

# New England States GFOA 76<sup>th</sup> Annual Conference

## What to Expect When Talking with the Rating Agencies



**Geoffrey E Buswick, Managing Director & Government Sector Lead**

**S&P Global**  
Ratings

September 12, 2023 – Rockport, Maine

# Agenda

- What is a rating?
- The rating process
- Local government criteria highlights
- Hot topics in public finance
  - Economy, urban core & workforce challenges
  - Disasters & insurance
  - Cyber (briefly)
  - AI & DeFi

**PLEASE ASK QUESTIONS THROUGHOUT**

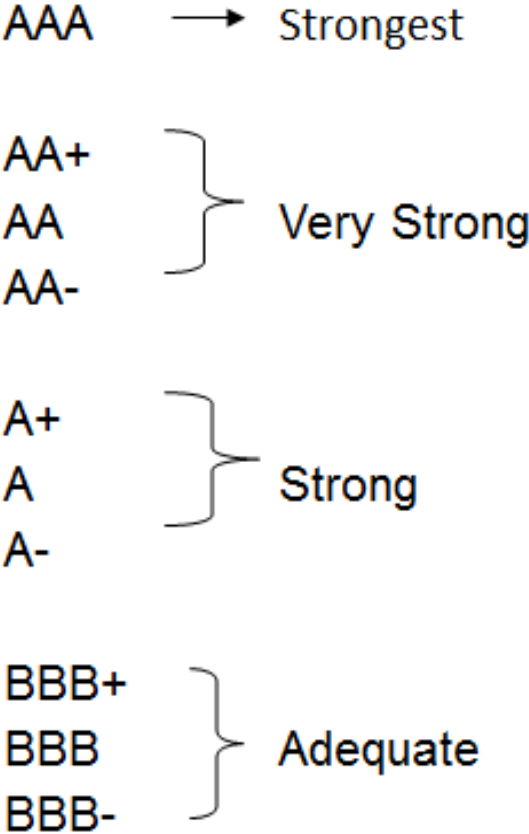
# Understanding S&P Global's Ratings

- An issuer's **ability** and **willingness** to pay debt in a **timely** manner
- Credit ratings are **forward looking**
- S&P Global ratings are **opinions**, not guarantees of credit quality or exact measures of the probability that a particular issuer or particular debt issue will default
- The Ratings scale **is relative** and based on the creditworthiness of an issuer or credit quality of an individual debt issue, from strongest to weakest, within a universe of credit risk
- Criteria provide the analytic framework to derive the rating opinion

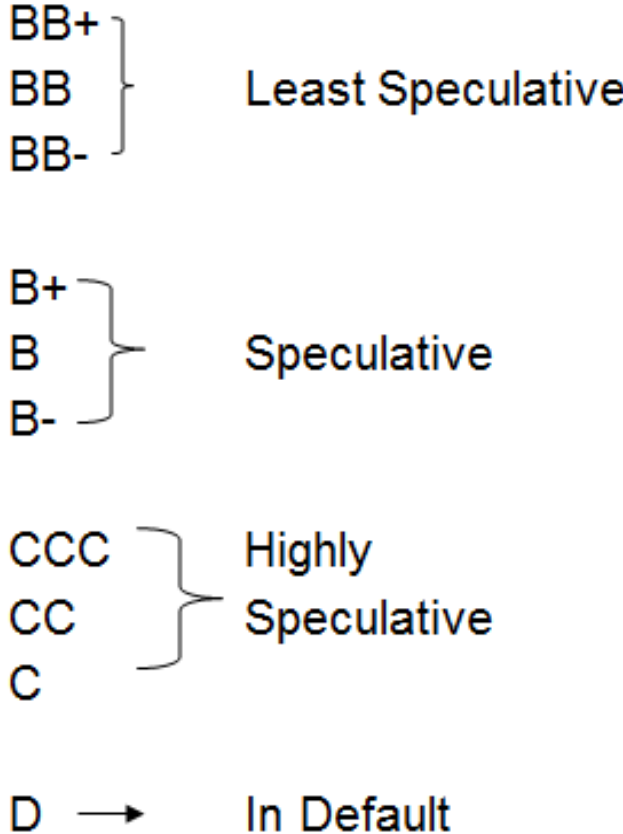
[Understanding Credit Ratings | S&P Global Ratings \(spglobal.com\)](https://www.spglobal.com)

