

# Ratings and Credit Conditions Update

Randy Layman  
Director  
U.S. Public Finance

Tennessee GFOA  
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# Agenda

- **S&P Ratings and the Rating Process**
- **U.S Public Finance Outlook**
- **Credit Conditions Update**
- **Tennessee Local Governments Credit Comparison**



# Ratings Overview

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**S&P Global**  
Ratings

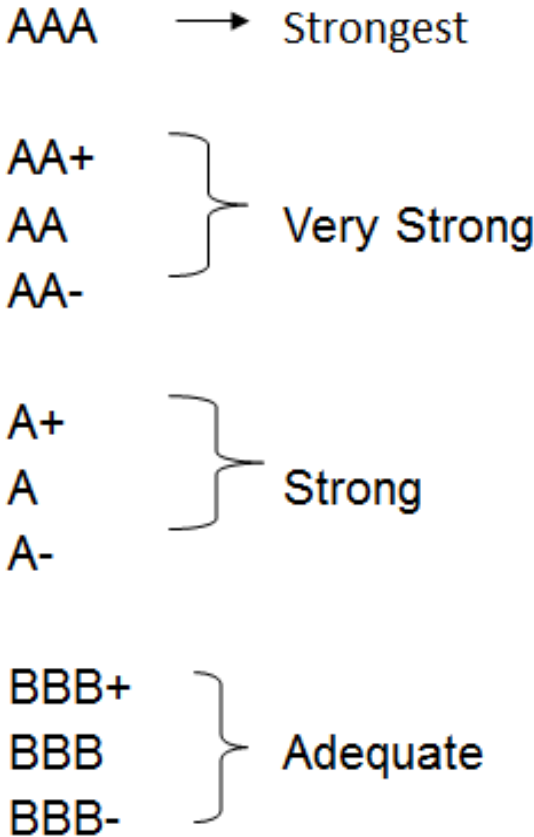
# Understanding S&P Global's Ratings

- 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

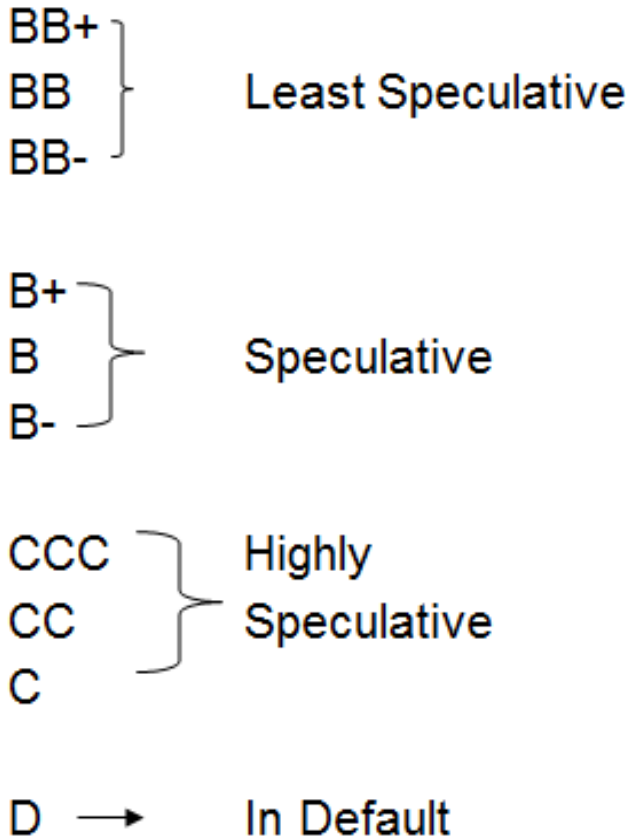
[Understanding Credit Ratings | S&P Global Ratings \(spglobal.com\)](https://www.spglobal.com)

# 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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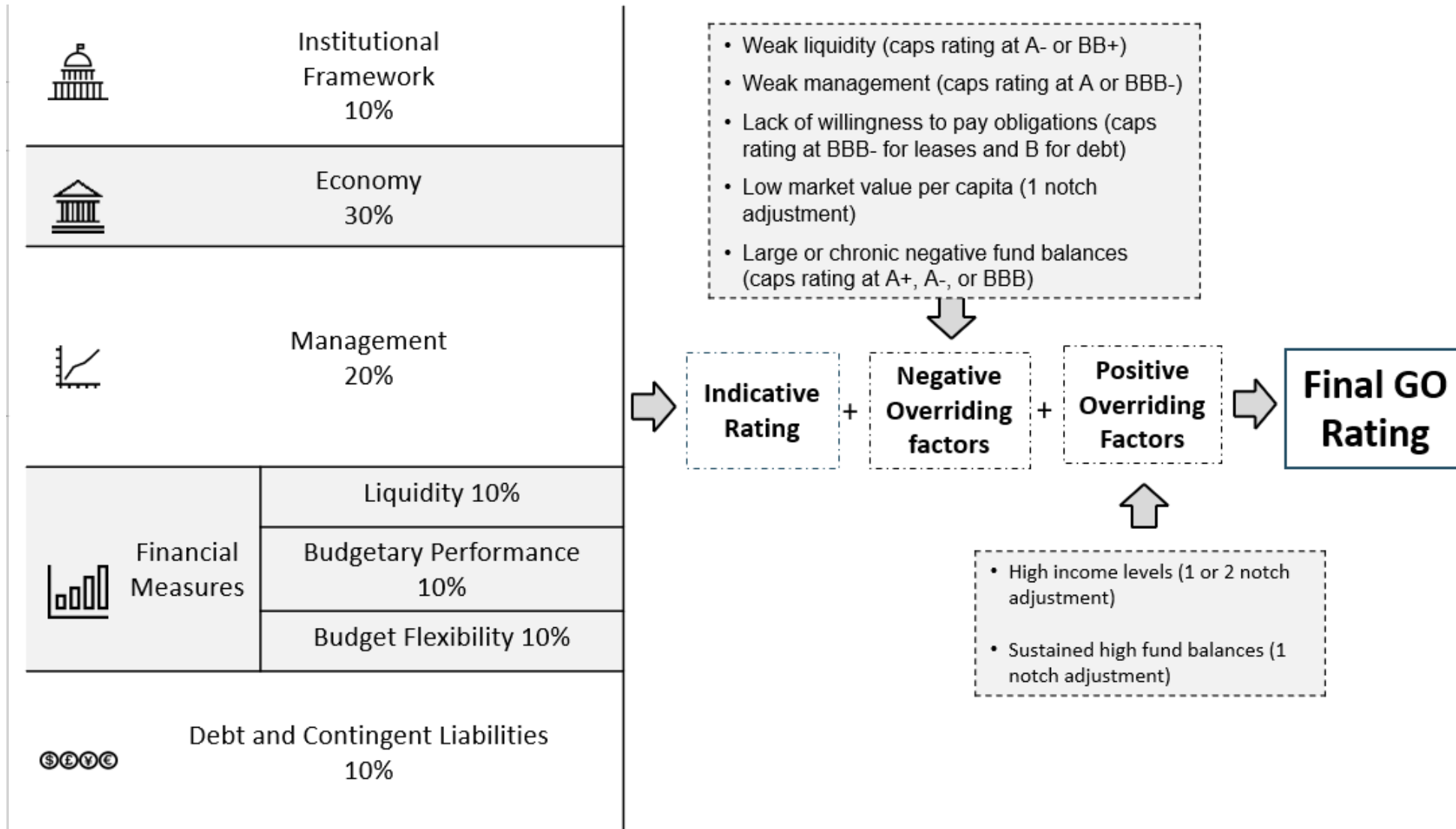
# S&P Global Ratings' process post-committee



Source: S&P Global Ratings.  
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# Analytical Framework For Local Government GO Ratings



# U.S. Public Finance Outlook

# U.S. Public Finance Ratings Landscape

## By the Numbers:

- **Ratings on 24,130 U.S. government institutions:**
- 340 Charter Schools (modal rating: speculative grade)
- 543 Higher education entities (A+)
- 486 Not-for-profit healthcare entities (A)
- 485 Housing entities (AA+)
- 17,817 Local governments and special districts (A+)
- 375 Public power utilities and co-ops (A)
- 2,085 water/sewer and sanitation utilities (A+)
- 309 Transportation entities (A)
- 50 States (AAA)

