



Moody's GO and Lease Methodologies Explained

Florida School Finance Officers Association (FSFOA)

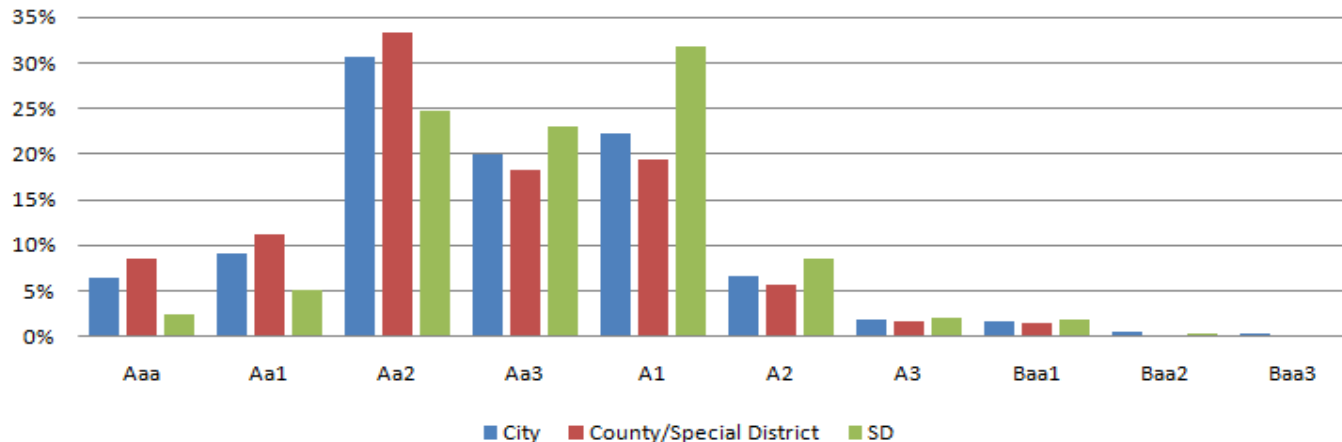
General Obligation Bonds

- This methodology focuses on local government ratings based on the General Obligation unlimited tax security
 - The methodology is based on a “typical” general obligation unlimited tax pledge
 - Contractual full faith and credit pledge of unlimited ad valorem taxing power
 - Specific definitions may vary by state

General Obligation Bonds – Rated Universe

- GO is the most commonly used security by local governments in the US
- We rate approximately 8,300 local government GO credits
- Strong sector due to the potency of the ad valorem taxing power, amortizing debt structures, and overall stable institutional frameworks
- Current ratings range from Aaa to Caa3
 - Sector median is Aa3
 - Only 2% rated Baa1 or below

Current Local Governments Ratings Distribution



Our GO Scorecard

| Factor 1 Economy/Tax Base | Factor 2 Finances | Factor 3 Management | Factor 4 Debt/Pensions |
|------------------------------|----------------------|------------------------|---------------------------|
| 30% | 30% | 20% | 20% |

Our GO Scorecard

Purpose and Use of the Scorecard:

- Enhances the transparency of our rating process
- Captures the key considerations that correspond to particular rating categories
- Not an exhaustive list of factors that we consider in every local government rating
- Each subfactor is a quantitative metric
- May notch up or down from the scorecard-indicated rating based on the additional below-the-line factors
- The scorecard acts as a starting point for a more thorough and individualistic analysis
- Final rating is determined by a Rating Committee

Our GO Scorecard Overview - Factors, Subfactors and Weights

| Factors & Sub-Factors | Weights |
|--|------------|
| Factor 1: Economy/Tax Base | 30% |
| Full Value (market value of taxable property) | 10% |
| Full Value per Capita | 10% |
| Median Family Income | 10% |
| Factor 2: Finances | 30% |
| Fund Balance as % of Operating Revenue | 10% |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 5% |
| Cash Balance as % of Revenues | 10% |
| 5-Year Dollar Change in Cash Balance as % of Revenues | 5% |
| Factor 3: Management | 20% |
| Institutional Framework | 10% |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures | 10% |
| Factor 4: Debt/Pensions | 20% |
| Net Direct Debt / Full Value | 5% |
| Net Direct Debt / Operating Revenue | 5% |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value | 5% |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues | 5% |