# Ratings 101 | S&P Global's Ratings Scale

## Investment-Grade



## Speculative-Grade



Short-term U.S. Public Finance note ratings: **SP-1+, SP-1, SP-2 & SP-3**

# Ratings 101 | Outlooks and CreditWatch

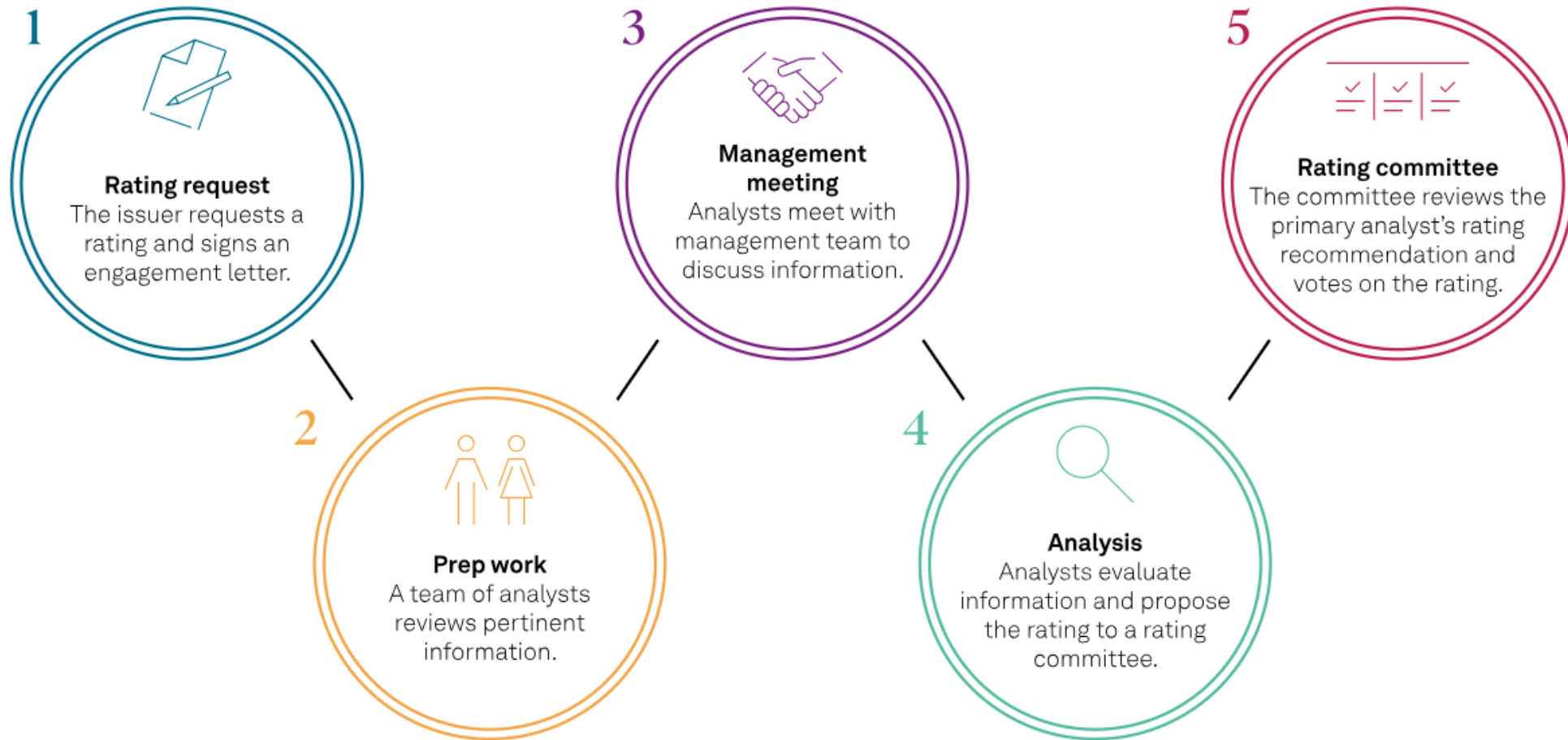
- Outlooks

- Potential rating change within 1 to 2 years
- At least 1-in-3 likelihood of rating action
- Outlooks can be:
  - Stable
  - Positive
  - Negative
  - Developing

- CreditWatch

- Potential rating change within 60 to 90 days
- At least 1-in-2 likelihood of rating action
- CreditWatch can be:
  - Positive
  - Negative
  - Developing

# S&P Global Ratings' process to committee



Source: S&P Global Ratings.  
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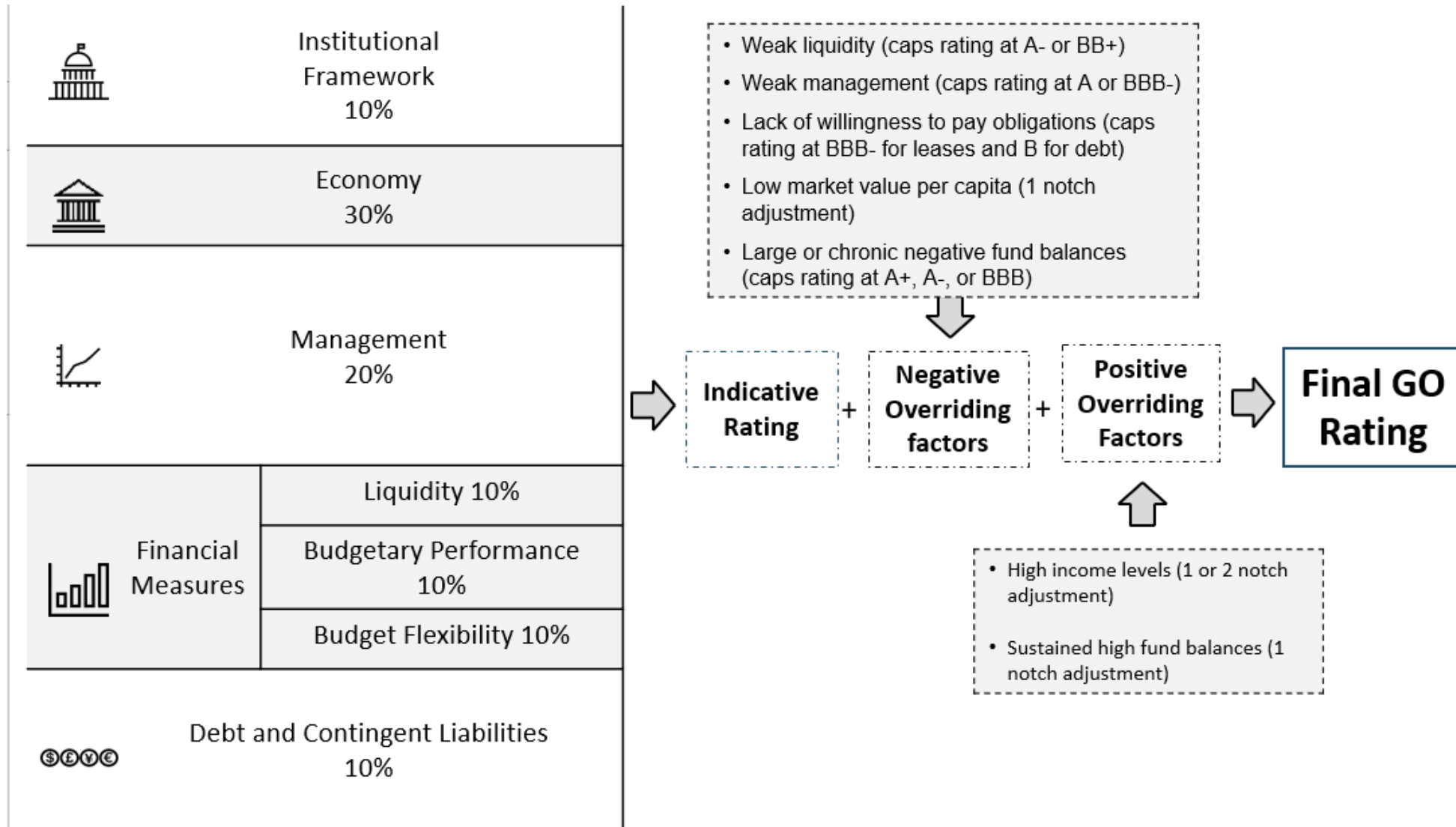
# S&P Global Ratings' process post-committee