## Tennessee Credit Coverage

- State of Tennessee (AAA/stable)
- Tennessee Valley Authority (AA+/stable)
- 61 Counties
- 78 Municipalities
- 11 Special School Districts
- 9 Healthcare facilities or systems
- 12 Higher education institutions
- 4 Housing Authorities
- 2 Airports
- 108 utility systems

# 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

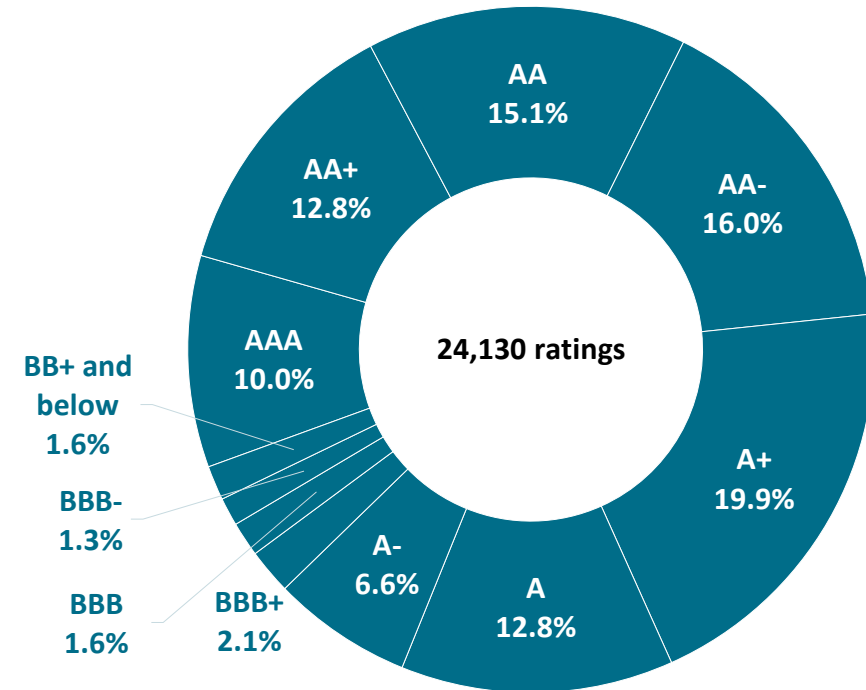
## Trends

- 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

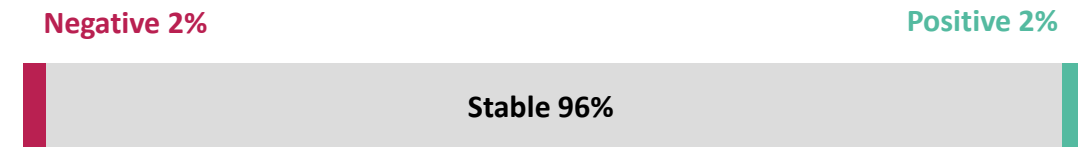
- Our baseline U.S. economic forecast is now for a shallower but more protracted slowdown rather than a recession; however, we don't expect this to disrupt credit stability for most issuers

U.S. Public Finance Ratings Distribution



Source: S&P Global Ratings.

Outlook distribution



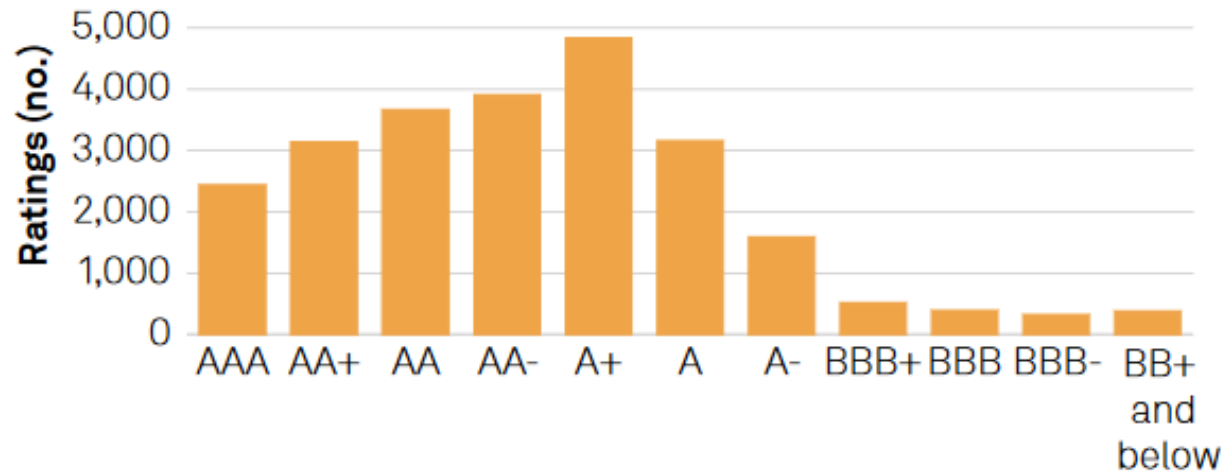
Source: S&P Global Ratings.

# U.S. Public Finance at a Glance (rated issuers, all sectors)

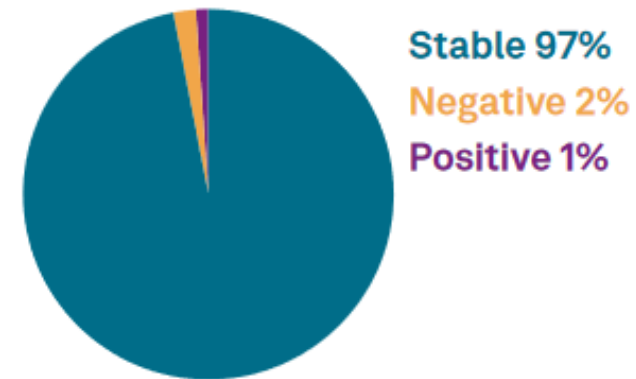
24,000+  
Ratings 

Rating changes	August 2023	2023 (no.)
<b>Upgrades</b>	69	580
<b>Downgrades</b>	14	170
<b>Outlook and CW changes</b>		
<b>Favorable</b>	39	204
<b>Unfavorable</b>	31	358

