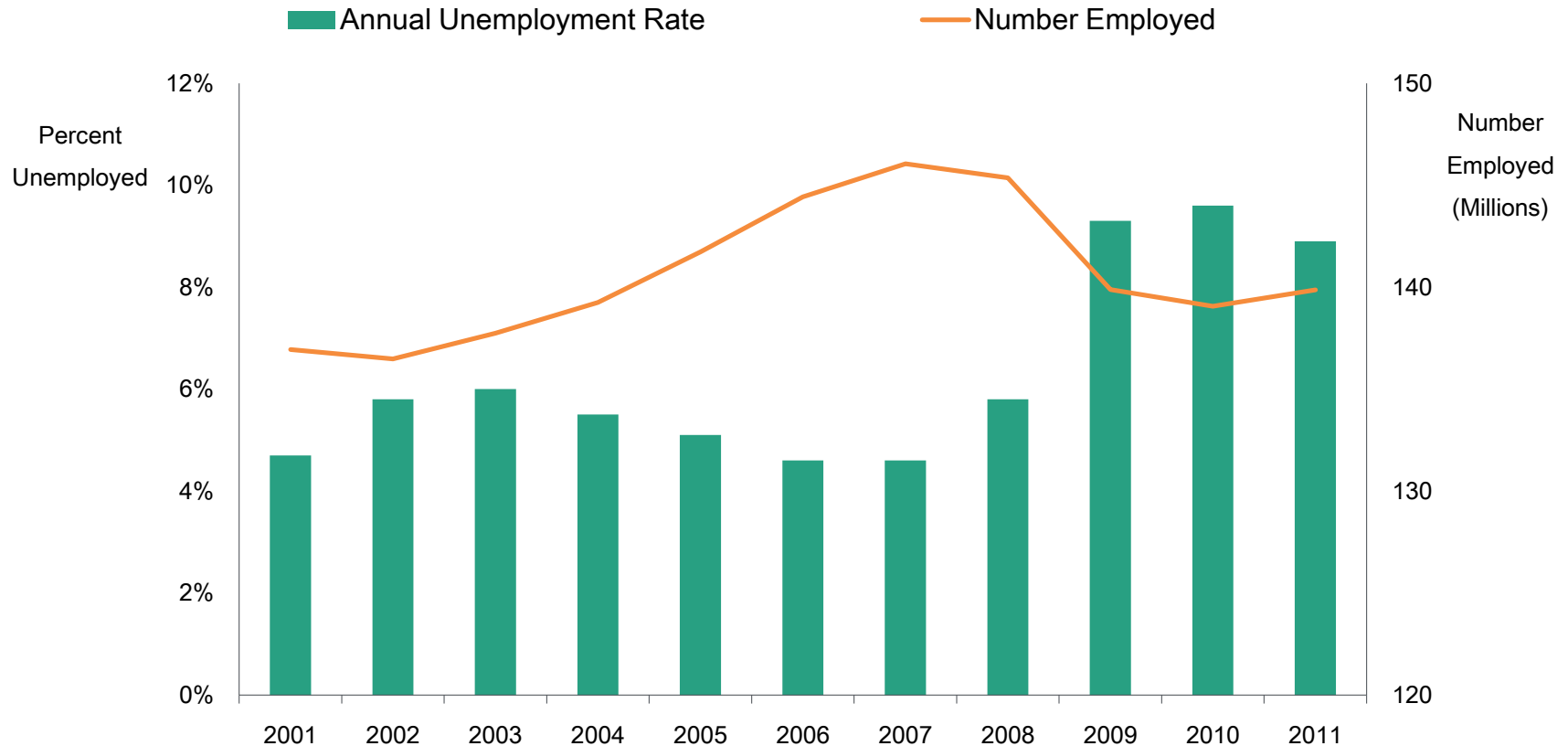
Downgrades Continue to Outpace Upgrades

- » Municipal market is broad and has diversity of credit risks
- » State and local governments continue to be stressed through the weak recovery
- » End of federal stimulus made 2011 an even more stressful year for state and local governments
- » Moody's has had negative outlooks on state and local governments for 4 years
- » Downgrades have outpaced upgrades for 13 consecutive quarters