Source: S&P Global Ratings.

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# Analytical Framework For Local Government GO Ratings





# USPF 2023 Midyear Outlook

## What we're watching

- Higher interest rates and inflation continue to be headwinds
- Summer storm and fire season heightens the possibility of catastrophic events

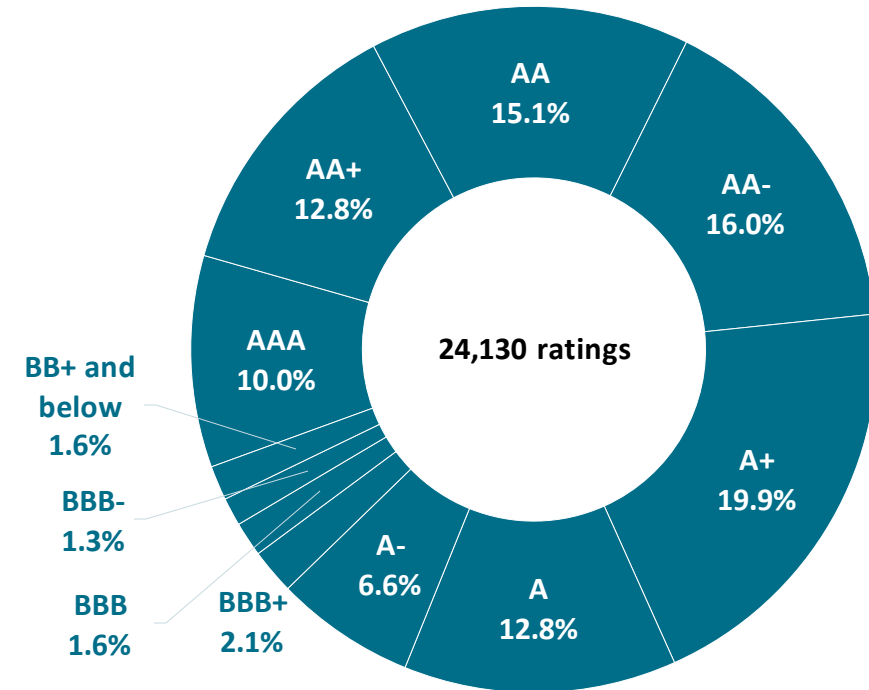
## Trends

- Credit conditions have been largely stable, and upgrades have exceeded downgrades this year for most sectors
- The U.S. economy has been resilient
- Federal stimulus and healthy financial reserves continue to provide significant flexibility

## Rest of year expectations

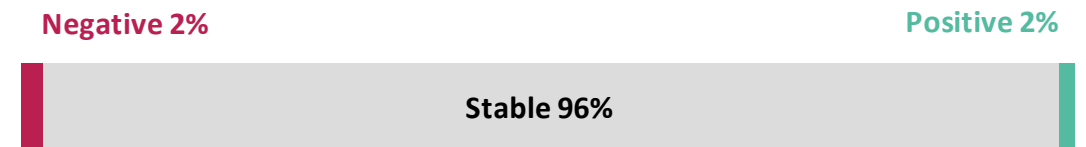
- Our baseline U.S. economic forecast is now for a shallower but more protracted slowdown rather than a recession; however, we don't expect this to disrupt credit stability for most issuers

U.S. Public Finance Ratings Distribution



Source: S&P Global Ratings.

## Outlook distribution



Source: S&P Global Ratings.