Rating distribution

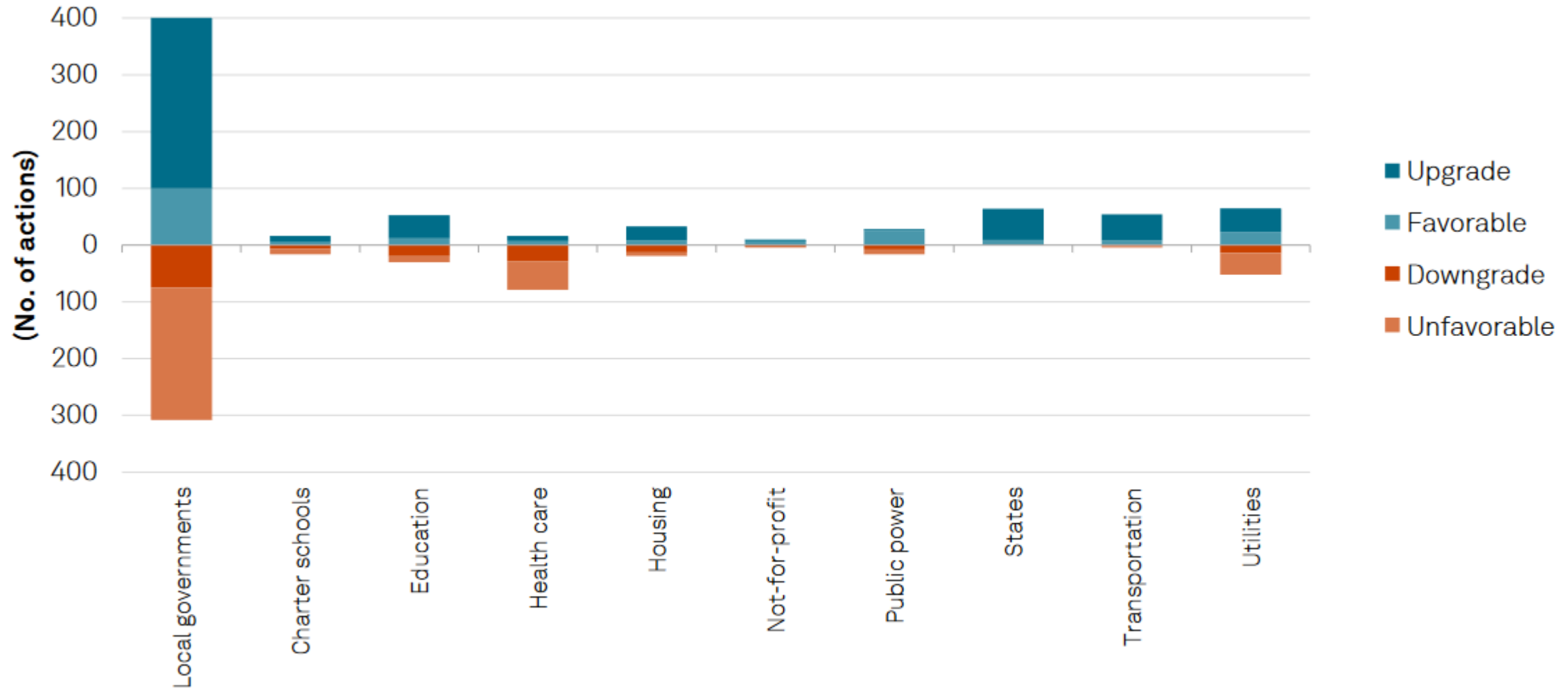


Outlook distribution



# Upgrades continue to outpace downgrades year to date, except in the healthcare sector

USPF rating actions by sector YTD 2023



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



## **Rates**

With rising interest rates, issuance remains down, but unspent federal stimulus can help fill the gap for funding capital in the next few years.



## **Inflation**

Higher cost of capital and supplies raise project costs, potentially limiting what can get done; any softness in revenue growth squeezes margins further, particularly in a high-wage environment.



## **Unemployment**

Low unemployment rates and high demand for skilled labor continue to create difficulties for many issuers across public finance. Expectations for ongoing low unemployment rates don't foretell a respite from the labor shortages.



## **Commercial real estate**

Softness in downtown real estate markets has not resulted in credit deterioration but bears watching, especially if office vacancy rates remain high and there is limited ability to raise property tax rates.



## **ARPA spending**

With 18 months left to designate the use of ARPA, greater use of federal stimulus for programs rather than for capital projects could signal budgetary challenges. This source of ready money could be reprogrammed by U.S. issuers seeing revenue softness.

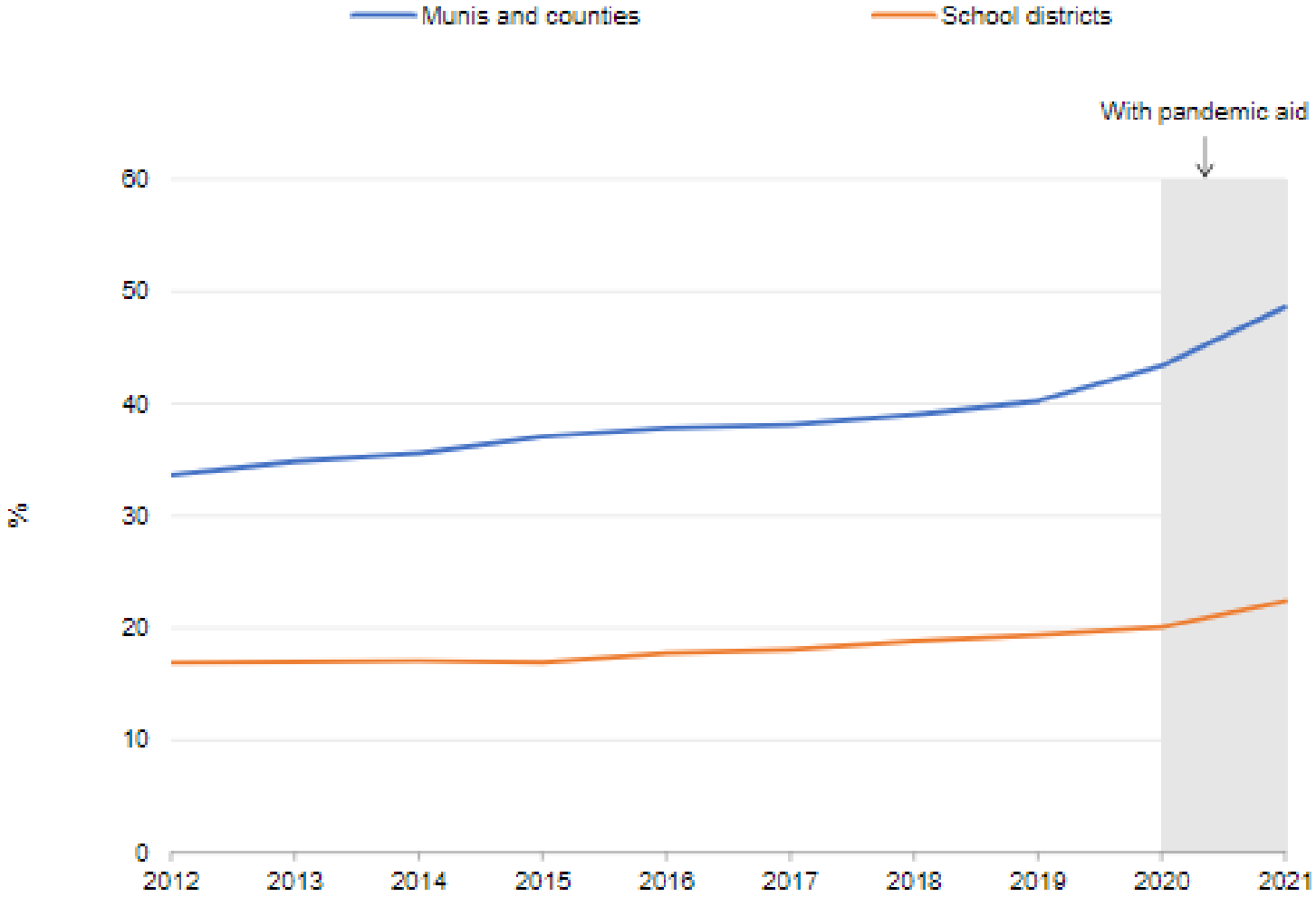


## **Federal budget**

In addition to changes made as part of the debt ceiling deal, contentious budget negotiations later in 2023 will increase the likelihood of cuts to programs and entitlements in the U.S., which can flow through to state and local government budgets.