Scorecard Factor 1: Economy/Tax Base – 30%

| | <i>Very Strong</i> | <i>Strong</i> | <i>Moderate</i> | <i>Weak</i> | <i>Poor</i> | <i>Very Poor</i> | |
|-------------------------------|---------------------|--------------------------|-------------------------|-------------------------|-------------------------|----------------------|---------------|
| | Aaa | Aa | A | Baa | Ba | B & Below | Weight |
| ECONOMY/TAX BASE (30%) | | | | | | | |
| Tax Base Size: Full Value | > \$12B | \$12B ≥ n > \$1.4B | \$1.4B ≥ n > \$240M | \$240M ≥ n > \$120M | \$120M ≥ n > \$60M | ≤ \$60M | 10% |
| Full Value Per Capita | > \$150,000 | \$150,000 ≥ n > \$65,000 | \$65,000 ≥ n > \$35,000 | \$35,000 ≥ n > \$20,000 | \$20,000 ≥ n > \$10,000 | ≤ \$10,000 | 10% |
| Socioeconomic Indices: MFI | > 150% of US median | 150% to 90% of US median | 90% to 75% of US median | 75% to 50% of US median | 50% to 40% of US median | ≤ 40% of US median | 10% |

- The tax base is the source of most local government revenues
- Full value: The market value of taxable property accessible to the municipality
- Full value per capita: scales tax base strength to the number of residents
- Median Family Income (MFI): Important measure of the strength and resiliency of a tax base

Scorecard Factor 2: Finances – 30%

| | <i>Very Strong</i> | <i>Strong</i> | <i>Moderate</i> | <i>Weak</i> | <i>Poor</i> | <i>Very Poor</i> | Weight |
|---|---|---|---|---|---|---------------------------|---------------|
| | Aaa | Aa | A | Baa | Ba | B & Below | |
| FINANCES (30%) | | | | | | | |
| Fund Balance as % of Revenues | > 30.0% > 25.0% for School Districts | 30.0% ≥ n > 15.0% 25.0% ≥ n > 10.0% for SD | 15.0% ≥ n > 5.0% 10.0% ≥ n > 2.5% for SD | 5.0% ≥ n > 0.0% 2.5% ≥ n > 0.0% for SD | 0.0% ≥ n > -2.5% 0.0% ≥ n > -2.5% for SD | ≤ -2.5% ≤ -2.5% for SD | 10% |
| 5-Year Dollar Change in Fund Balance as % of Revenues | > 25.0% | 25.0% ≥ n > 10.0% | 10.0% ≥ n > 0.0% | 0.0% ≥ n > -10.0% | -10.0% ≥ n > -18.0% | ≤ -18.0% | 5% |
| Cash Balance as % of Revenues | > 25.0% > 10.0% for School Districts | 25.0% ≥ n > 10.0% 10.0% ≥ n > 5.0% for SD | 10.0% ≥ n > 5.0% 5.0% ≥ n > 2.5% for SD | 5.0% ≥ n > 0.0% 2.5% ≥ n > 0.0% for SD | 0.0% ≥ n > -2.5% 0.0% ≥ n > -2.5% for SD | ≤ -2.5% ≤ -2.5% for SD | 10% |
| 5-Year Dollar Change in Cash Balance as % of Revenues | > 25.0% | 25.0% ≥ n > 10.0% | 10.0% ≥ n > 0.0% | 0.0% ≥ n > -10.0% | -10.0% ≥ n > -18.0% | ≤ -18.0% | 5% |

- Fund Balance (10%) – the net financial resources available in the short term
- Cash Balance (10%) – the paramount liquid resource available; excludes accruals
- 5-Yr. \$ Change in Fund Balance and Cash Balance as % of Revs (each 5%)
 - Incorporated to capture trend information; avoids overweighting point-in-time data
 - The focus here is on whether financial reserves and liquidity are increasing in step with budgetary growth

Scorecard Factor 3: Management – 20%

| | <i>Very Strong</i> | <i>Strong</i> | <i>Moderate</i> | <i>Weak</i> | <i>Poor</i> | <i>Very Poor</i> | |
|--|--|---|---|--|---|--|---------------|
| | Aaa | Aa | A | Baa | Ba | B & Below | Weight |
| MANAGEMENT (20%) | | | | | | | |
| Institutional Framework | Very strong legal ability to match resources with spending | Strong legal ability to match resources with spending | Moderate legal ability to match resources with spending | Limited legal ability to match resources with spending | Poor legal ability to match resources with spending | Very poor or no legal ability to match resources with spending | 10% |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures | > 1.05x | 1.05x ≥ n > 1.02x | 1.02x ≥ n > 0.98x | 0.98x ≥ n > 0.95x | 0.95x ≥ n > 0.92x | ≤ 0.92x | 10% |

