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Government Ratings

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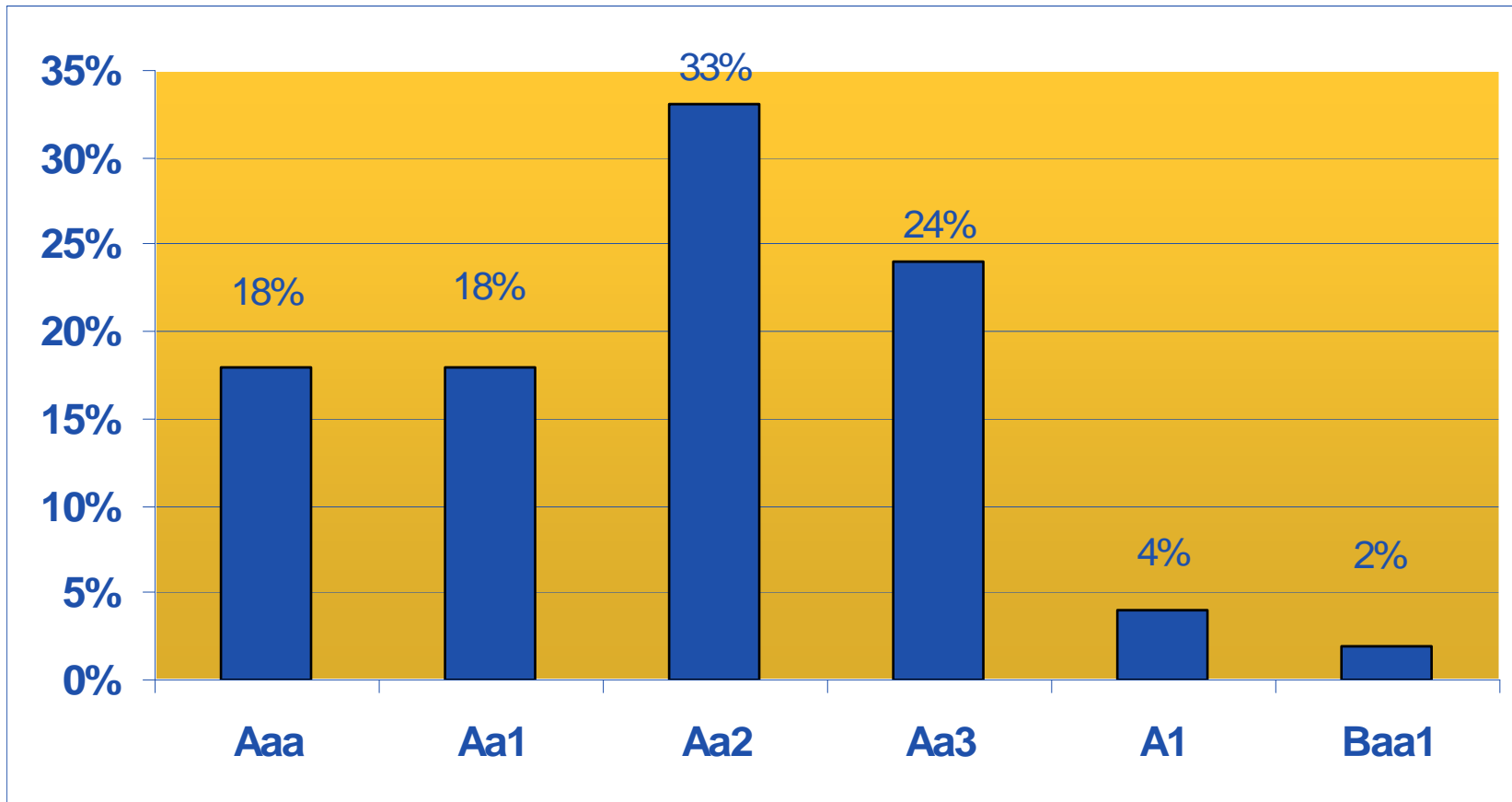
**State of the U.S. States:  
Impact of “Great Recession” Lingers**