# USPF 2023 Midyear Sector Summary

## Local government

### What we're watching

- The potential for lower consumer spending that could affect collections of economically sensitive revenues
- Credit strength/stability of state governments

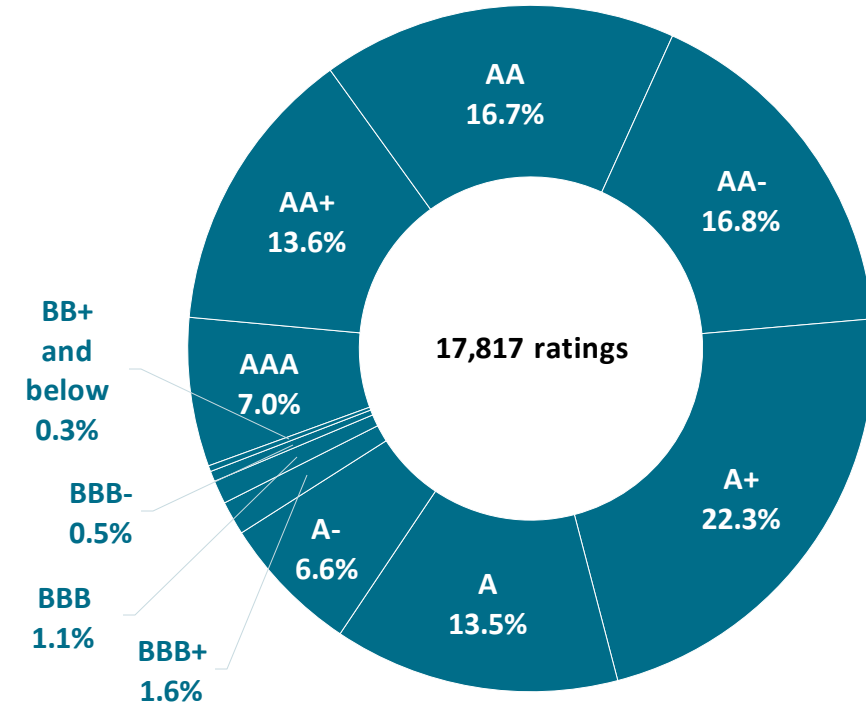
### Trends

- Reserve growth has been supported by good revenue collections and ongoing tax base growth
- Pandemic-related federal stimulus is helping to support capital needs and offset rising operating costs

### Rest of year expectations

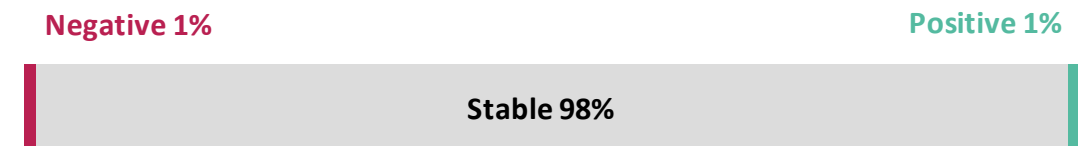
- Credit quality and stability will continue to be supported by federal stimulus dollars
- Summer storm season increases the possibility of catastrophic events

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

# S&P Global Ratings' U.S. Economic Forecast Overview

## Key indicators

	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Real GDP (annual average % change)	2.3	-2.8	5.9	2.1	1.7	1.3	1.5	1.8
Real consumer spending (annual average % change)	2.0	-3.0	8.3	2.8	2.0	1.2	1.4	2.1
Real equipment investment (annual average % change)	1.3	-10.5	10.3	4.3	-0.7	1.4	2.0	2.7
Real nonresidential structures investment (annual average % change)	2.3	-10.1	-6.4	-6.5	8.0	0.2	-0.3	1.1
Real residential investment (annual average % change)	-1.0	7.2	10.7	-10.5	-11.5	1.1	4.4	1.8
Core CPI (annual average % change)	2.2	1.7	3.6	6.2	5.0	3.3	2.4	2.2
Unemployment rate (%)	3.7	8.1	5.4	3.6	3.5	4.0	4.5	4.6
Housing starts (annual total in mil.)	1.3	1.4	1.6	1.6	1.4	1.3	1.4	1.4
Light-vehicle sales (annual total in mil.)	17.0	14.5	15.0	13.8	15.1	15.1	15.9	16.0
10-year Treasury (%)	2.1	0.9	1.4	3.0	3.7	3.6	3.4	3.3

# U.S. Local Governments | What We're Watching



## Federal stimulus

ARPA and other federal stimulus can help maintain credit quality and provide liquidity for many LGs



## Looming recession

Federal aid helps with downside cushion, but a deteriorating economy could still disrupt stability



## Inflation implications

Higher costs affect labor, materials, borrowing, etc., and could have long-term implications



## Housing market

Slower housing market should cool prices, but an extended slowdown could affect tax base



## State credit health

State credit strength lessens the chance for cuts to locals and supports economic stability



## Wildcards

- RTO/downtown core
- Unemployment
- Infrastructure needs

# U.S. Local Governments | By The Numbers

**45,310**

Number of LG projects where ARPA funds were deployed



**69%**

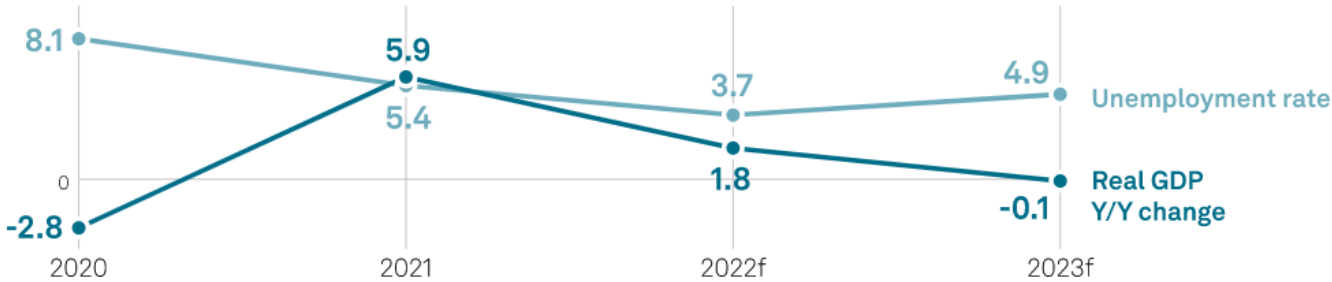
Finance officers reporting being better able to meet needs in FY2023 vs. FY2022



