

# Methodology For Rating U.S. Governments

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Feb. 25, 2025

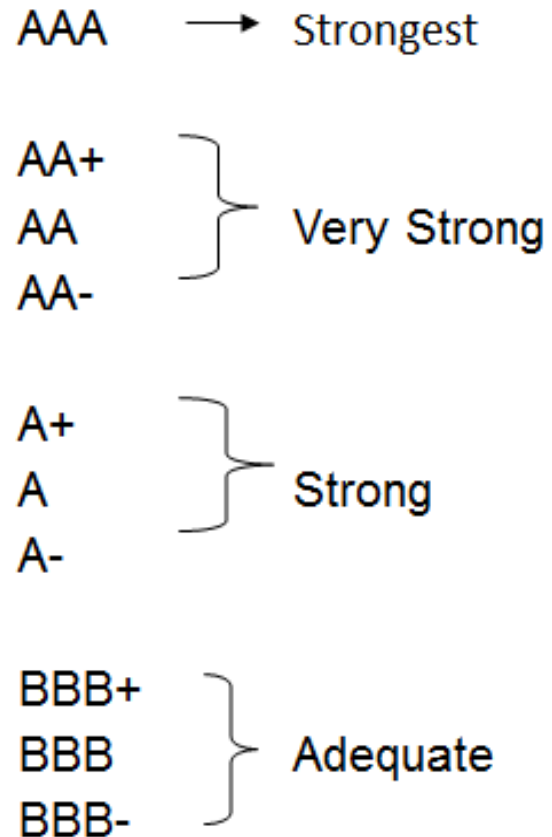


# Understanding S&P Global's Ratings

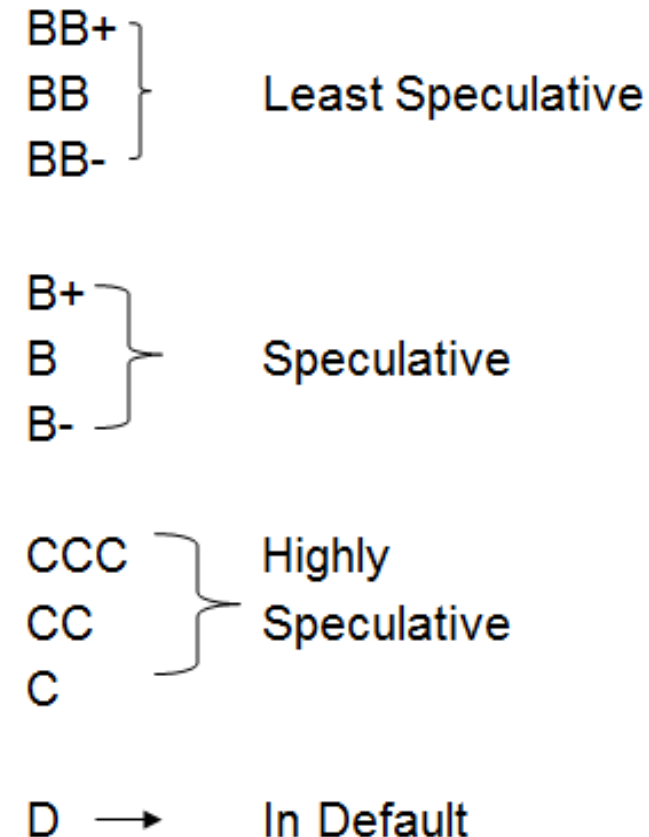
- An issuer's *ability* and *willingness* to pay debt in a *timely* manner
- Credit ratings are *forward looking*
- S&P Global ratings are *opinions*, not guarantees of credit quality or exact measures of the probability that a particular issuer or particular debt issue will default
- The Ratings scale *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

