

Financial Friday:  
Proposed New Special Tax  
Methodology  
April 2024

# Sector-Based Methodologies

## Recap

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US PFG has moved several government sectors into sector-based methodologies that rate certain debt instruments relative to the entity's issuer rating

US K-12 Public Schools (January 2021)

US States & Territories (March 2022)

Cities & Counties (November 2022)

On January 16, Moody's published an RFC on a proposed update to the US Special Tax Methodology that would rate certain instruments relative to the entity's issuer rating

This proposal reflects our view that the general economic, operational and financial profiles of the governments are a primary driver of credit strength or weakness for many special tax debt instruments

# Issuer and debt instrument ratings



**Issuer Rating**

Fundamental credit quality

+



**Instrument Considerations**

Evaluation of debt instrument characteristics

=



**Debt Instrument Rating**

Placed relative to issuer rating

# What is a special tax instrument?

Pledge of special taxes, fees, assessments and similar revenues - other than real property taxes

Broad	Somewhat Broad	Narrow
» Sales and use tax	» Utility income or service tax	» Hotel tax or fee
» Income or payroll tax	» Gasoline tax	» Cigarette tax
» Corporate gross receipts tax	» Restaurant food or beverage tax	» Gaming tax (other than lottery)
» Assessments on payrolls, insurance policies or other non-property bases	» Motor vehicle registration and similar surcharges or fees	» Extraction and production of natural resource tax
» Allocations of broad taxes from higher levels of government	» Liquor tax	» Real estate transaction tax
	» Lottery tax	» Parking tax
	» Allocations of somewhat broad taxes from higher levels of government	» Motor vehicle rental tax
		» Court fines and fees
		» Allocations of narrow taxes from higher levels of government



# Proposed methodology placement for special tax credits

Today

Instruments rated today using existing Special Tax Methodology

Group A

Instruments with an issuer rating assigned under:

Proposed approach

States

Cities / Counties

K-12

+

+

+

Proposed special tax instrument considerations

Group B

Instruments where issuer rating is not highly relevant

Group C

Instruments without an identifiable issuer rating

Remain in existing Special Tax Methodology

# General approach for assigning instrument ratings

## SECURITY FEATURES

Do security features enhance or detract from the revenue pledge?

## ACTIVE OR PASSIVE

Does the issuer have the ability to adjust or otherwise actively manage the pledge?

## CHARACTERISTICS OF REVENUE BASE

What is the breadth, stability, and diversity of the pledged revenue base relative to the issuer?

## DEBT SERVICE COVERAGE

What level of debt service coverage do pledged revenues provide?