**NAST Issues Conference  
New York**

# How Recession Has Affected State Ratings



## Distribution of Current State G.O. Ratings



» 39 General Obligation Ratings

» 7 Issuer Ratings

## Rating Downgrades Reflect Recessionary Pressure

Rating Actions	2001	2002	2003	Subtotal		2007	2008	2009	Subtotal
Upgrades	1	0	1	2		5	1	0	6
Positive Outlook Changes	0	3	0	3		5	0	4	9
Positive Watchlist Actions	2	1	3	6		0	0	0	0
<b>Downgrades</b>	<b>4</b>	<b>2</b>	<b>8</b>	<b>14*</b>		<b>1</b>	<b>0</b>	<b>5</b>	<b>6**</b>
Negative Outlook Changes	12	8	3	23		6	5	7	18
Negative Watchlist Actions	2	2	6	10		0	0	5	5

» **2001-2003: Sudden sharp decline; rapid rebound**

» **2007-2009: Slower, but deeper decline; slow rebound expected**

» **Federal fiscal stimulus has cushioned the fall**

» **More negative rating actions to come**

**\* affecting 10 states**

**\*\* affecting 5 states**

## State Sector Outlook is Negative

States With Negative Outlooks	
<u>State</u>	<u>Rating</u>
Arizona	Aa3
Connecticut	Aa3
Florida	Aa1
Kentucky	Aa2
Michigan	Aa3
New Jersey	Aa3
Ohio	Aa2
Pennsylvania	Aa2
Rhode Island	Aa3
Wisconsin	Aa3
State on Watchlist for Possible Downgrade	
Illinois	A1
State with Positive Outlook	
Louisiana	A1
West Virginia	Aa3

# Outlook for States is Negative

- » Employment is declining
- » Unemployment rate is climbing
- » Tax receipts have plunged
  - PIT – high-end income has weakened
  - Sales tax receipts are declining
  - Corporate taxes are way off
- » Consumer spending is weak
  - Credit crunch and reduced home equity extraction have restrained the consumer
  - Consumer confidence remains weak

www.moody's.com

**Outlook**

**Moody's**  
**U.S. Public Finance**

February 2009

**Outlook Remains Negative for U.S. States:**  
Federal Fiscal Stimulus May Moderate Recession's Effects on U.S. States; Impact from Recession Will Not Be Equal

The outlook for U.S. state ratings is negative. This outlook expresses Moody's expectations for the fundamental credit conditions in the sector over the next 12 to 18 months.

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**Summary Opinion**

U.S. states are facing serious financial and budgetary pressure due to the slowing economy and the dislocation in the capital markets. While most states were better prepared for a downturn going into the current recession than they were prior economic downturns, the breadth and depth of this recession is significantly straining available resources. At the same time, states are faced with escalating budgetary pressures in the areas of social services, retiree benefits and infrastructure. Additionally, market conditions have changed the financing landscape and states can no longer depend on timely and limitless borrowing to address financial underperformance. All of these factors combined lead us to extend our negative outlook on the state sector.

Nonetheless, recent actions by the federal government to aggressively stimulate the economy through capital spending, operating assistance to states and a variety of other measures may lessen the most severe aspects of the downturn on state finances.

Additionally, states continue to be financially strong and highly rated due to their constitutional authority to raise revenues, cut spending and manage their programmatic obligations.

  
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# Six Critical Factors

- » Revenue Declines
- » Liquidity Position
  - Available Cash
  - Variable Rate Exposure
- » Recession-Induced Spending Pressures
  - Short-Term Expenses
  - Longer-Term Expenses
- » Deficit Financing
- » Mitigants
  - Federal Fiscal Stimulus
  - Management

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**Special Comment**

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**Moody's**  
**U.S. Public Finance**

October 2009

**Potential Risks of Variable Rate Debt and Interest Rate Swaps for U.S. State and Local Governments are Heightened by Economic and Financial Crisis**  
Issuer Management and Other Factors are Key to Mitigating Risks

**Summary Opinion**

The market turmoil of the past two years has exacerbated the potential risks of variable rate debt and interest rate swaps for U.S. state and local governments. For some issuers, these once hypothetical risks have recently been realized, causing unprecedented financial stress. This special comment describes the potential risks of variable rate debt and swaps for state and local government issuers, the ways in which Moody's measures an issuer's exposure to the risks, and the factors that limit an issuer's vulnerability to the risks. In our assessment, the majority of Moody's rated municipal issuers of variable rate debt and swaps have thus far managed these risks without adversely impacting credit quality.