**81%**

Rate of voter approval for bond referendums in Nov 2022 elections

Unemployment rate vs. GDP growth (%)



**7 years**

until all Baby Boomers will be over **65**



**90%**

Share of MSAs with overvalued home prices



**+50%**

Growth in S&P/Case-Shiller National Home Price Index (2020-2022)

**-14.3%**

Projected 2023 Y/Y change in real residential investment



**15 bil.**

of dollars of weather and climate disasters in the U.S. (Jan-Oct 2022)

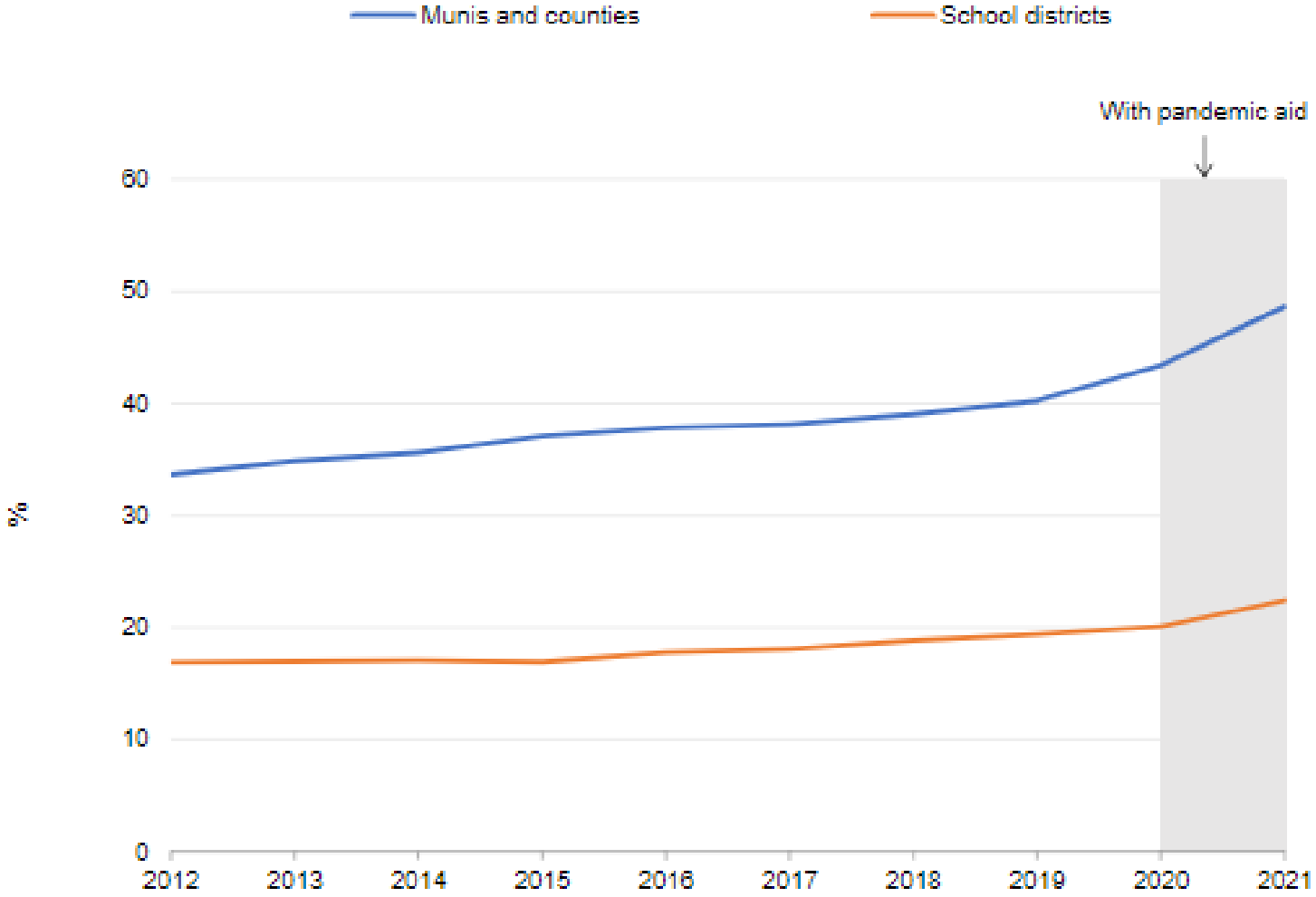


**60%**

Share of households that will not be able to buy a house by 2025

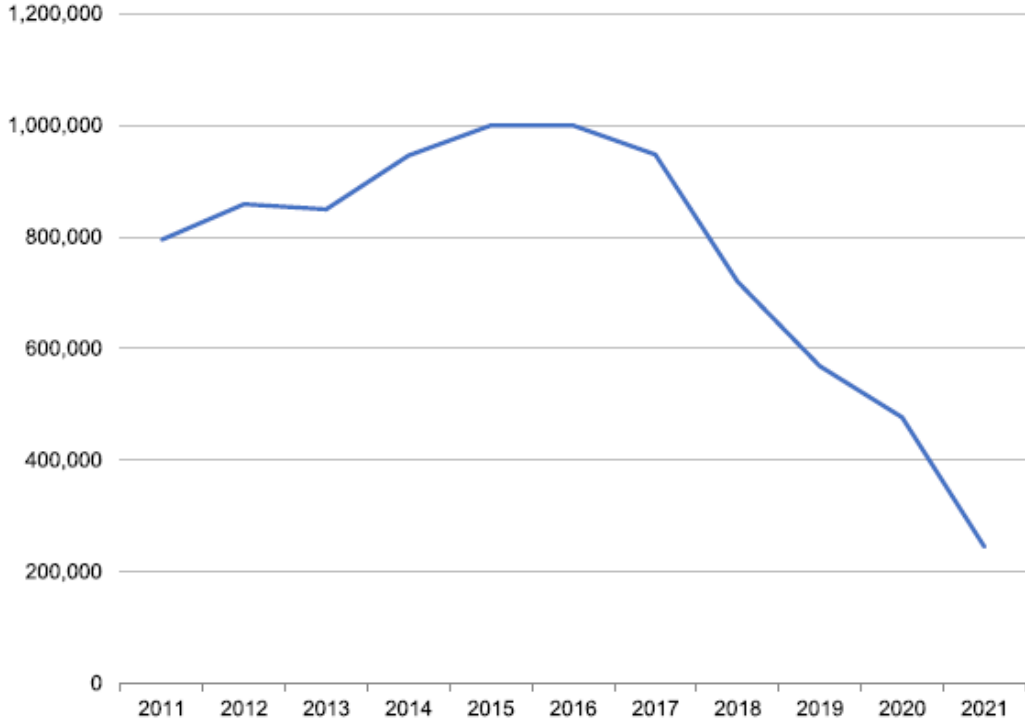
# U.S. Local Governments | Reserve Trends

## Unassigned General Fund Balance as Share of General Fund Expenditures



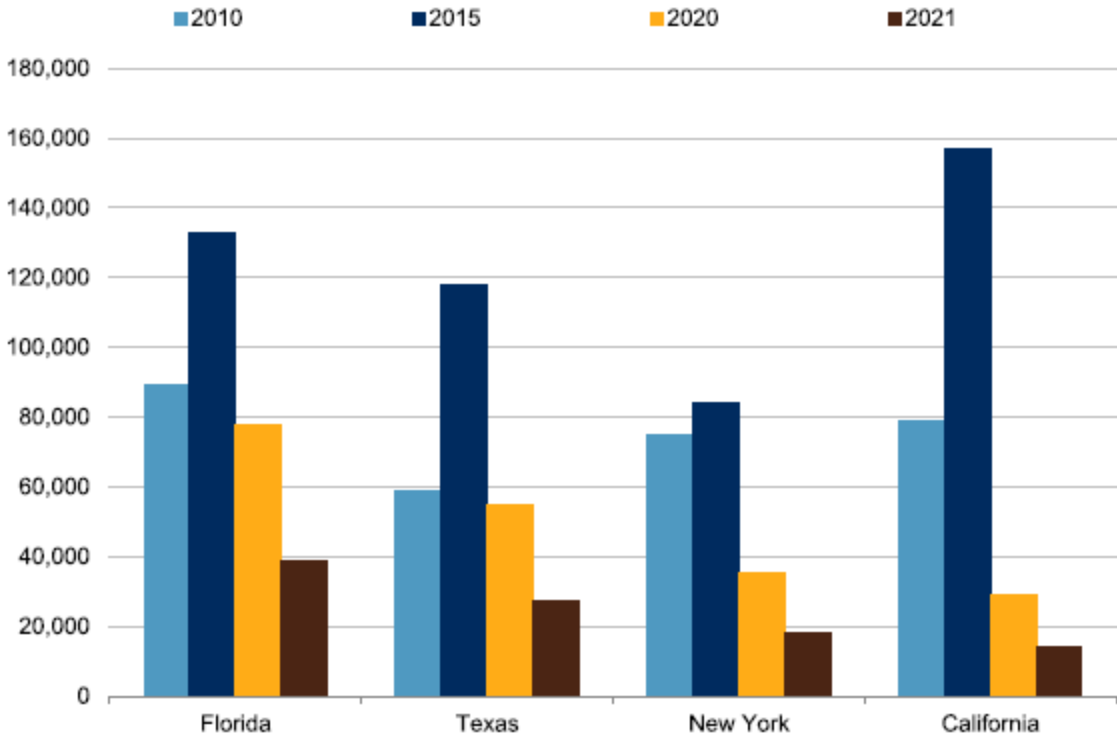
# Workforce Challenges | Demographics/Migration