# U.S. Local Governments | Reserve Trends

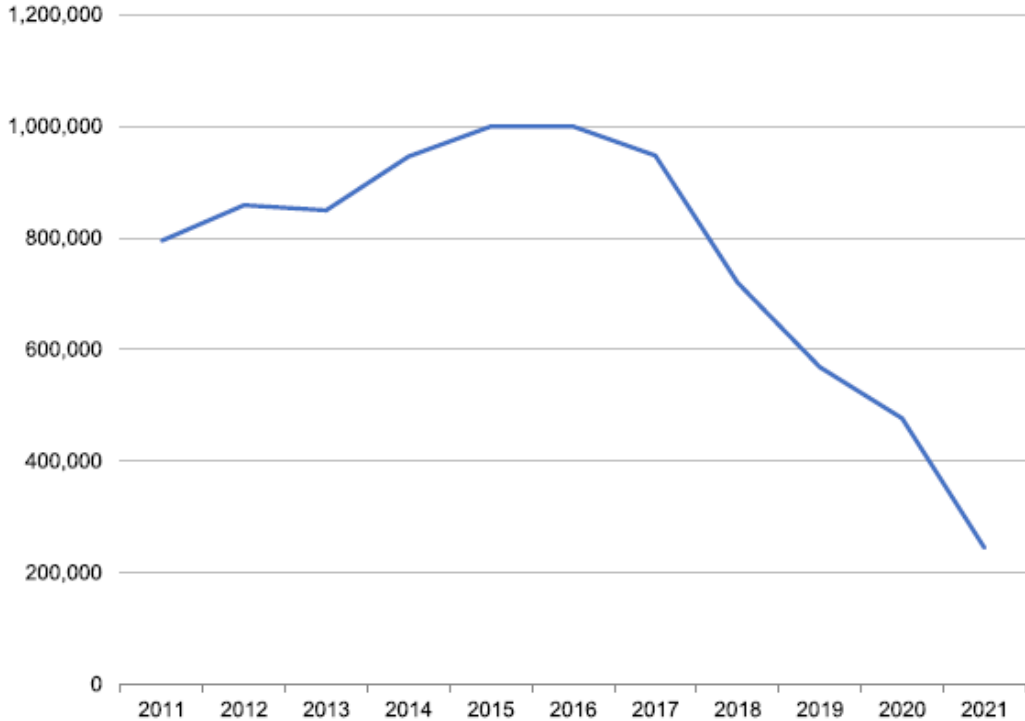
## Unassigned General Fund Balance as Share of General Fund Expenditures





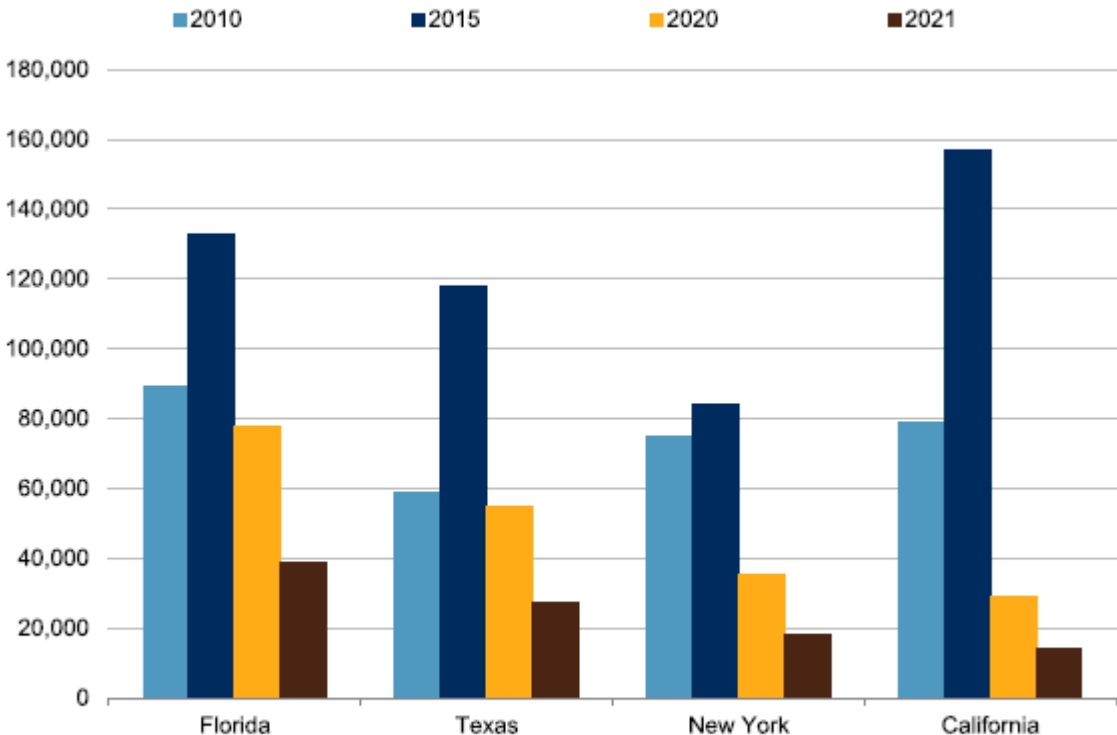
# Workforce Challenges | Demographics/Migration

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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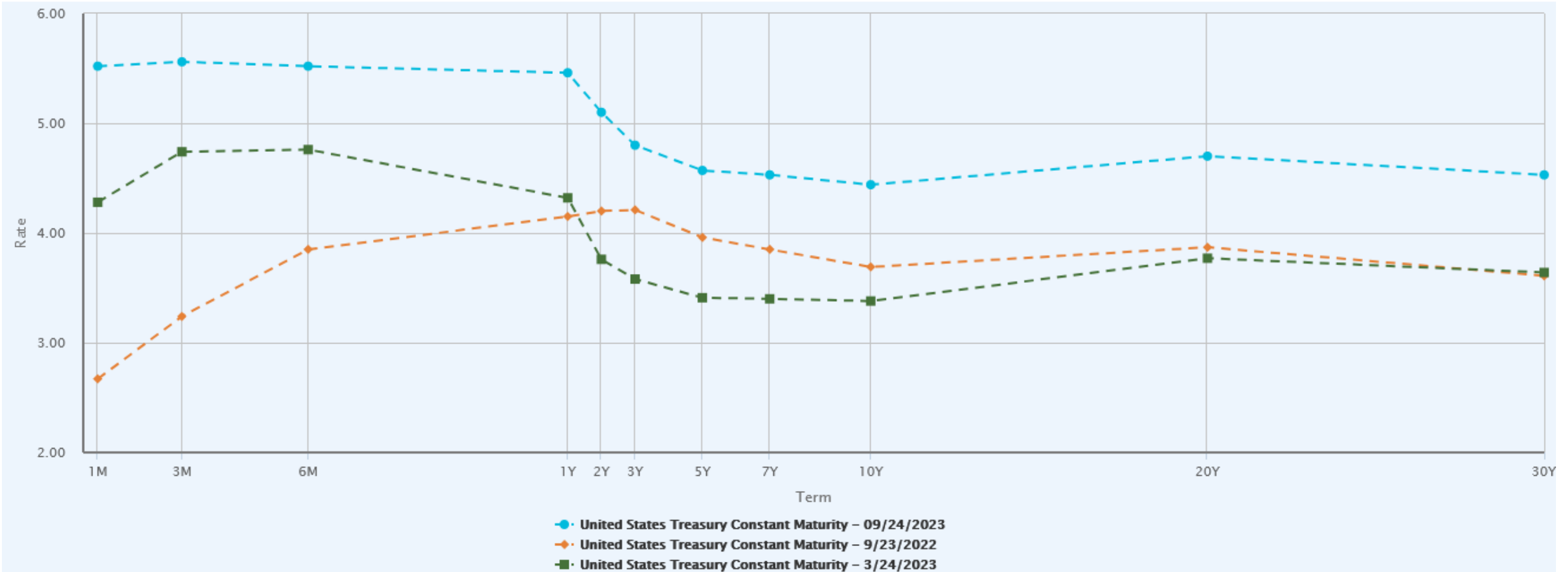
# Credit Conditions Update