**Background: Market Disruption**

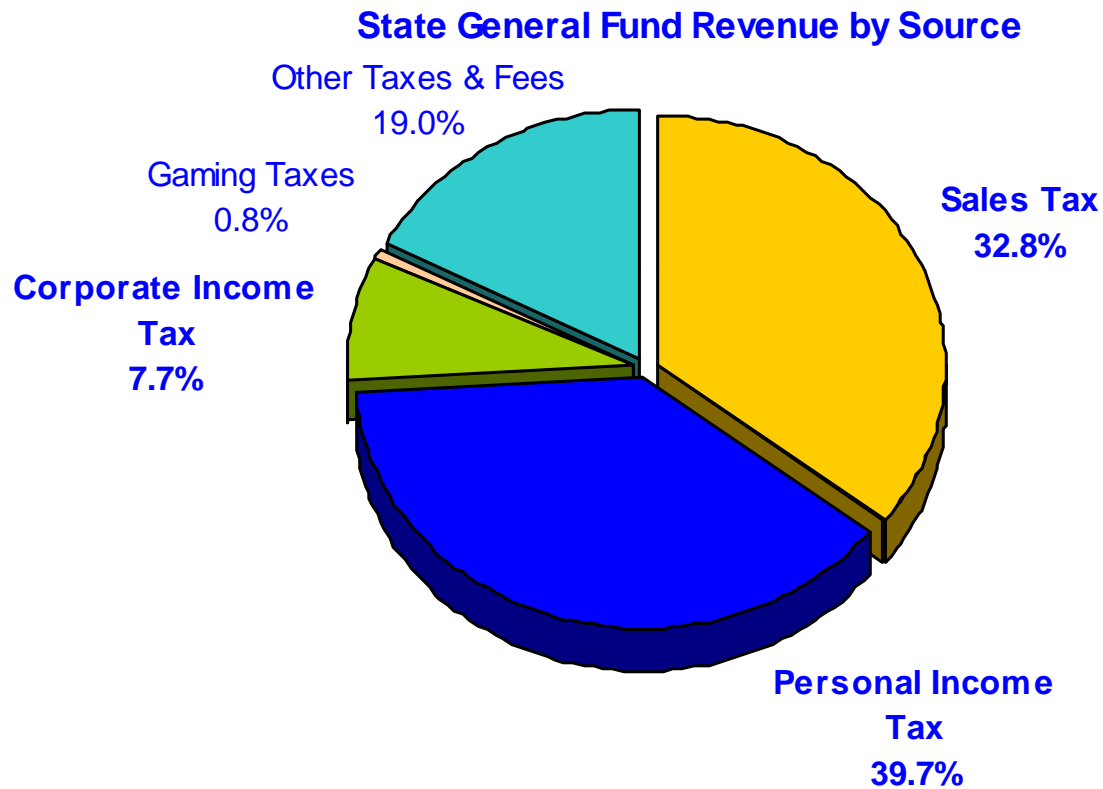
In the 1990s and early 2000s, the use of variable rate debt and swaps by municipal issuers increased significantly, a trend that reflected the benefits of these instruments. Under the right interest rate and credit market conditions, state and local governments can use variable rate debt and swaps to reduce interest costs and improve cash flows. The use of these instruments by municipalities had been relatively uneventful until late 2007, when the credit market disruption exposed their considerable risks. In the widely publicized case of Jefferson County, Alabama, variable rate debt and swaps were a primary cause of the county's fiscal collapse. The ramifications have been far less severe for most municipal issuers of variable rate debt and swaps.