Source: Moody's Investors Service

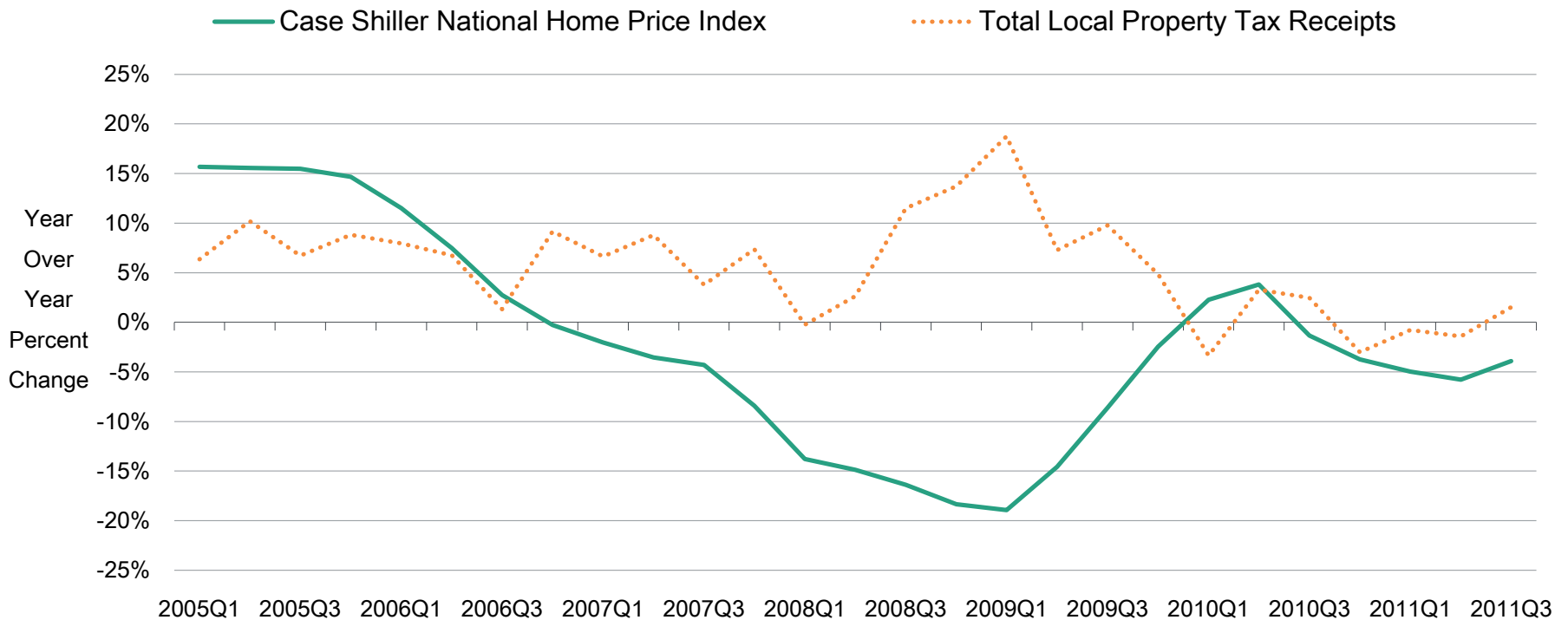
Weak National Economic Recovery is Primary Drag on Local Government Credit Quality