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

## Resilient Demand, Diminishing Labor Imbalance, Higher for Longer

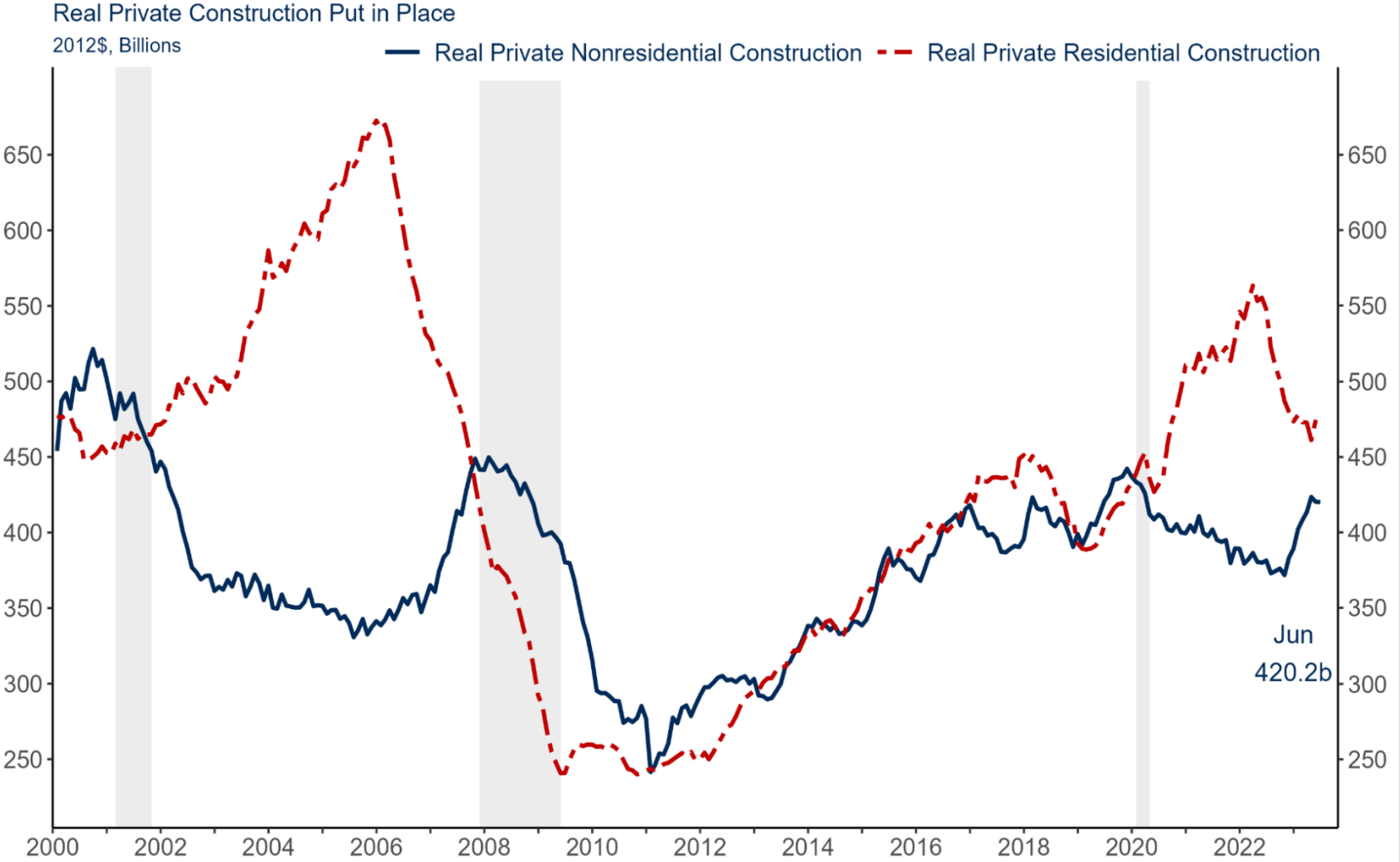
	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Real GDP (annual average % change)	2.3	-2.8	5.9	2.1	2.3	1.3	1.4	1.8
Real consumer spending (annual average % change)	2.0	-3.0	8.3	2.7	2.5	1.4	1.5	2.1
Real equipment investment (annual average % change)	1.3	-10.5	10.3	4.3	-0.8	1.4	1.7	2.2
Real nonresidential structures investment (annual average % change)	2.3	-10.1	-6.4	-6.6	7.6	1.1	0.5	3.2
Real residential investment (annual average % change)	-1.0	7.2	10.7	-10.6	-11.1	0.7	3.2	1.8
Core CPI (annual average % change)	2.2	1.7	3.6	6.2	4.7	2.6	2.3	2.3
Unemployment rate (%)	3.7	8.1	5.4	3.6	3.6	4.1	4.7	4.8
Housing starts (annual total in mil.)	1.3	1.4	1.6	1.6	1.4	1.4	1.4	1.4
Light-vehicle sales (annual total in mil.)	17.0	14.5	15.0	13.8	15.3	15.1	15.5	15.6
10-year Treasury (%)	2.1	0.9	1.4	3.0	3.9	4.0	3.6	3.6

# Yield Curve Remains Inverted



Source: S&P Global Ratings

# Real Private Construction | Residential vs Non-Res.

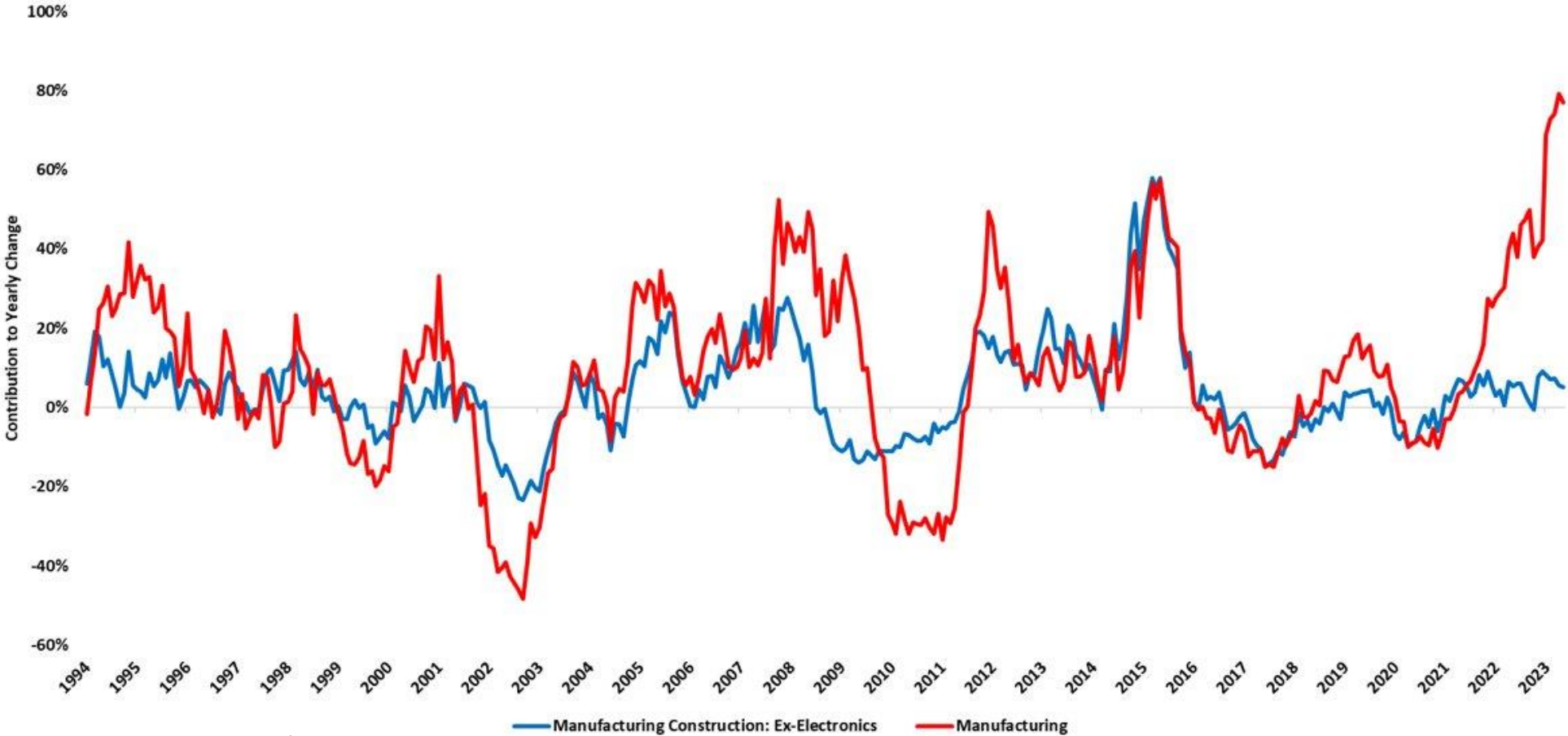


Source: Census Bureau; Notes: Private nonresidential construction deflated using the price index for private fixed investment in nonresidential structures and private residential construction deflated using the private residential investment chain price index.