  
Moody's Investors Service

# State Finances

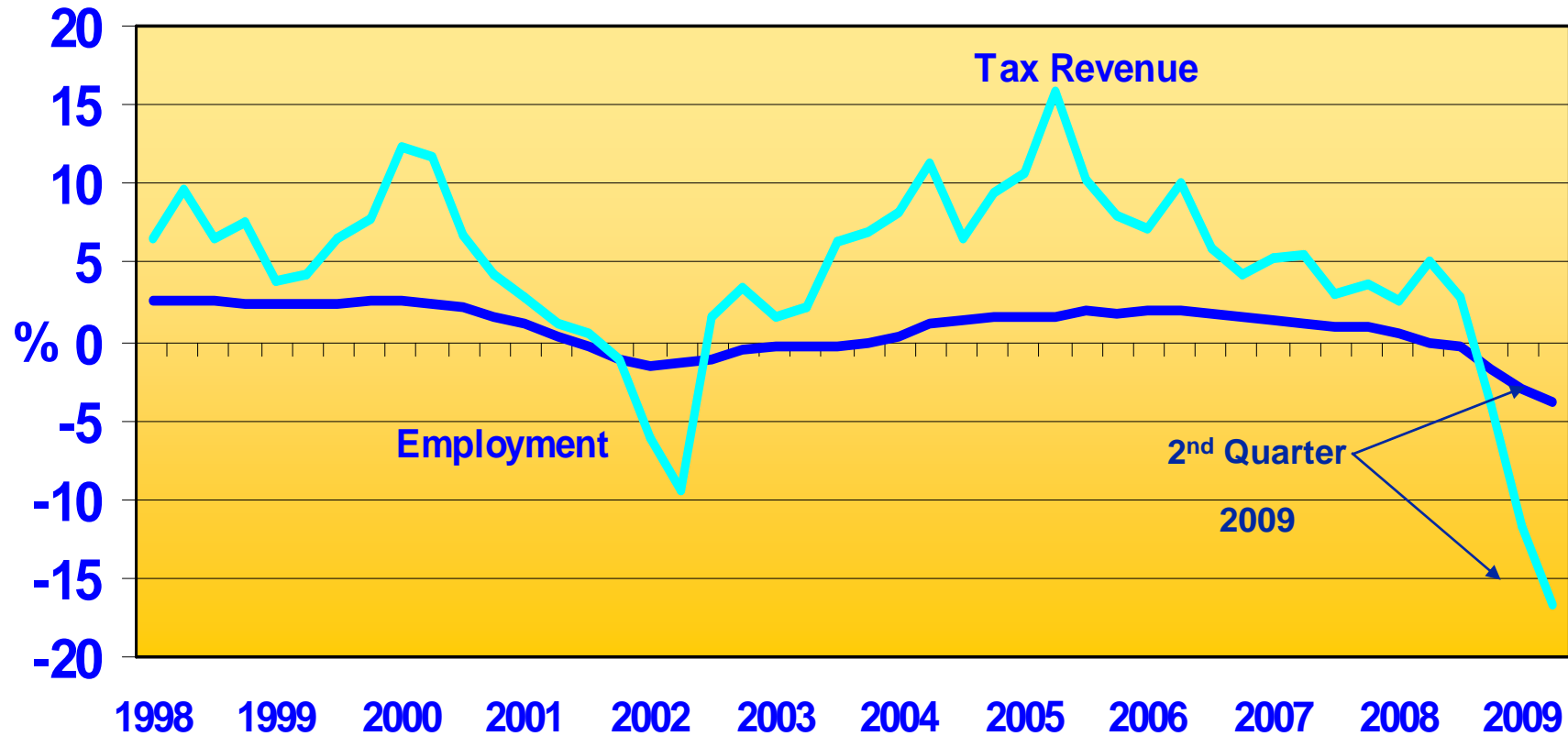


## States Rely on Big 3 Taxes Income, Sales and Corporate