# S&P Global's Ratings Scale

## Investment-Grade

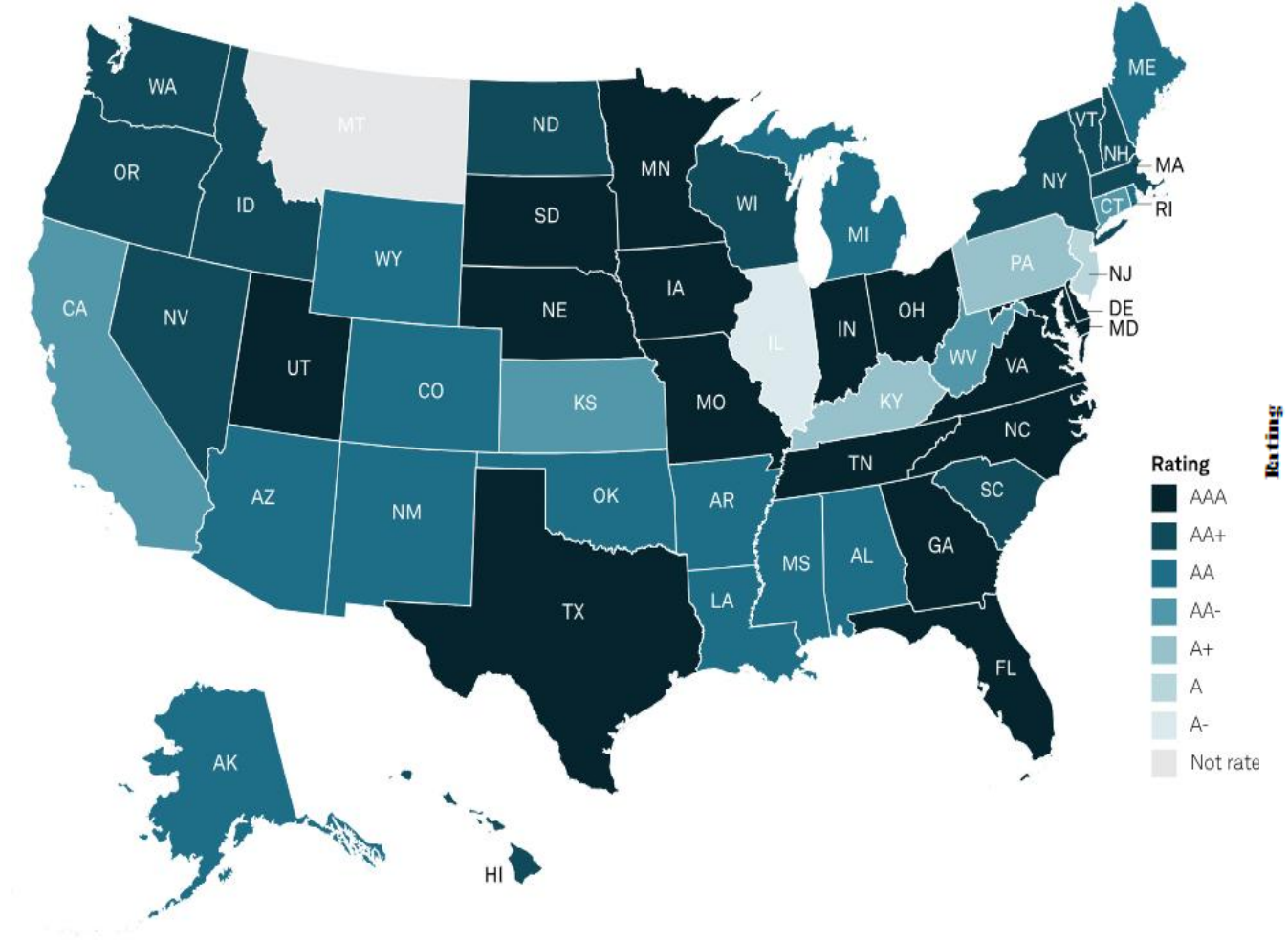


## Speculative-Grade