# Fiscal Policy Driven | Boom in US Manufacturing Construction

The Infrastructure Investment and Jobs Act (IIJA), Inflation Reduction Act (IRA), and CHIPS Act each provided direct funding and tax incentives for public and private manufacturing construction.

Manufacturing Construction: Total Construction vs. Construction Ex-Electronics



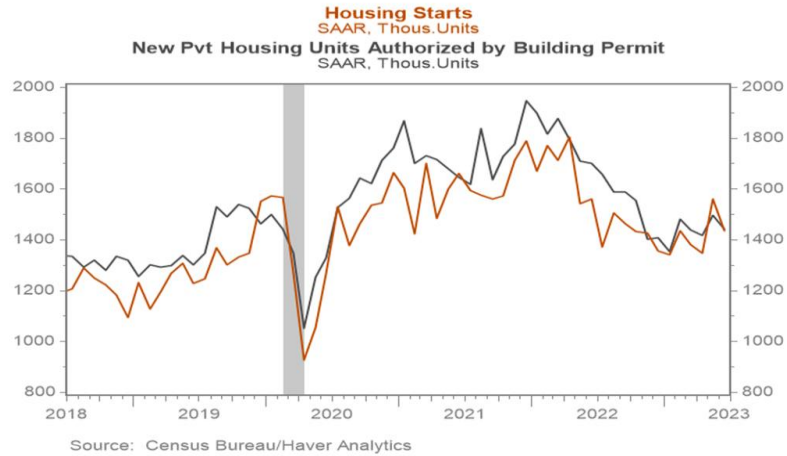
Source: US Department of Treasury

Note: IIJA, IRA, and CHIPS combined is the largest government spending programs directed at the nation’s infrastructure and industry since the 1930’s. Too early to tell if it will indeed lift productivity and living standards sustainably, but it is clear they are currently stimulating economic growth.

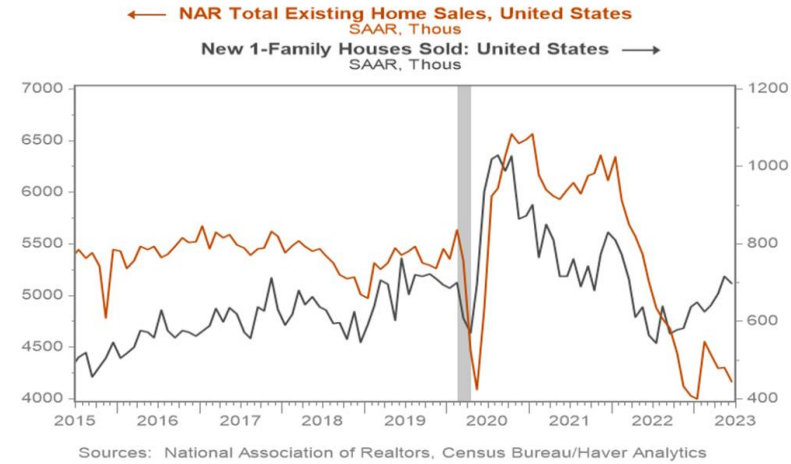
# Residential Investments | Found a Floor? Another leg Down?

## Affordability concerns all around.

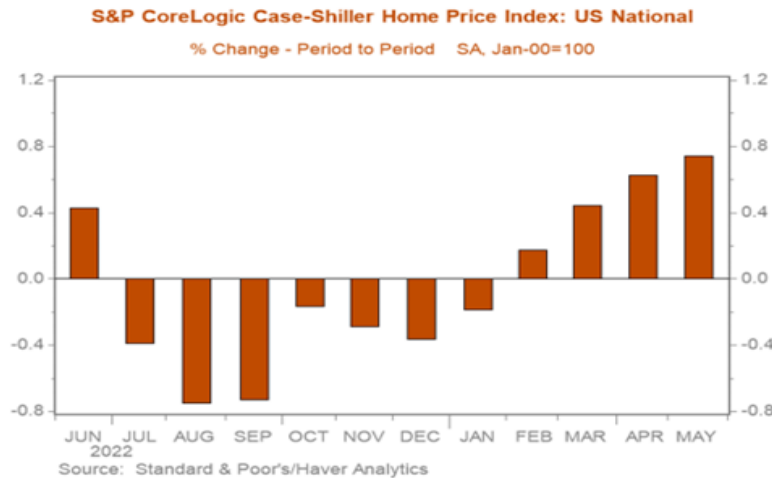
Residential construction activity remains resilient



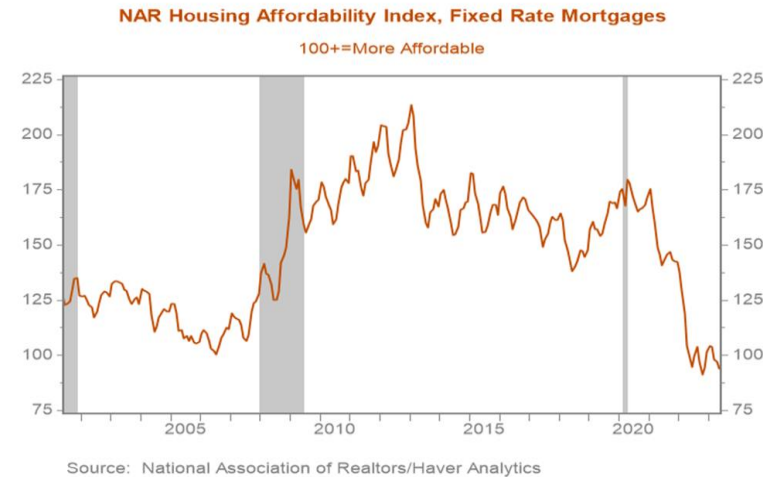
The resilience of new home sales partially reflects a dearth of homes in the resale market, which has benefited homebuilders.



The recent uptick in home prices leaves them just 1% below their June 2022 peak.



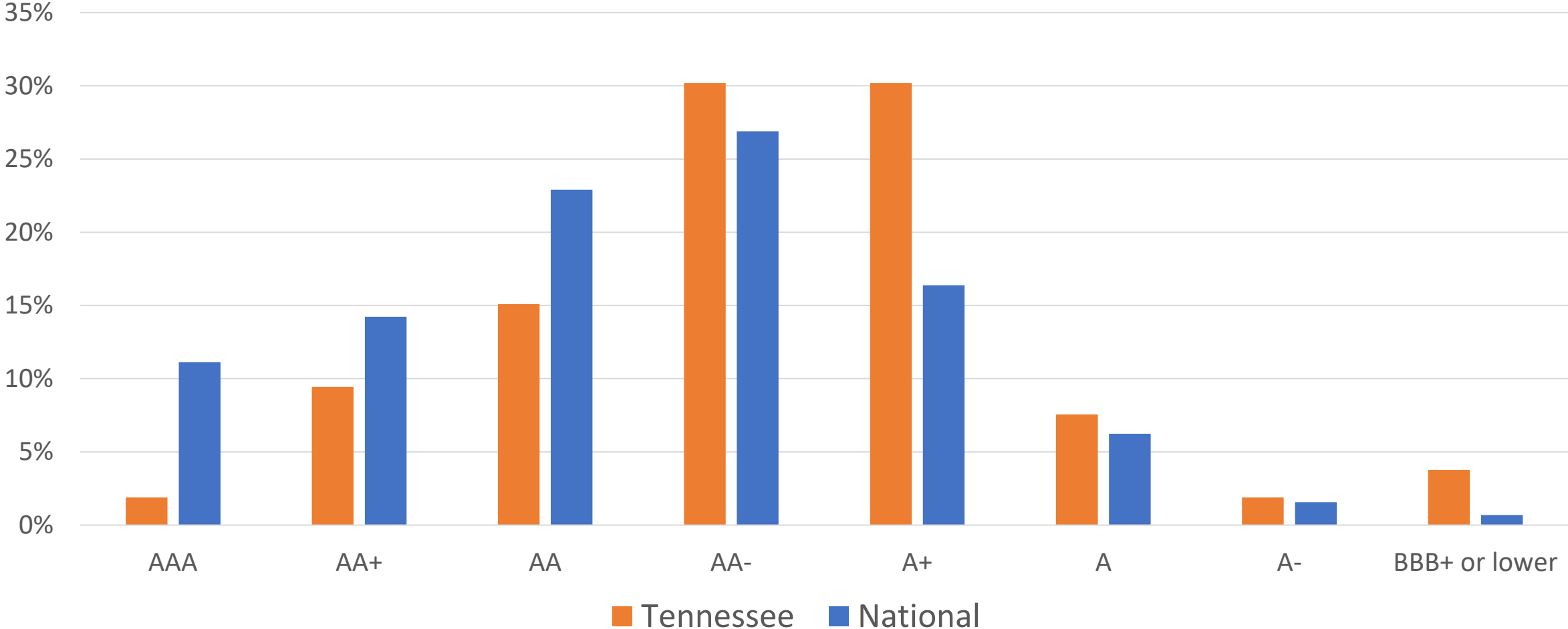
The ability of a median income household to purchase a median priced existing home remains stretched.