- Overall factor weight maintained at 20%
- Institutional Framework
 - Focuses on issuers' legal ability to match revenues with expenditures based on their legal apparatus
 - Standard inputs determined for each state/sector combination; revisited annually for possible updates
- Operating History
 - Measures the degree that an issuer has demonstrated the practical ability and willingness to match revenues with expenditures
 - Input: Five-year average of the ratio of operating revenues to operating expenditures

Scorecard Factor 4: Debt/Pensions – 20%

| | <i>Very Strong</i> | <i>Strong</i> | <i>Moderate</i> | <i>Weak</i> | <i>Poor</i> | <i>Very Poor</i> | |
|---|--------------------|-------------------|-----------------|----------------|---------------|----------------------|---------------|
| | Aaa | Aa | A | Baa | Ba | B & Below | Weight |
| DEBT/PENSIONS (20%) | | | | | | | |
| Net Direct Debt / Full Value | < 0.75% | 0.75% ≤ n < 1.75% | 1.75% ≤ n < 4% | 4% ≤ n < 10% | 10% ≤ n < 15% | > 15% | 5% |
| Net Direct Debt / Operating Revenues | < 0.33x | 0.33x ≤ n < 0.67x | 0.67x ≤ n < 3x | 3x ≤ n < 5x | 5x ≤ n < 7x | > 7x | 5% |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value | < 0.9% | 0.9% ≤ n < 2.1% | 2.1% ≤ n < 4.8% | 4.8% ≤ n < 12% | 12% ≤ n < 18% | > 18% | 5% |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues | < 0.4x | 0.4x ≤ n < 0.8x | 0.8x ≤ n < 3.6x | 3.6x ≤ n < 6x | 6x ≤ n < 8.4x | > 8.4x | 5% |

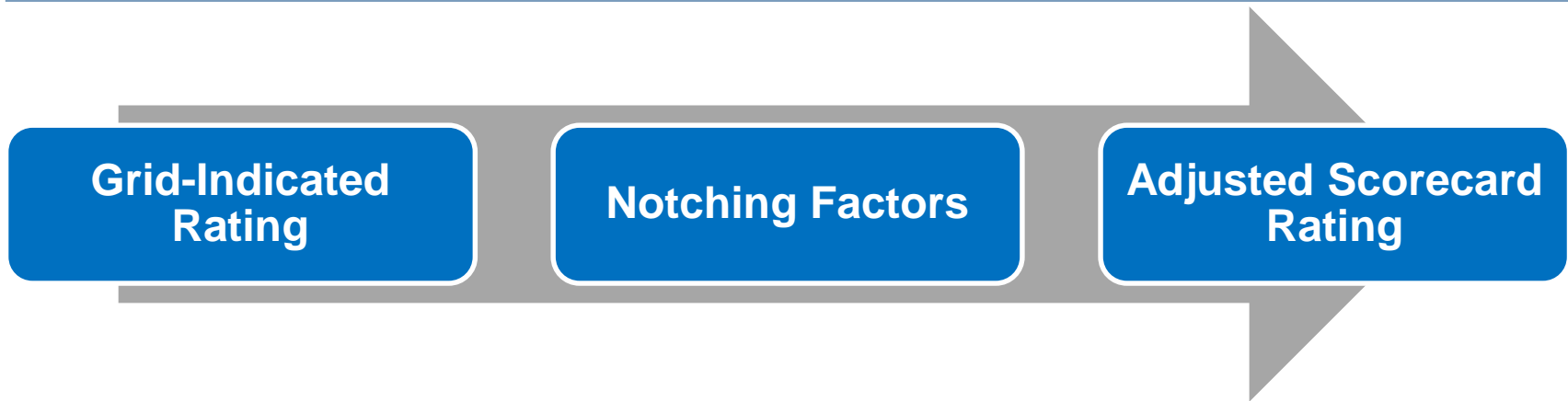
- Specific metrics proposed:

- Debt: Measures the magnitude of debt obligations relative to resources (using the tax base as a proxy) and operations (using operating revenues as a proxy)
- Pensions: Utilize Moody's adjusted net pension liability metrics

GO Scorecard - Notching Factors

| Adjustments/Notching Factors | |
|---|------------------|
| <u>Description</u> | <u>Direction</u> |
| Economy/Tax Base | |
| Institutional presence | up |
| Regional economic center | up |
| Economic concentration | down |
| Outsized unemployment or poverty levels | down |
| Other analyst adjustment to Economy/Tax Base factor (specify) | up/down |
| Finances | |
| Outsized contingent liability risk | down |
| Unusually volatile revenue structure | down |
| Other analyst adjustment to Finances factor (specify) | up/down |
| Management | |
| State oversight or support | up/down |
| Unusually strong or weak budgetary management and planning | up/down |
| Other analyst adjustment to Management factor (specify) | up/down |
| Debt/Pensions | |
| Unusually strong or weak security features | up/down |
| Unusual risk posed by debt/pension structure | down |
| History of missed debt service payments | down |
| Other analyst adjustment to Debt/Pensions factor (specify) | up/down |
| Other | |
| Credit event/trend not yet reflected in existing data sets | up/down |

Applying the Analytical Factors



- Analysts will score each subfactor in the grid
- The weighted average of the analyst-assigned scores will determine a raw score that maps to Moody's rating scale → the grid-indicated rating
- Analyst and Rating Committee will determine any notching factors → the adjusted scorecard rating
- The final public rating may differ from the adjusted scorecard rating

Under our Proposal for New Lease Methodology, What's Staying the Same?—Our Fundamental Rating Approach

- » No change to how Florida COPs are viewed
- » Starting point: the obligor's general obligation rating using the relevant methodology
 - US Local Government General Obligation Debt published in 2014
- » Notch downward from the GO rating, primarily for essentiality and legal structure
 - **Essentiality:** An estimate of how important an asset/project is to the obligor in fulfilling its governmental mission, with consideration given to both the nature of the asset and the nature of the government obligor
 - **Legal structure** of the transaction in terms of the administrative steps the obligor covenants to engage in related to the annual appropriation of the funds used for debt service
- » Incorporate “additional considerations” into final rating assignment

Essentiality Matrix

Essentiality Categories by Asset Type

More Essential to Government Operations

Affordable housing

Continuing care centers/nursing homes

Courthouses

Jails

Landfills

Libraries

Parking garages attached to essential facilities

Parks

Police and fire stations

Roads, streets, and interchanges

School buildings

Water and sewer system facilities

Less Essential to Government Operations

Animal shelters

Community centers

Convention centers

Golf courses

Hotels

Ice rinks

Marinas

Miscellaneous economic development projects

Parking garages attached to non-essential facilities

Sports stadiums

Theaters and concert halls

Undeveloped land

Notching Guide

- » The scoring of the weakest, key rating factor determines the notching guidance within the range established for each security (0-2 for lease-backed and annual appropriation ordinances; 2-4 for moral obligations)

Notching Guide for Lease, Appropriation, and Moral Obligations

| Security Type | Lease-backed/Annual Appropriation | | | Moral Obligation | | | |
|--------------------------------|-----------------------------------|---------|------|------------------|---------|------|------|
| Essentiality | More | | Less | More | | | Less |
| Legal structure | Strong | Average | Weak | Strong | Average | Weak | |
| <i>Notches from GO rating:</i> | | | | | | | |
| Zero | X | | | | | | |
| One | | X | | | | | |
| Two | | | X | X | | | |
| Three | | | | | X | | |
| Four | | | | | | X | X |

- » Final rating outcome incorporates all additional considerations

Additional Considerations

» Political

- Unusual political risk (-)

» Structural

- Absence/presence of debt service reserve
 - » Absence of debt service reserve is a credit negative for abatement leases (-)
 - » Debt service reserve is a positive consideration for annual appropriation leases (+)
- Absence/presence of standard insurance provisions for leased asset (-/+)
- Final debt maturity extends beyond the lease term (-)
- Unusual construction/procurement risk (sufficiency of capitalized interest) (-)
- Third-party bankruptcy risk (-)