Source: U.S. Bureau of Labor Statistics

Property Tax Collections Lag Property Valuations

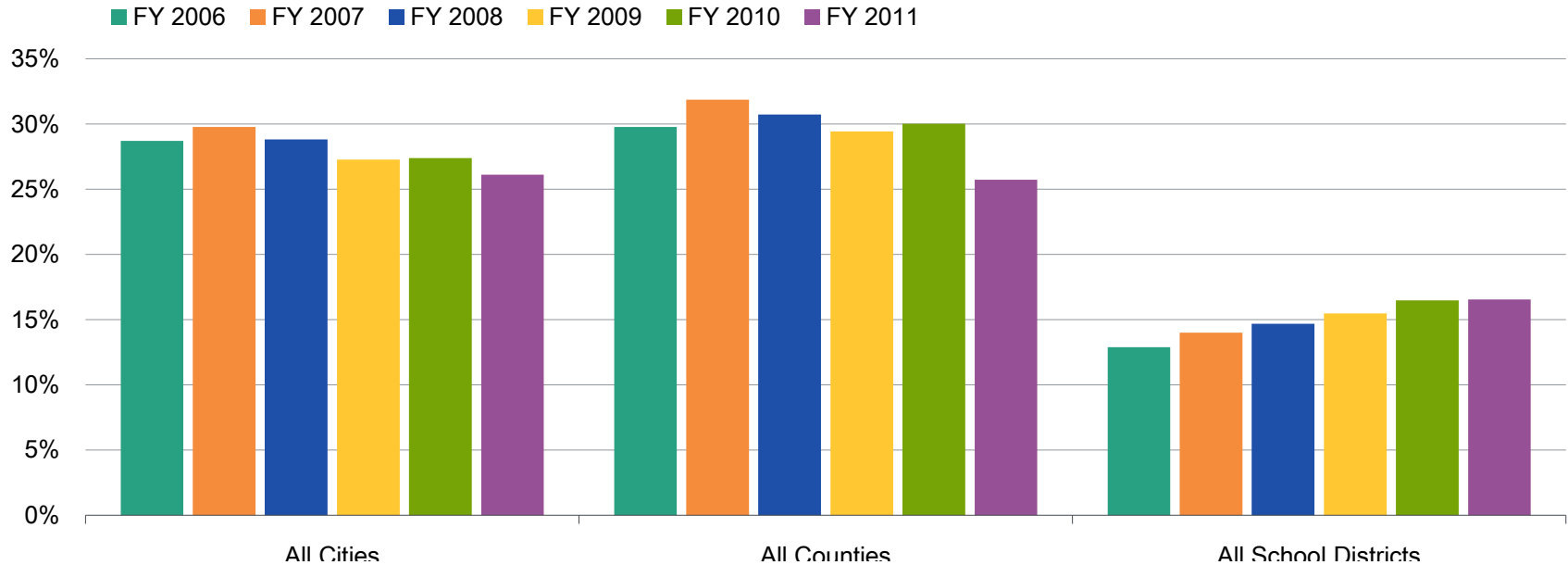
- » Tax appraisals typically occur 12 to 18 months before taxes are collected
- » Property value reductions in late 2010 and throughout 2011 are now beginning to affect local government revenues



Source: Case-Shiller Index, U.S. Census Bureau

Reduced Reserve Levels Bring Tough Choices

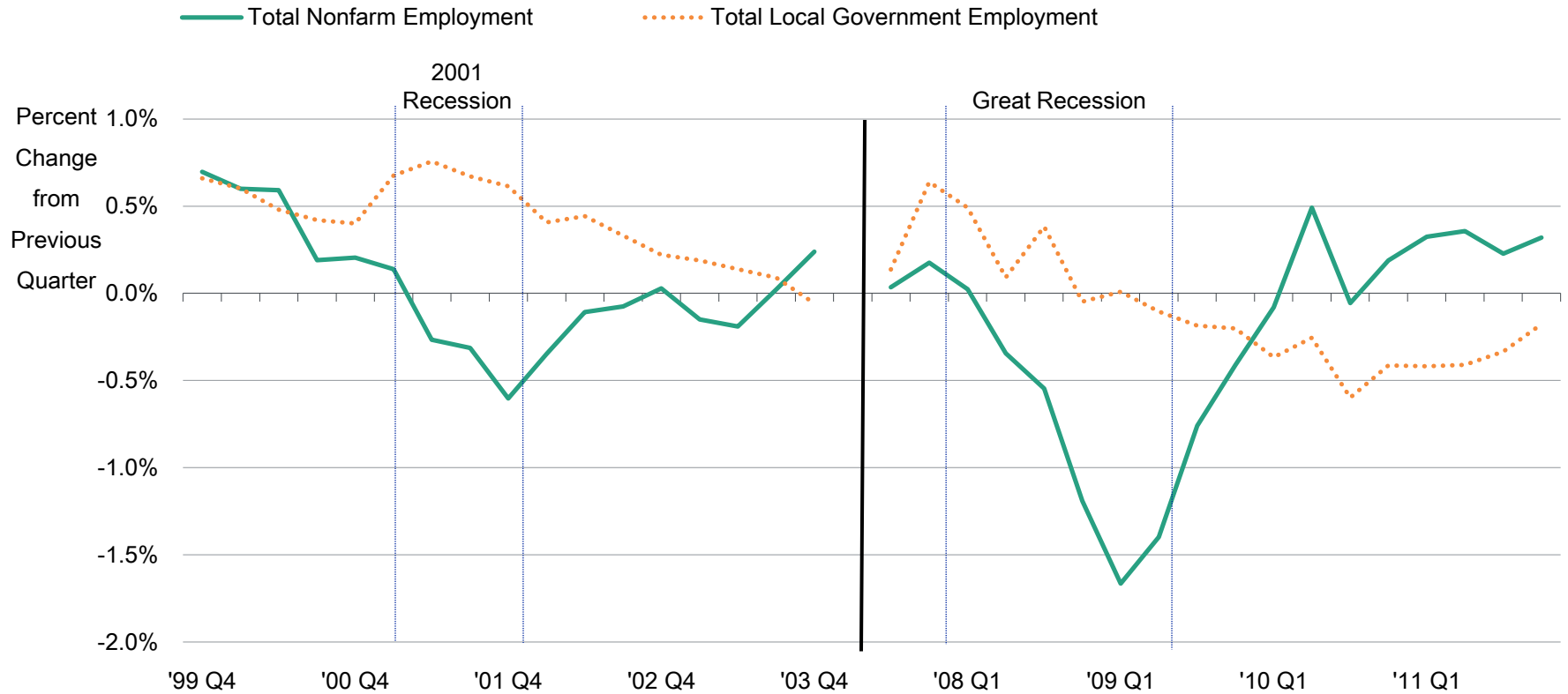
Median General Fund Balance as a Percent of Revenues