Source: National Association of State Budget Officers

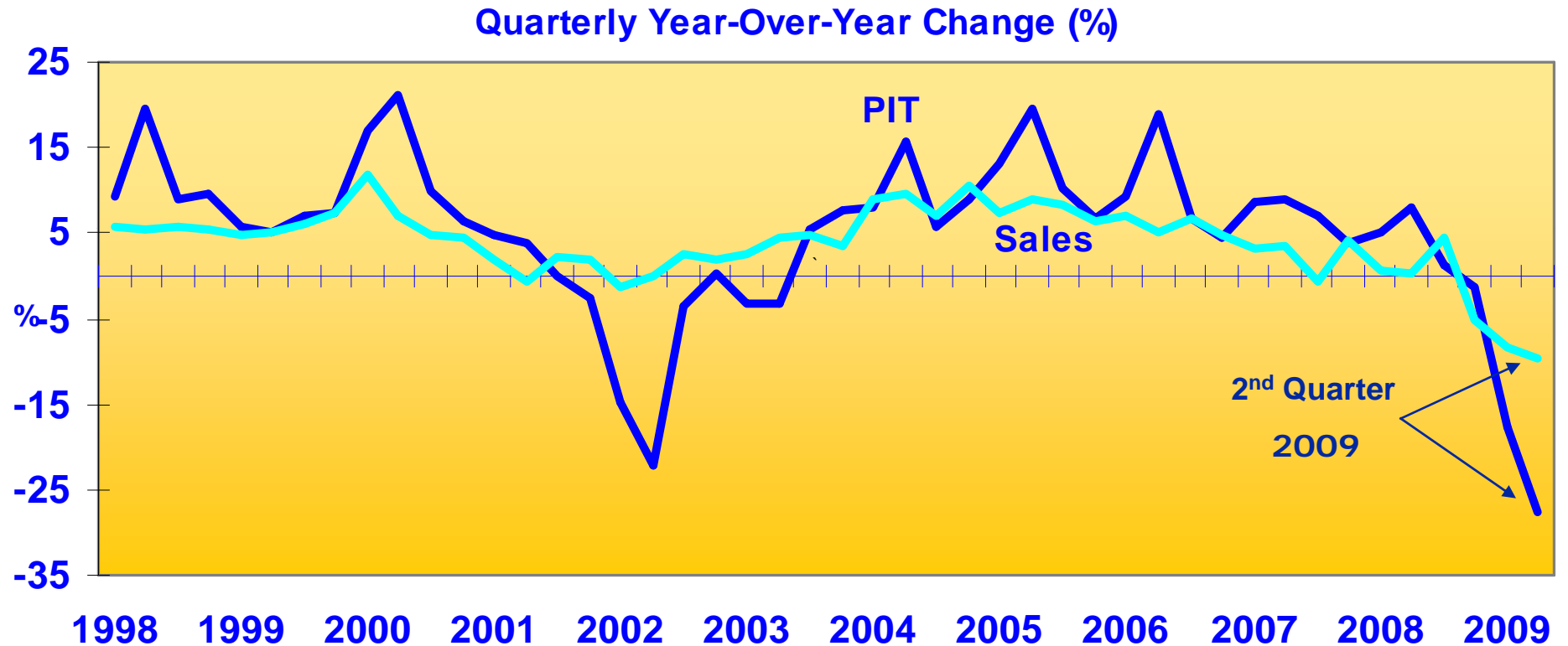
## State Tax Revenue Falling (through June 2009)