» Financial

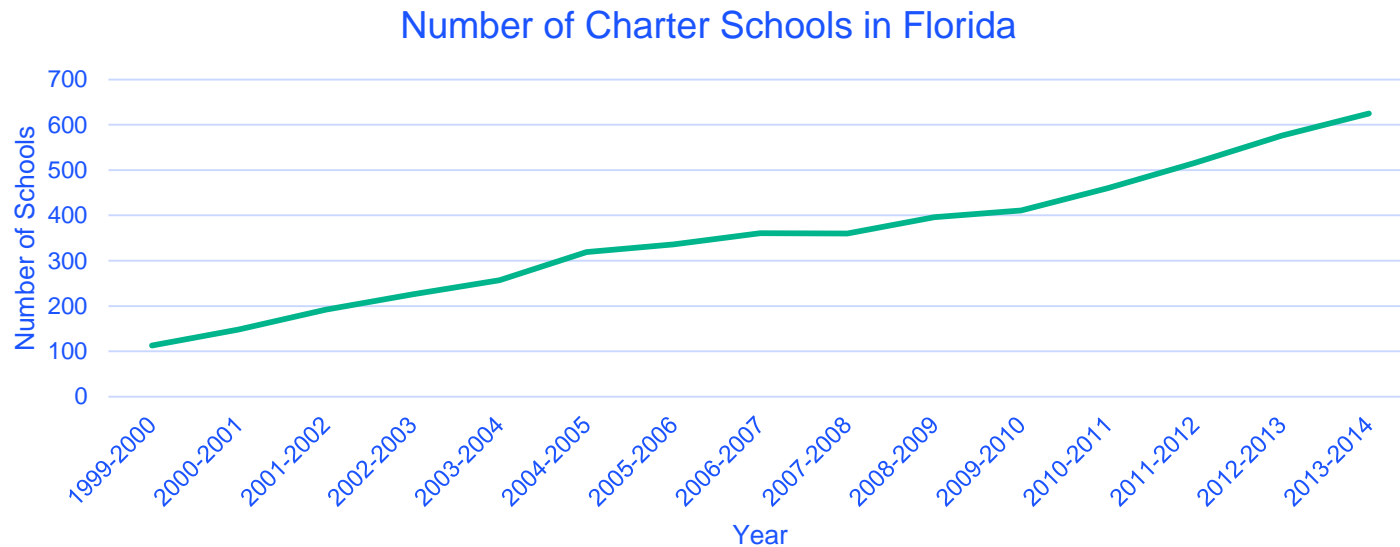
- Obligor expects the project/lease to be “self-supporting” from project revenues or project-related growth in other, general revenues (-)
- Non-pledged, designated debt service support from a Moody’s-rated, investment grade enterprise or revenue source (+)
- Unusually high or low fixed cost burden on the general government obligor, including explicit consideration of lease burden overall and from the specific, rated borrowing (-/+)

» Other

- Reputational/economic risk; likelihood of above average continued willingness to pay to preserve market access and low borrowing costs (+)
- Payment/default history (-)

Charter Schools

- » Charter schools are now a significant competitor for public K-12 school districts in many states, including Florida



Source: National Alliance for Public Charter Schools

- » Total charter schools in Florida have more than tripled in the last twelve years to 625 in fiscal 2014 serving 230,000 students
- » 6,440 charter schools in the United States

Charter Schools

- » Four key credit risk drivers for traditional public school districts
 - » Weak demographics and district financial stress
 - » Weak capacity to adjust operations in response to charter growth
 - » State policy frameworks that support charter school growth
 - » Lack of integration with a healthier local government