## OTHER FACTORS

- Essentiality
- Other instrument specific risks or strengths

ISSUER RATING

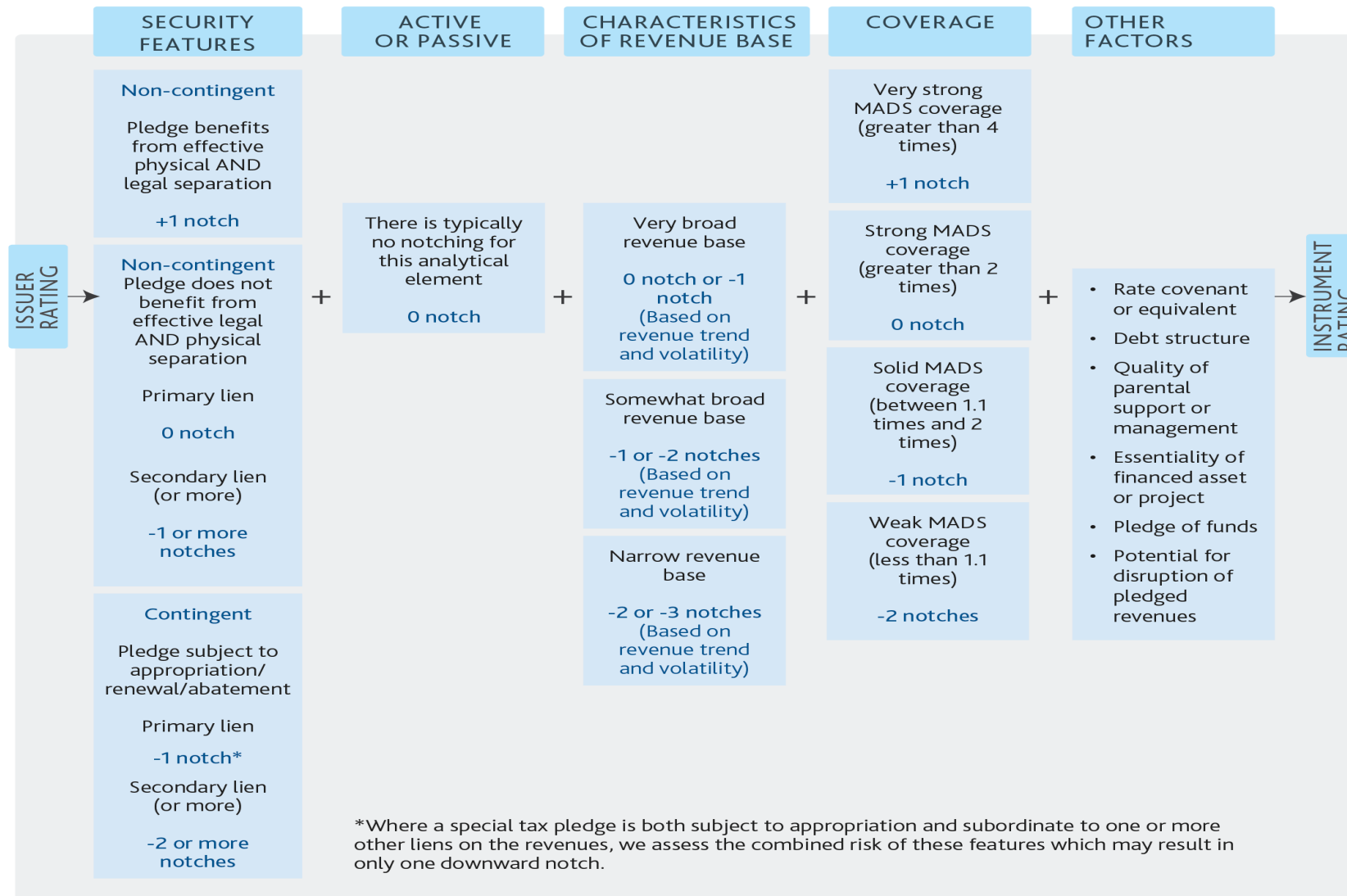
Real Property-based Pledges

Non-contingent General Promises to Pay and Contingent Obligations

Special Tax Pledges

INSTRUMENT RATING

# Special tax pledges: Illustrative notching



# Identifying the issuer rating

Instrument has an issuer rating		Instrument lacks an issuer rating
Group A	Group B	Group C
<ul style="list-style-type: none"> <li>» A government rated under the State, City &amp; County or K-12 methodology* owns the revenue and either:               <ul style="list-style-type: none"> <li>– directly pledges the revenues to bondholders, or</li> <li>– assigns revenues to a related entity (i.e., conduit issuer or component unit) that is directly controlled by the government</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>» Credit profile of the government is not a highly relevant driver for the special tax instrument               <ul style="list-style-type: none"> <li>– Ex. geographic tax base is significantly smaller</li> </ul> </li> <li>» Special tax is assigned to a related entity (i.e. conduit issuer or component unit) that is independent or governed by multiple jurisdictions</li> </ul>	<ul style="list-style-type: none"> <li>» Obligated entity is not rated under the State, City &amp; County or K-12 methodology</li> <li>» Obligor is governed by multiple governments or special taxes are pledged by multiple governments</li> <li>» Instruments issued by an entity that has meaningful operating risk that is not already captured in the Issuer Rating               <ul style="list-style-type: none"> <li>– Ex. special tax instruments issued by mass transits</li> </ul> </li> <li>» Obligor is a special purpose entity with independent authority to levy or collect pledged revenue</li> </ul>
<p><b>Proposed special tax instrument considerations</b></p>		<p><b>Existing Special Tax Methodology</b></p>

\*Where there is no issuer rating, we would assign one using the relevant state or local government sector methodology.