Source: Rockefeller Institute and Bureau of Labor Statistics

# PIT Revenue is Plunging

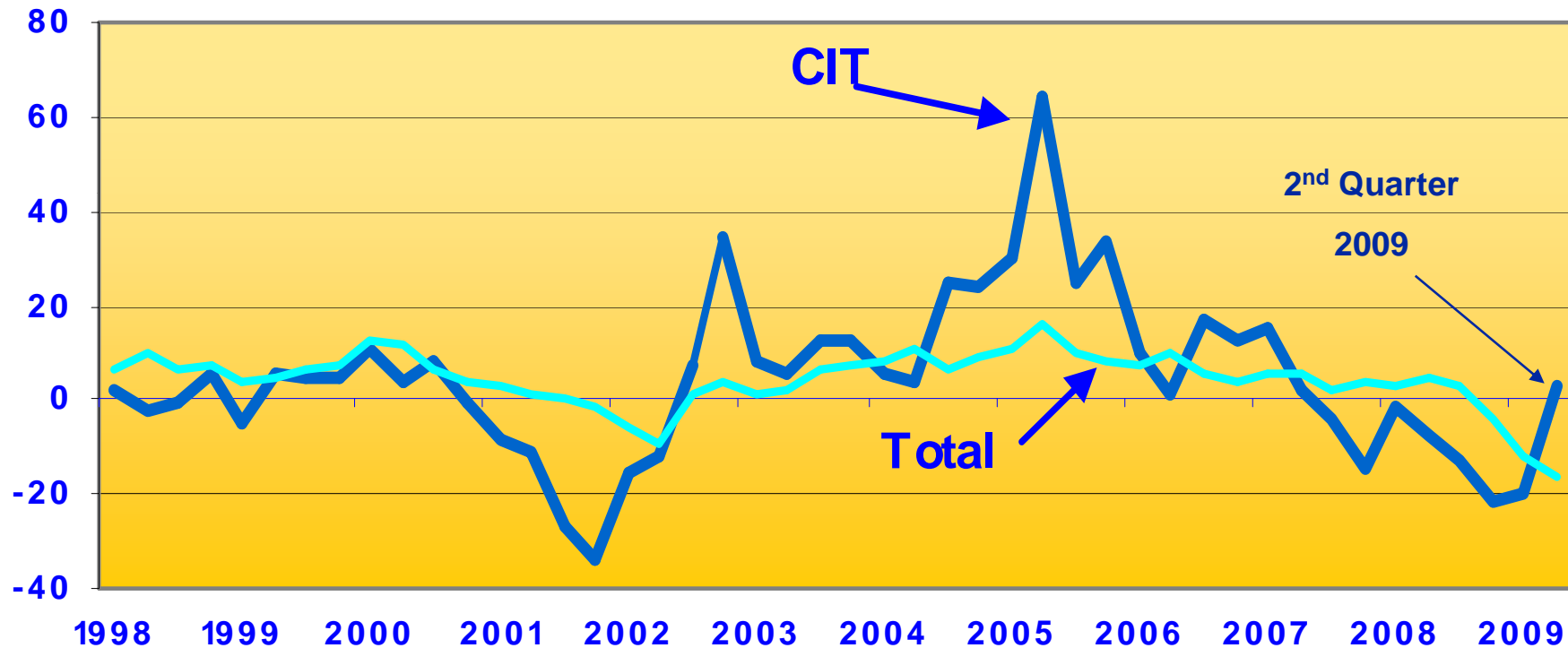
## Sales Taxes are also Declining



Source: State Revenue Report, Rockefeller Institute, July 2009

## Corporate Taxes Slightly Positive

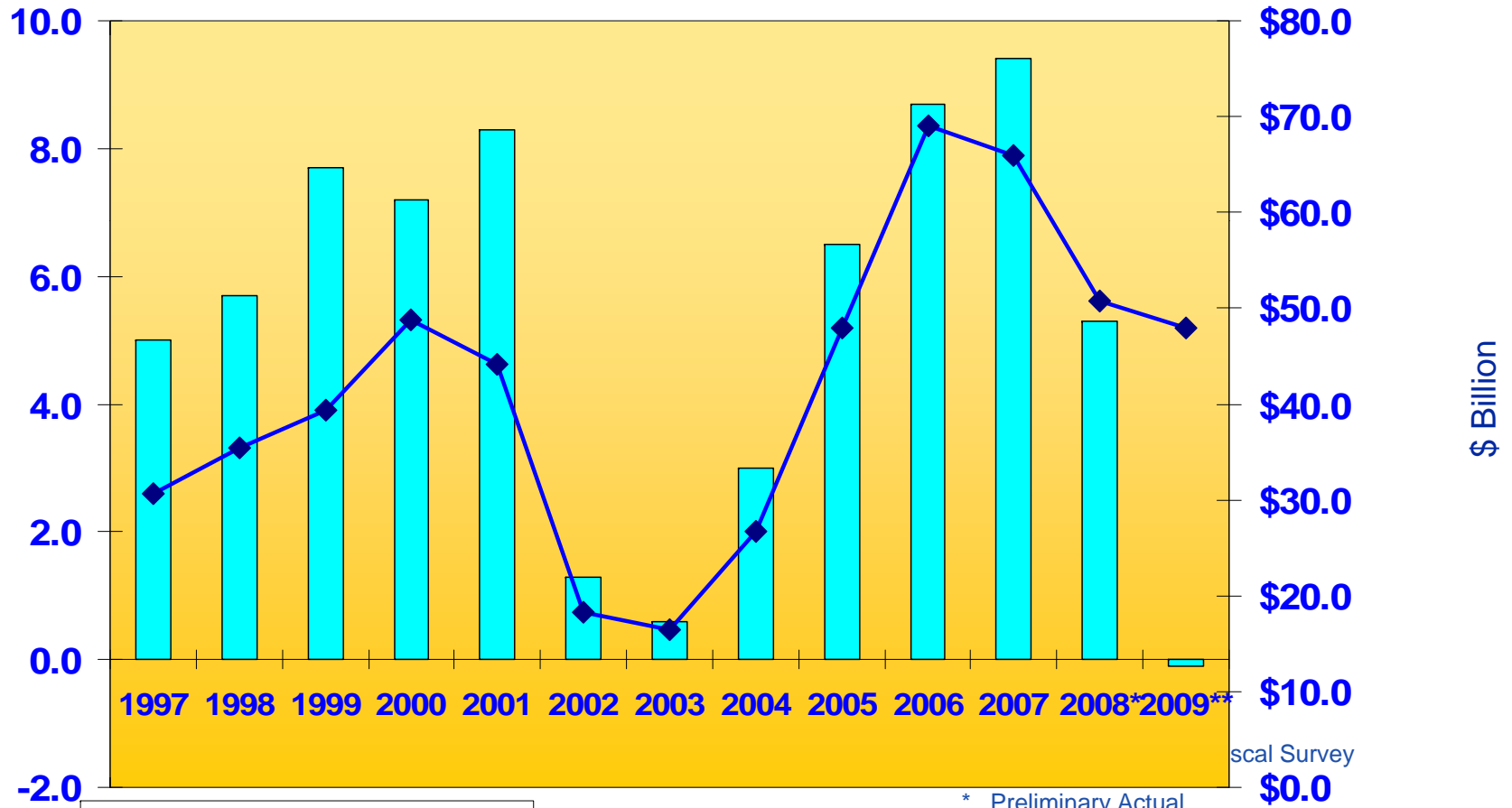
Quarterly, Year-Over-Year Change in States' CIT and Total Tax Revenues



Source: State Revenue Report, Rockefeller Institute, March 2009

# Changes in General Fund Expenditures and Fund Balances

States Year-Over-Year GF Expenditure Changes



■ % Change (left)  
◆ Year-End Balances (right)

\* Preliminary Actual  
 \*\* Appropriated

# The Great Recession May Have Ended

## Recessions since World War II

Peak	Trough	Duration in Months		Peak-to-Trough % Change		Jobless Rate		