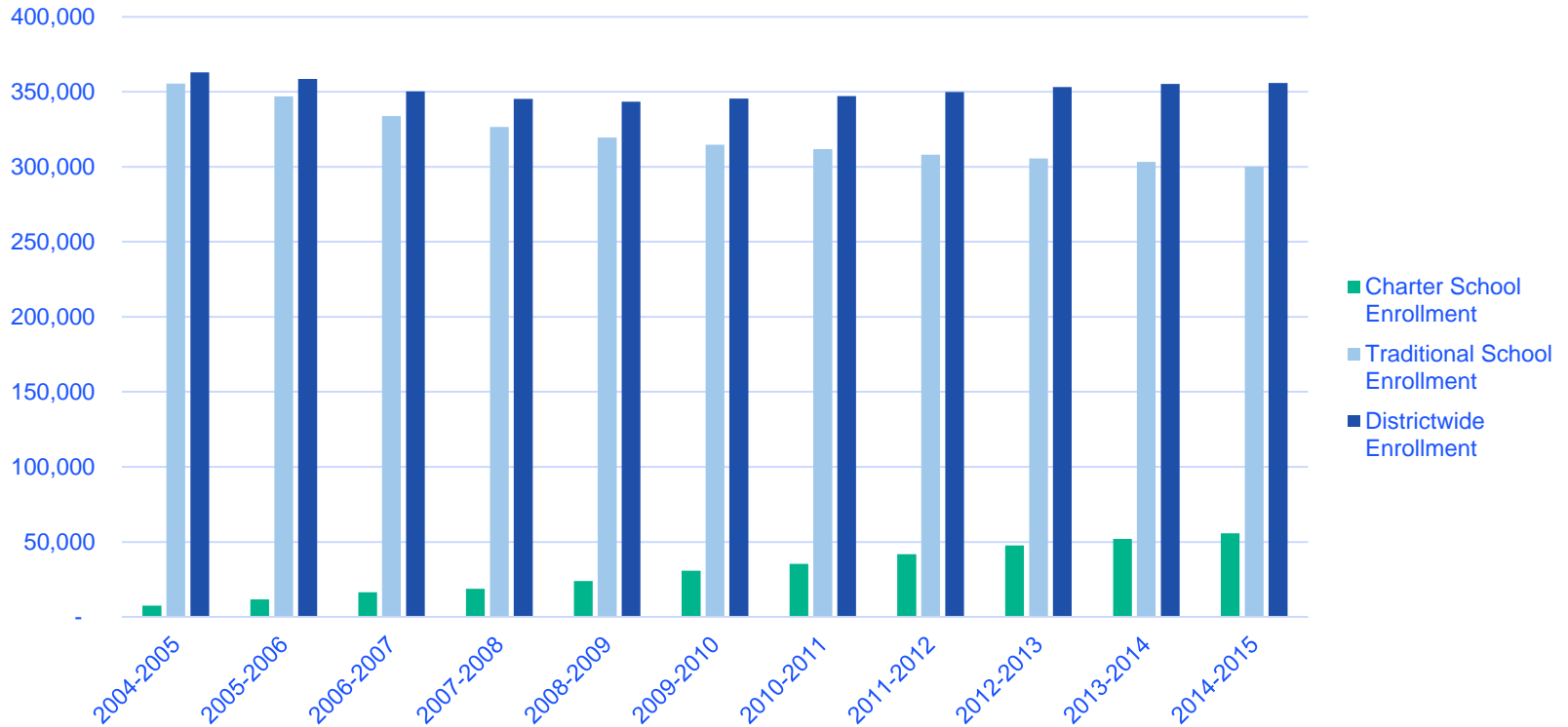
Charter Schools

- » Weak demographics and district financial stress
 - » Outsized effect on urban public school systems, particularly in Northeast and Midwest
 - » Districts with declining enrollment at greater risk

Charter Schools

» Despite moderate enrollment declines, Miami Dade County School District manages Charter School pressures

Miami Dade County Enrollment



Charter Schools

- » Weak capacity to adjust operations in response to charter growth
 - » Barriers to cutting staff, closing schools when students depart for charters
 - » Enrollment declines are spread across facilities and grade levels which can make consolidation difficult
 - » Contractual bargaining agreements can impair staff reductions

Charter Schools

- » State policy framework that supports charter school growth
 - » Local school districts are primary charter school authorizers
 - » Florida allows for multiple authorizers
 - » National Alliance for Public Charter Schools annually ranks each state for how supportive their legal frameworks are to charters; Florida ranked 8th in 2014
 - » Negative pressure can arise under a variety of funding approaches

Charter Schools

- » Lack of integration with a healthier local government
 - » High level of integration (where the district is a component unit of the city or county) can provide insulation from charter school pressures
 - » Florida school districts are independent, but coterminous with counties; can benefit from being large

| | Aaa | Aa | A |
|--|-------------|--------------|--------------|
| Florida median tax base <i>(in 000s)</i> | N/A | \$51,334,581 | \$17,961,188 |
| US median tax base <i>(in 000s)</i> | \$8,552,630 | \$3,338,412 | \$819,404 |

Greg Lipitz

(212) 553-7782

Gregory.Lipitz@moodys.com

Valentina Gomez

(212) 553-4861

Valentina.Gomez@moodys.com



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