Net International Migration



Source: U.S. Census Bureau  
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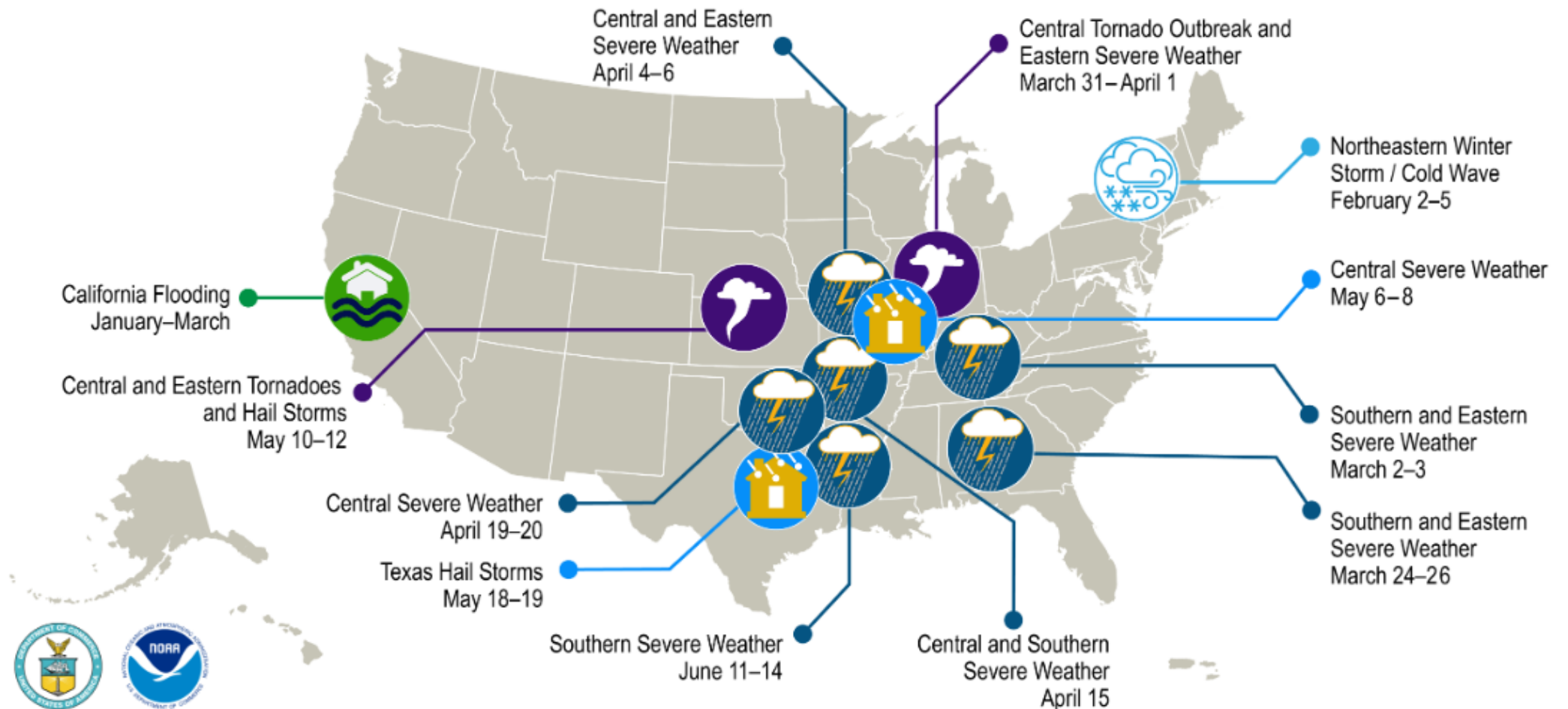
Net International Migration To Select High-Immigration States



Source: U.S. Census Bureau  
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# Disasters | Extreme Weather Risk

## U.S. 2023 Billion-Dollar Weather and Climate Disasters



This map denotes the approximate location for each of the 12 separate billion-dollar weather and climate disasters that impacted the United States through June 2023.



# Disruptors | Cyber Risk Management



## Prepare

- ✓ Identify areas of risk
- ✓ Protect assets and data



## Respond

- ✓ Detect and respond to an attack



## Recover

- ✓ Recover data
- ✓ Maintain sufficient liquidity
- ✓ Disclose attacks

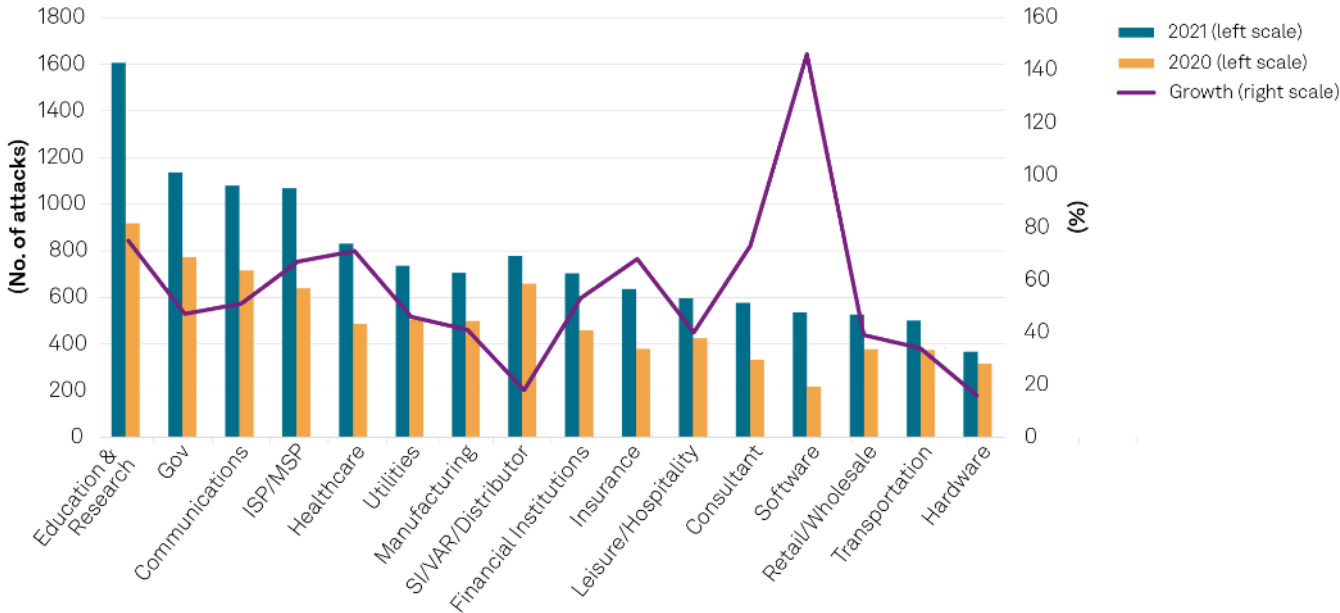
Source: S&P Global Ratings.