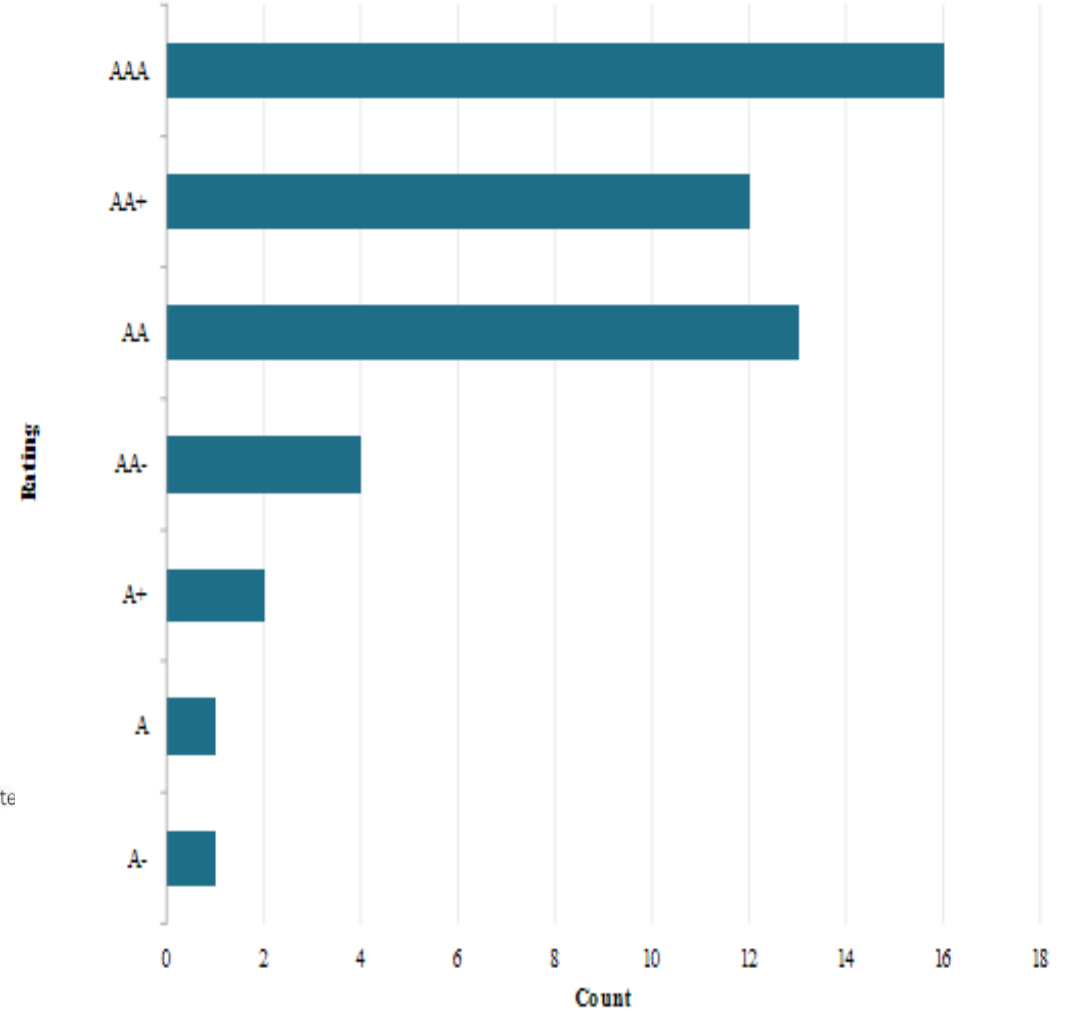
**Short-term U.S. Public Finance note ratings: SP-1+, SP-1, SP-2 & SP-3**