# S&P Global - Tennessee Local Government Coverage



# General Obligation Rating Distribution – 61 TN Counties



Source: S&P Global Ratings

# Tennessee Counties Median Credit Factors

	TN Counties	U.S.
Projected per capita EBI* % U	69.7%	82.2%
Market value per capita (\$)	88,460	106,557
Available general fund % expenses	42.8%	50.8%
Total liquidity % expenses	86.8%	75.1%
Fixed costs** % expenses	16.0%	9.9%
Net Direct Debt % Revenues	96.0%	50.0%
Pension % funded	114.2%	87.0%

\*effective buying income

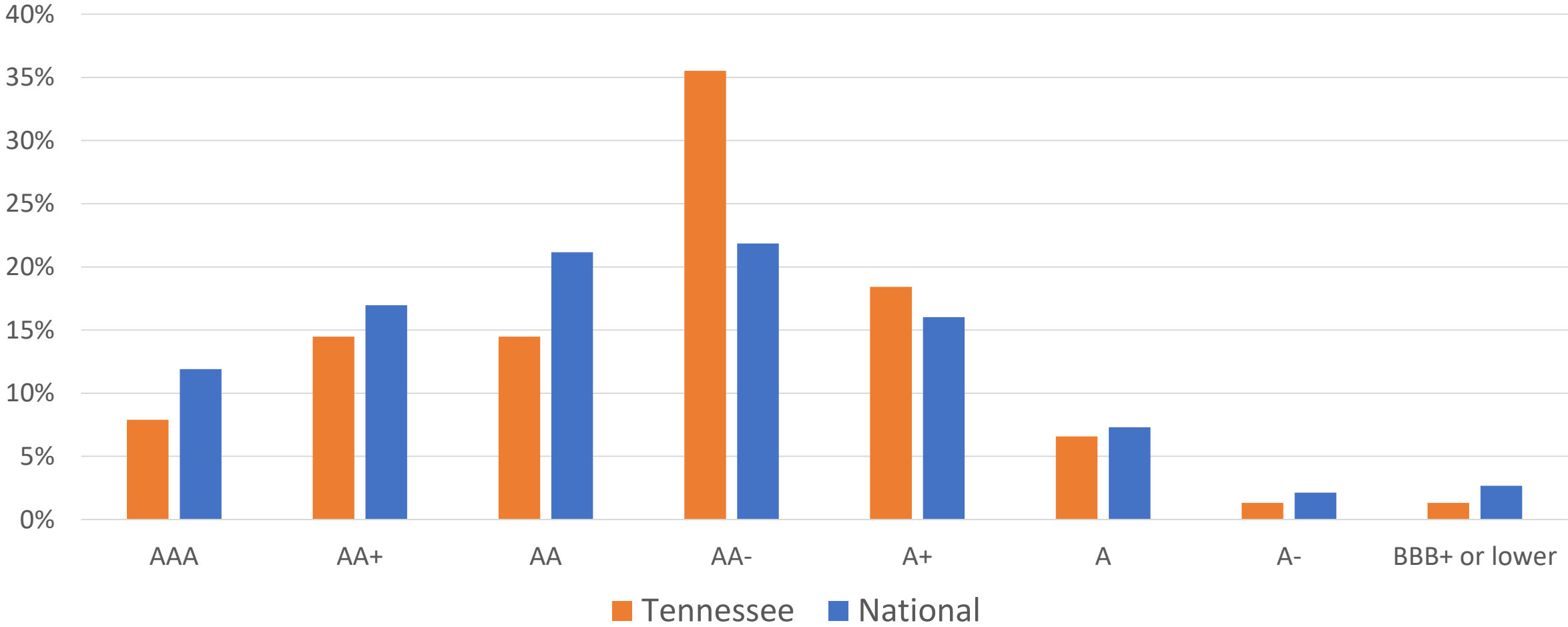
\*\*debt service + debt + retirement

## S&P Financial Management Assessment Distribution

	TN Counties	U.S.
Strong	6%	13%
Good	21%	28%
Standard	70%	57%
Vulnerable	4%	2%

Source: S&P Global Ratings

# General Obligation Rating Distribution – 78 TN Municipalities



Source: S&P Global Ratings

# Tennessee Munis Median Credit Factors

	TN Munis	U.S.
Projected per capita EBI* (%)	72.2%	94.1%
Market value per capita (\$)	92,396	104,555
Available general fund % expenses	71.4%	46.3%
Total liquidity % expenses	118.5%	94.2%
Fixed costs** % expenses	9.4%	14.5%
Net Direct Debt % Revenues	61.3%	89.1%
Pension % funded	105.4%	82.1%

\*effective buying income

\*\*debt service + debt + retirement

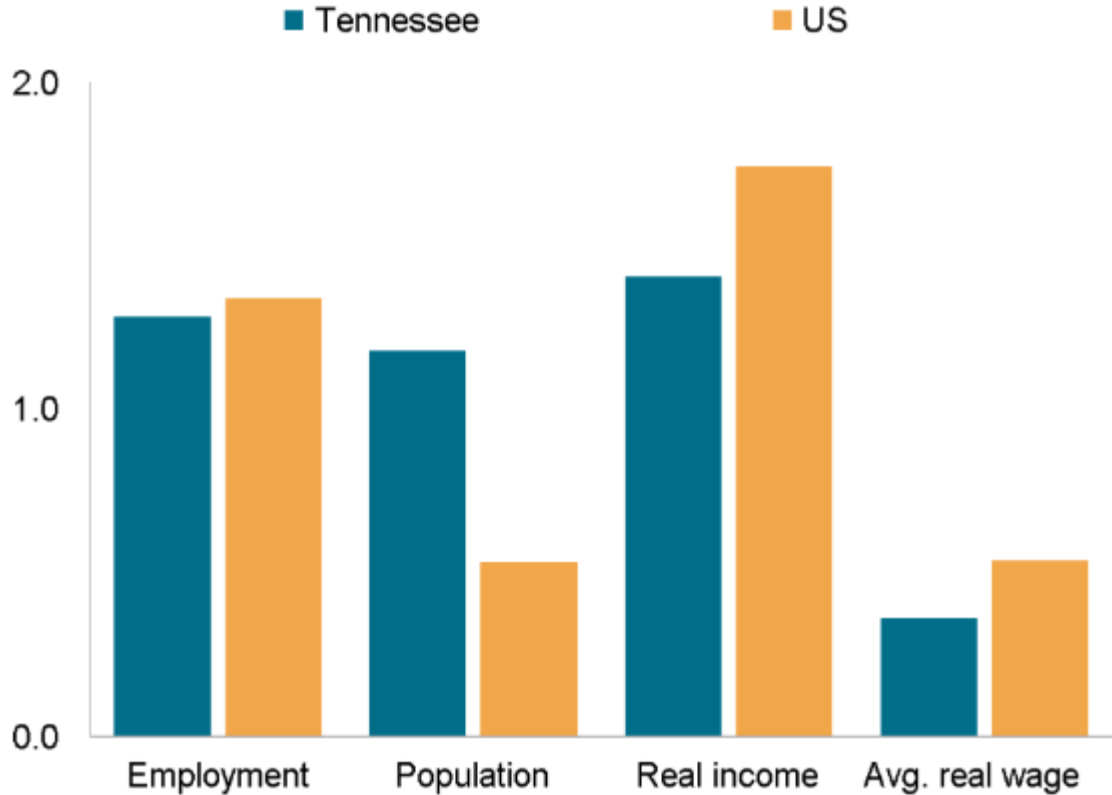
## S&P Financial Management Assessment Distribution