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# Disruptors | Risk Management

## Cyberattacks Increasing Across All Industries

Average Weekly Cyberattacks Per Organization By Industry



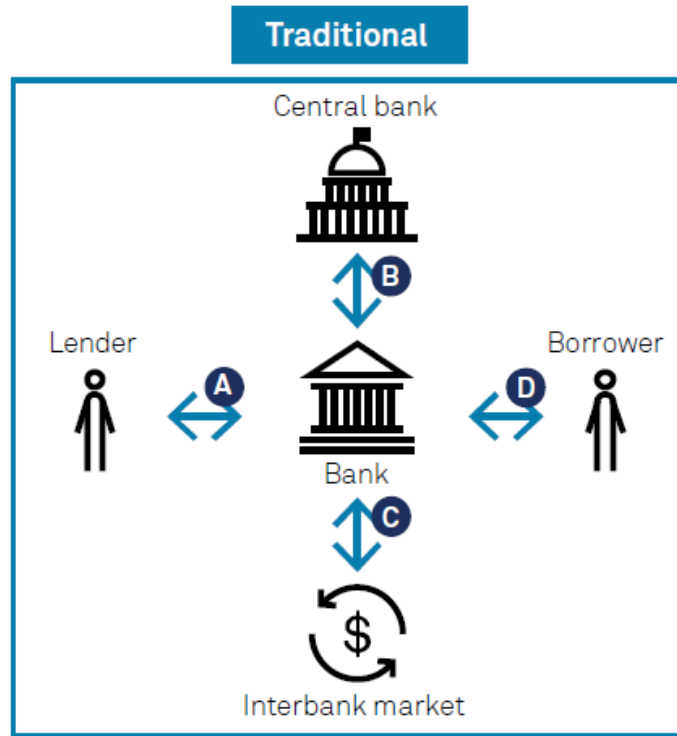
Source: Check Point Research  
 As Threats Rise, U.S. Public Finance Entities Take On Mounting Challenges To Secure The Digital Front Line, published Dec. 13, 2022

## Cryptocurrency and Decentralized Finance

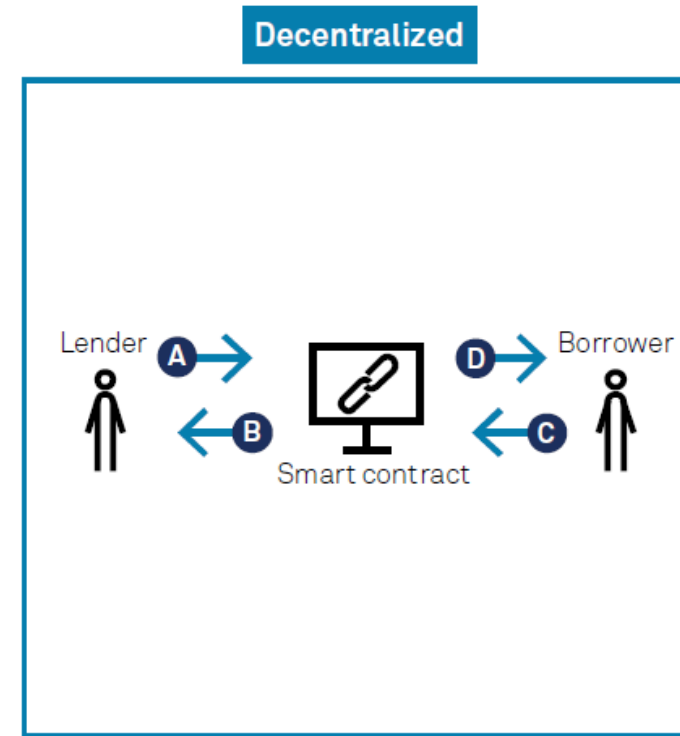


Source: Exploring Crypto And DeFi Risks In Credit Ratings, published June 30, 2022

# Disruptors | DeFi Uses Smart Contracts In Place Of Conventional Financial Risk Functions



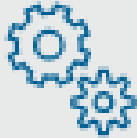
- A** Lender deposits fiat money to receive interest
- B** Central bank provides liquidity to banks and sets interest rates based on inflation and other parameters
- C** Interest rates on bank loans affected by interbank market
- D** Loan approval and interest rate for borrower depends on collateral and borrower risk profile



- A** Provides eligible crypto assets as liquidity
- B** Receives tokens as determined by protocol as form of interest
- C** Provides other eligible crypto assets as collateral\*
- D** Receives a borrowed amount of crypto assets

# Disruptors | What is AI?

## Machine Learning



AI subset which uses statistical models and deep neural networks - typically algorithms - to enable machines to improve through repetitive iterations

## Decision Tree



Uses flow-chart structures to move down a 'tree' of possible outcomes to arrive at a conclusion or predict an outcome

## Topic Modeling



Scans groups or articles of documents to discover latent themes

## Clustering



Using functions to search for commonalities between elements, and then grouping them

## Regression



A mathematical formula which measures the relationship between two or more variables

## Instance Based



Compares new problem instances with previous instances in memory to come to a conclusion

## Feature Engineering



The process of extracting features from raw data to transform the data, which enables the building of models

## K-Means



Uses averages to group data by category or topic

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