Budgetary Choices:

- » Reduce core services
- » Raise taxes
- » Further deplete reserves

Payroll is Primary Target to Reduce Expenditures

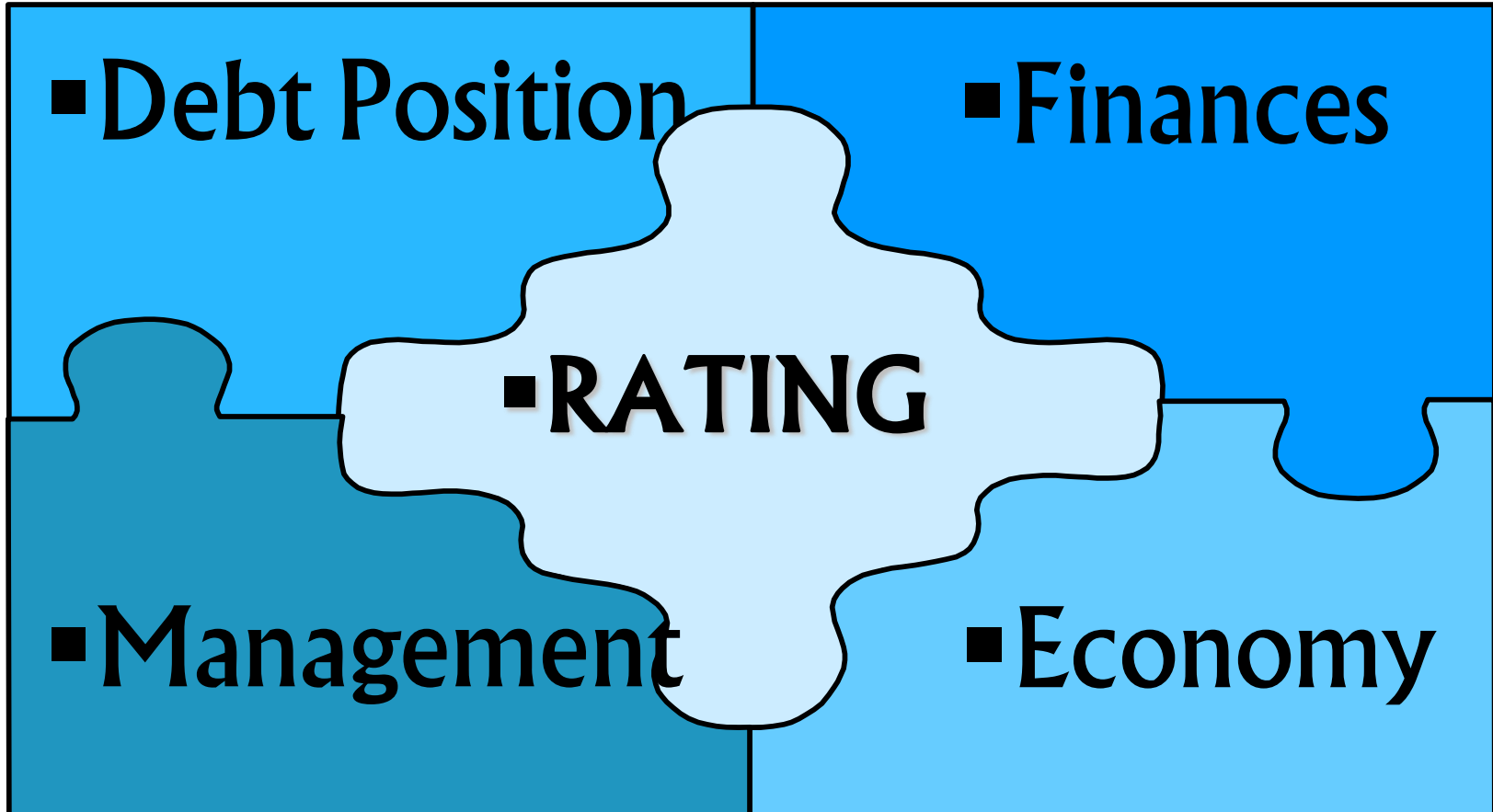


Source: U.S. Bureau of Labor Statistics

New Trend: Reducing Pension Benefits

What Are Signs of a Distressed Locality?