		Recession Peak to Trough	Expansion Trough to Peak	Real GDP	Nonfarm Employment	Low	High	Change
<b>Dec 2007</b>	<b>September 2009</b>	<b>22</b>	<b>73</b>	<b>-3.9</b>	<b>-5.5</b>	<b>4.4</b>	<b>10.1</b>	<b>5.7</b>
Mar 2001	Nov 2001	8	120	-0.4	-2.0	3.8	6.3	2.5
Jul 1990	Mar 1991	8	92	-1.3	-1.5	5.0	7.8	2.8
Jul 1981	Nov 1982	16	12	-2.9	-3.1	7.2	10.8	3.6
Jan 1980	Jul 1980	6	58	-2.2	-1.3	5.6	7.8	2.2
Nov 1973	Mar 1975	16	36	-3.1	-2.7	4.6	9.0	4.4
Dec 1969	Nov 1970	11	106	-1.0	-1.4	3.4	6.1	2.7
Apr 1960	Feb 1961	10	24	-1.3	-2.3	4.8	7.1	2.3
Aug 1957	Apr 1958	8	39	-3.8	-4.4	3.7	7.5	3.8
Jul 1953	May 1954	10	45	-2.7	-3.3	2.5	6.1	3.6
Nov 1948	Oct 1949	11	37	-1.7	-5.1	3.4	7.9	4.5
<b>Average for past recessions</b>		<b>10</b>	<b>57</b>	<b>-2.0</b>	<b>-2.7</b>	<b>4.4</b>	<b>7.6</b>	<b>3.2</b>