	TN Munis	U.S.
Strong	16%	13%
Good	34%	35%
Standard	49%	50%
Vulnerable	1%	2%

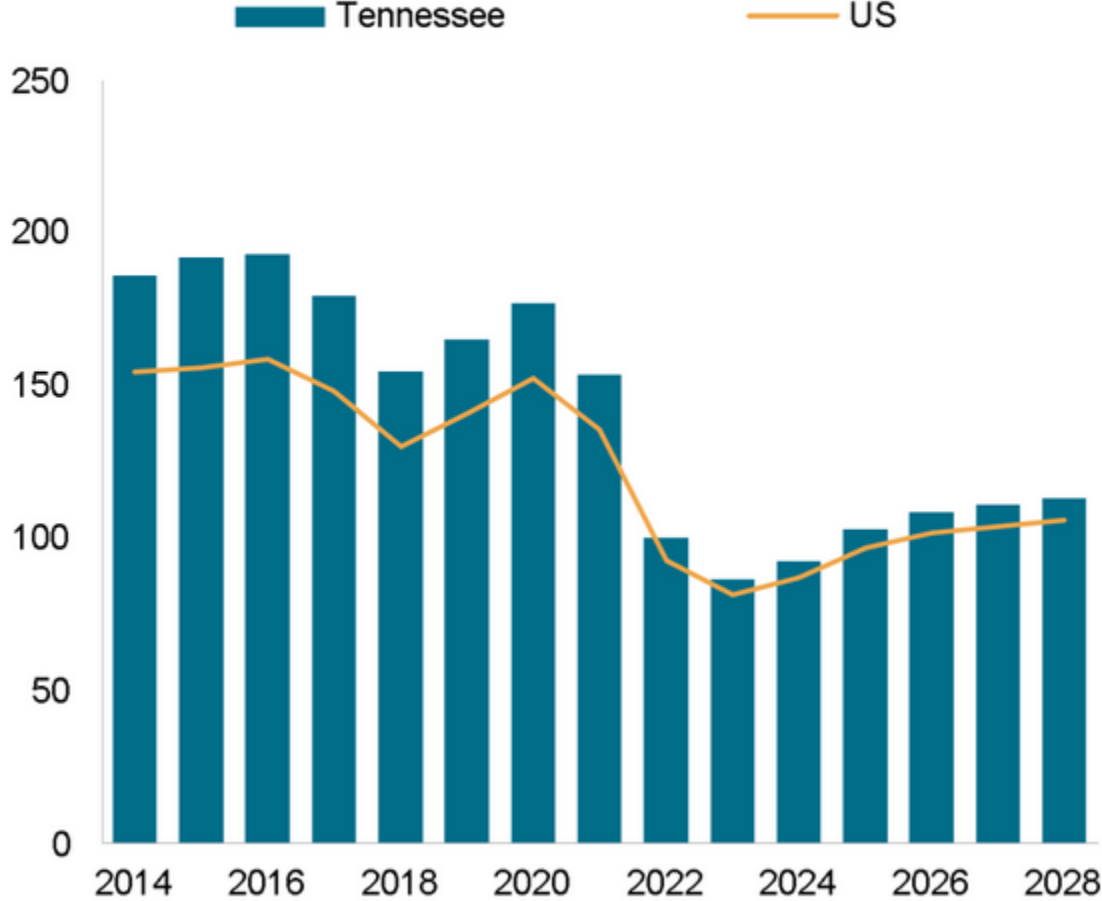
Source: S&P Global Ratings

# Tennessee Economic Trends

Relative growth in key indicators, 2022 to 2024 (CAGR)

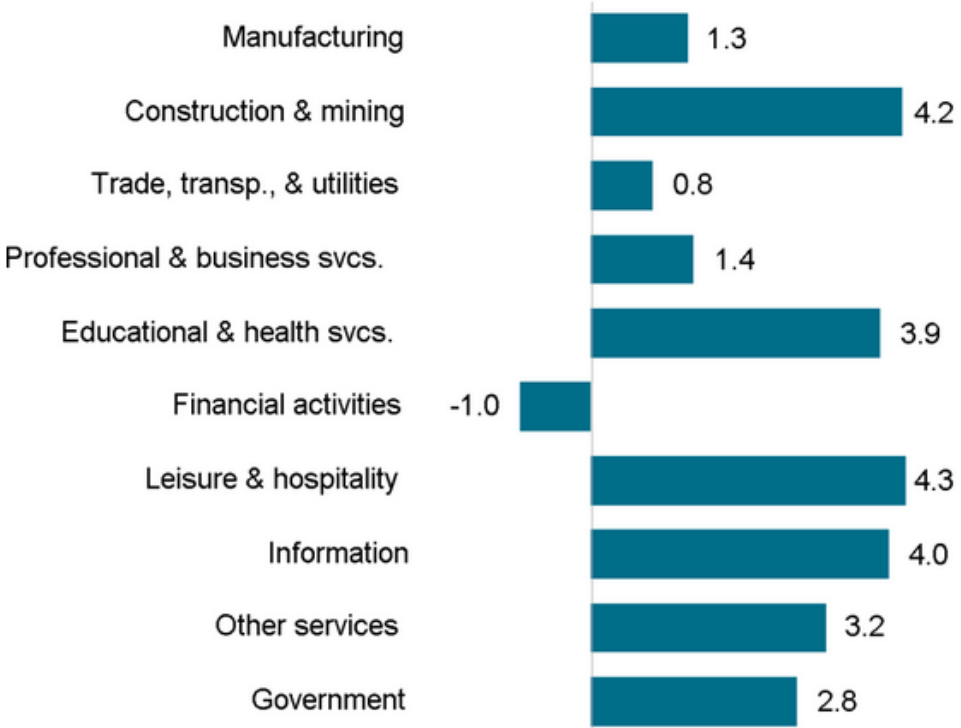


Housing affordability (higher index reading = more affordable)



# Tennessee Employment

**Employment growth by sector, July 2023  
(percent change vs. year earlier)**



	2023 % of Total	2023 Location quotient (US avg = 100)	2023 % of Total	2023 Location quotient (US avg = 100)
<b>Construction</b>	4.60%	91	4.60%	88
<b>Natural Resources and Mining</b>	0.10%	34	0.10%	32
<b>Manufacturing</b>	11.00%	133	9.40%	130
<b>Trade, Transportation, and Utilities</b>	20.70%	112	18.90%	112
<b>Information</b>	1.70%	86	1.50%	81
<b>Financial Activities</b>	5.20%	90	5.30%	93
<b>Professional and Business Services</b>	14.40%	97	16.30%	101
<b>Education and Health</b>	14.10%	87	15.00%	87
<b>Leisure and Hospitality</b>	11.00%	103	10.70%	104
<b>Other Services</b>	3.90%	103	4.20%	106
<b>Government</b>	13.40%	92	14.00%	93

MSA = metropolitan statistical area.  
 Source: S&P Global Market Intelligence.  
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# Tennessee Local Government Outlook

## Credit Positives:

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- Growing population, incomes, and wealth levels
- Strong employment growth in a variety of industries
- Strong reserve positions
  - County Median — TN: 42.8%; US: 50.8%
  - Muni Median — TN: 71.4%; US: 46.3%
- High degree of revenue flexibility and ability to balance budgets (no circuit breakers or property tax caps, strong local legislative authority)
- *Still* affordable housing relative to U.S. as a whole
- Well-funded pension positions

## Credit Challenges:

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- Slowing revenue growth as the post-COVID boom wanes and ‘normalization’ of growth from online sales tax collections
- Increasing capital needs associated with a growing population; challenges with contractor and laborer availability
- Competitive labor market driving up personnel costs
- Slowing manufacturing employment growth due to uncertain global demand.

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