Moody's Long-Term Credit Factors



Signs of Distress—Tax Base & Local Economy

- » Significant changes in major taxpayer or employers
- » Taxpayer concentration, especially in a stressed industry
- » Local economy dependence on a single industry
- » Deteriorating tax collections
- » High foreclosure rates
- » Steep declines in assessed valuations
- » Steady declines in population or weakening of demographic profile

Signs of Distress—Financial Condition

- » Qualified audit opinion or unfavorable management letter
- » Declining financial margins or liquidity
- » Large or growing receivables
- » Sizeable transfers out to other funds
- » Mismatch of recurring/nonrecurring revenues and expenditures
- » Growing reliance on fund balance appropriations
- » Rising or outsized mandated or fixed costs
- » Delayed tax or utility billing
- » Deficit fund balance

Signs of Distress—Debt

- » Increased cash flow borrowing
- » Deficit financing
- » Unfavorable debt structure
- » Large amount of off-balance sheet debt
- » Significant variable-rate or derivative exposure
- » Joint venture debt
- » Debt or guarantee exposure to enterprise risk, especially with an underperforming enterprise

Signs of Distress—Management

- » Non-compliance with adopted policies or management goals and procedures
- » Unrealistic long-range plans or forecasts
- » Failure to make mid-year adjustments when necessary
- » Late audit/CAFR or missing disclosure
- » Outstanding litigation with large exposure for unfavorable settlement
- » Non-appropriation for obligations

Signs of Distress—Enterprise Risk

- » Enterprise projects add strain to local governments
 - Some previously self-supporting enterprises are not meeting projections, unable to support debt and/or operations
 - The debts of some stressed competitive enterprises are falling on local government balance sheets
 - Due to legal guarantees the governments pledged to the debt
 - Or due to political or contractual pressure to support debt or operations of the failing enterprises
 - Examples include sports facilities, convention centers, healthcare facilities
 - Also includes other types of previously self-supporting debt, such as TIF or development related obligations

Signs of Distress—Enterprise Risk

- » When the projects are sizable relative to the local government's budget, the financial impact if it falters can be pronounced
 - About one-quarter of all Moody's below investment grade-rated local government GO ratings are directly linked to enterprises that have contributed to financial strain
- » Examples
 - City of Harrisburg, PA: Guaranteed \$262 million on Harrisburg Authority debt for an incinerator project.
 - » The city began FY 2011 with only \$31 million of outstanding GO debt
 - » When incinerator net revenues were not sufficient to cover debt, the city defaulted on its GO guaranty obligation
 - City of Wenatchee, WA: Provided a backstop for interest on \$36.6M in BAN's issued by its regional public facilities district for a sports arena.
 - » The BANs defaulted (arena had cost overruns)
 - » City GOULT downgraded from Aa3 to A3/neg, then to Ba2
 - » The city asserts it lacks sufficient resources in the general fund, liquidity to borrow from other funds, and additional ad valorem levying capacity to generate funds for the interest payment

What are we watching? What could change?

- » Small, weaker local government issuers will be most stressed, some distressed
- » Risks:
 - Further state aid cuts
 - Some have exposure to enterprise risk with outsized debt levels
 - Exposure to financial institutions, liquidity and credit facilities expiring
 - Breakdown in political process that results in failure to pay debt, bankruptcy filing
 - Impact of federal debt ceiling / deficit reduction plans

Aaa/Negative Outlook

Indirect Linkage to US Government Rating

- » US Government rating: Aaa/negative outlook
- » Sovereign/Subsovereign Relationship
 - Strong legal and financial connections
 - Unusual to have subsovereign ratings higher than sovereign
 - 3 Aaa states and 118 Aaa local governments remain on negative outlook
- » Higher exposure to federal downsizing or capital market disruptions
- » Local Government Screening factors
 - Federal employment as % of total employment
 - Federal procurement contracts as % of GDP
 - Health care employment as % of total employment
 - Medicaid/public hospital expenditures as % of General Fund revenues
 - Puttable variable rate debt as % of available resources

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