# Examples to be rated under new proposal

## **City Sales Tax Bonds**

*Pledge:* Senior lien on 1% of the city's authorized sales tax levied on most retail activity across the entire city

*Revenue detail:* Tax is levied by the city

## **County Sales Tax Bonds**

*Pledge:* Annual fixed allocation from the state of broad sales tax levied across the state

*Revenue detail:* Tax is levied by the state and allocated/remitted to the city as authorized by state statute

## **County Convention Center Bonds**

*Pledge:* County's local and state-shared hotel taxes

*Revenue detail:* Local hotel taxes are levied by the county and state-shared hotel taxes are levied by the state and allocated/remitted to the city as authorized by state statute



# Examples to be rated under existing Special Tax Methodology

## **Regional Transit Authority**

*Pledge:* 1% sales taxes collected throughout the city and county

*Revenue detail:* Tax is levied by the county, allocated to the transit system, and remitted directly to the trustee

*Rationale:* Independent transit board is appointed by multiple jurisdictions; operating risk of the transit system is not captured in the county issuer rating

## **Regional Convention Center Authority**

*Pledge:* Sales and hotel taxes collected throughout the city and county

*Revenue detail:* Tax is levied by the city and the county and assigned to the trustee through the conduit issuer

*Rationale:* The taxes are levied by multiple jurisdictions and therefore one issuer rating from which the instrument rating would be notched cannot be determined

## **City Center Mall Project**

*Pledge:* Sales taxes levied only at one specific mall, not city-wide

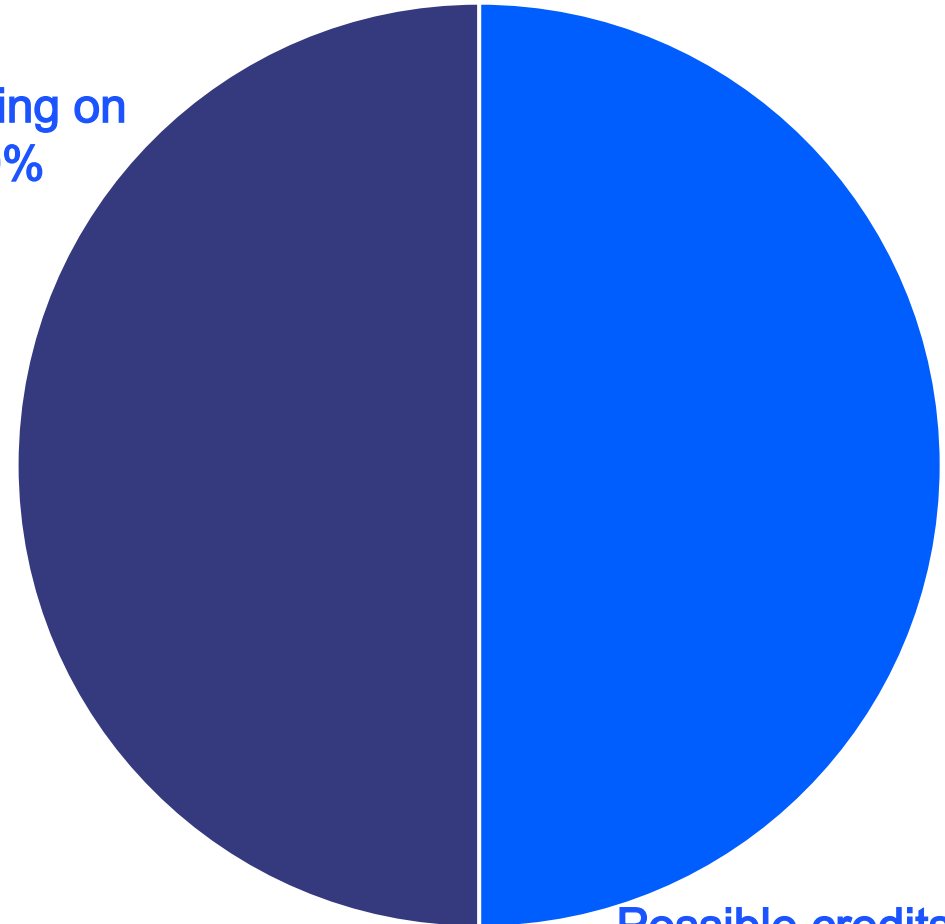
*Revenue detail:* Tax is levied by the state and remitted to the city monthly

*Rationale:* The taxes are levied on a geographic area significantly more narrow than the obligor's overall economic base

# Possible ratings impact if methodologies updated as proposed:

- » Approximately 50% of credits in the existing special tax methodology would be placed on review for possible upgrade or downgrade
- » Most would go on review for possible upgrade, and we expect most rating changes would be by one notch

Credits not going on review 50%



Possible credits going on review for rating change 50%

# Methodology development process



Develop  
methodology  
proposal



Publish  
Request for  
Comment



Receive market  
feedback



Consider  
comments



Publish final  
methodology

# Questions and Answers

# Thank you

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