Sources: NBER, BEA, FRB, BLS, Moody's Economy.com

# Federal Fiscal Stimulus



# Federal Government Comes To The Rescue

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**Special Comment**

**Moody's**  
**U.S. Public Finance**

February 2009

**U.S. Federal Stimulus Likely to Relieve Short-term Credit Pressures Facing a Number of Municipal Issuers**

**Most Affected: State Governments, Public K-12 Schools, Public Universities, Hospitals, Mass Transit**

The \$787 billion fiscal stimulus package—the American Recovery and Reinvestment Act of 2009—is likely to have an overall beneficial credit impact on a number of municipal issuers to varying degrees in the near-term. The measure contains both substantially expanded direct funding to issuers, as well as new tax credits and tax-related provisions totaling approximately \$222 billion that will affect the municipal market more broadly. However, this relief is unlikely to create longer term credit benefits for most municipal issuers because many of them face credit challenges that may well persist beyond the two years covered by most of the stimulus actions in the bill.

The stimulus bill is larger in size and scope than previous federal interventions following economic downturns, amplifying and greatly broadening a pattern of expanded federal fiscal assistance following natural disasters such as floods and hurricanes. State governments are the lynchpin to the bill's direct and indirect effects on municipal issuers because states will receive substantial funding directly for their own programs, as well as funding that will assist programs operated by other issuer groups. The credit impact on individual states, as well as some other issuers, will depend largely on the effectiveness with which each state deploys its share of the stimulus funds.

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- » States are getting operating and capital assistance
- » Offsets need for more serious spending cuts and tax increases
- » Stimulus funds appear to have staunched the bleeding
- » What will happen when the funds run out?
- » Will there be a second stimulus
  - With money infused directly into the economy?
  - With money, again, directed to state and local governments?

# Outlook for the Future



## Major Questions

- » **Has the recession ended?**
  
- » **Will there be a “double-dip” recession?**
  - **Commercial real estate market is now weakening**
  - **Banks are still holding sizeable inventory of foreclosed vacant residential real estate**
  
- » **Will there be a sudden rebound or will there be a gradual improvement?**
  
- » **How will states cope with rising expenditure pressures in light of falling revenues?**
  
- » **How well will states prepare for lack of federal fiscal stimulus dollars?**
  
- » **Will the federal government offer another stimulus package?**
  
- » **Will national health care reform result in increased expenses for states?**

## Conclusion

- » **Broad and deep recession**
- » **Major state revenues hit very hard**
- » **Federal fiscal stimulus cushioned the blow**
- » **Hard to see what will lead us out of the recession**
- » **Long and slow recovery**
- » **More negative pressure on state ratings**

# Global Scale Ratings Migration



## Current Status of Moody's Municipal Rating Recalibration

- » **Moody's remains committed to ensuring that our US public finance ratings are comparable to ratings in other sectors**
- » **Temporary pause in planned migration prompted by current conditions in the credit market**
- » **Moody's ongoing efforts:**
  - Surveillance of public finance ratings
  - Taking ratings actions when appropriate – on the municipal scale
  - Publishing research on the municipal credit environment
- » **Recalibration of approximately 20,000+ outstanding public finance credits**
  - ~20,000 distinct issuer security pledges, over 70,000 individual sales and approximately one million CUSIPS
- » **All public finance sectors to be considered in the recalibration**
  - Governments, higher ed, infrastructure, health care, housing
- » **Result will be comparability of Moody's municipal ratings with ratings in other sectors such as sovereign, sub-sovereign, corporate and financial institutions**

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