## U.S. States: State Ratings Distribution



Source: S&P Global Ratings.  
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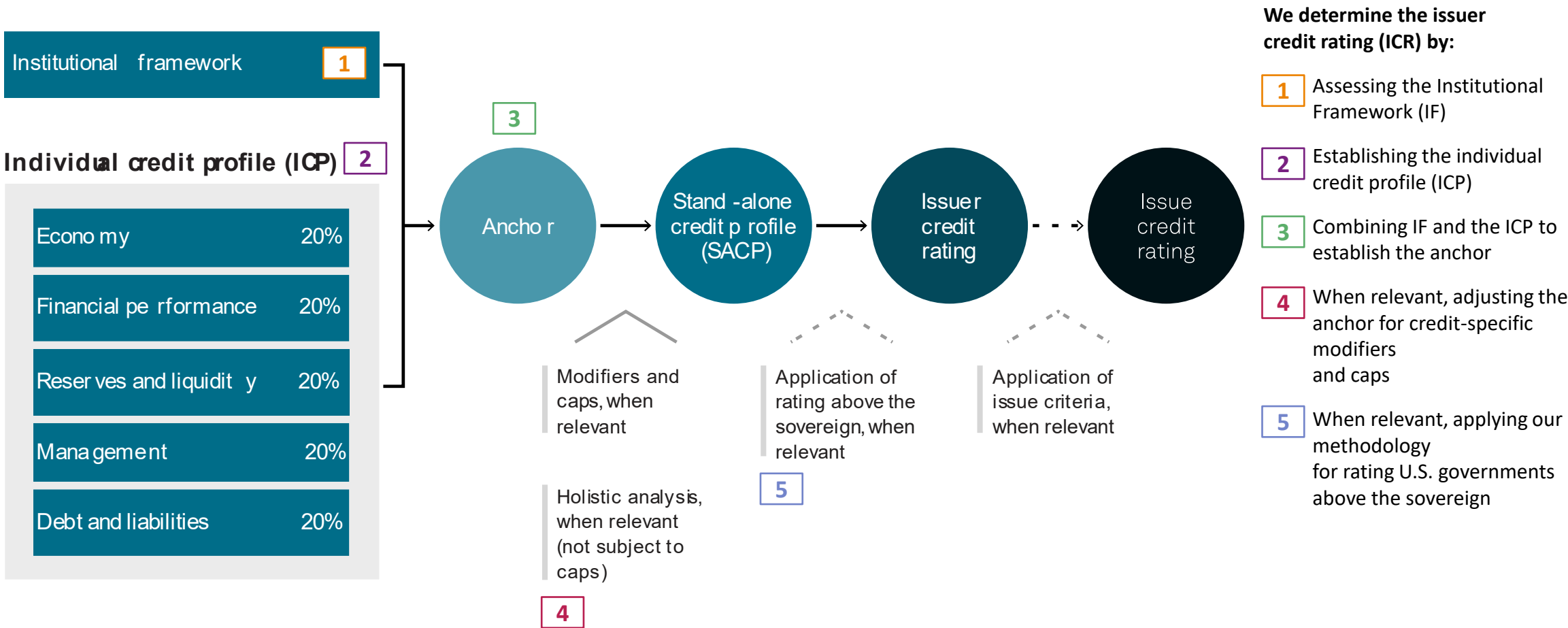
**S&P Global**  
Ratings



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# The Analytical Framework

Framework for ratings U.S. governments



# Institutional Framework

- The IF is the set of formal rules and laws, practices, customs, and precedents that shape the environment in which governments operate.
- We assess the IF by state and government type (i.e., states, counties, municipalities, schools).
- When the legal or practical environment for a specific local government differs from the norm in its state (portfolio assessment), we will assess accordingly.

## Predictability (25%)

The ability of a government to forecast its revenues and expenditures

## Revenue/expenditure balance and system support (50%)

The ability of a government to finance the services it provides, and the degree of ongoing and exceptional support from a higher-level government

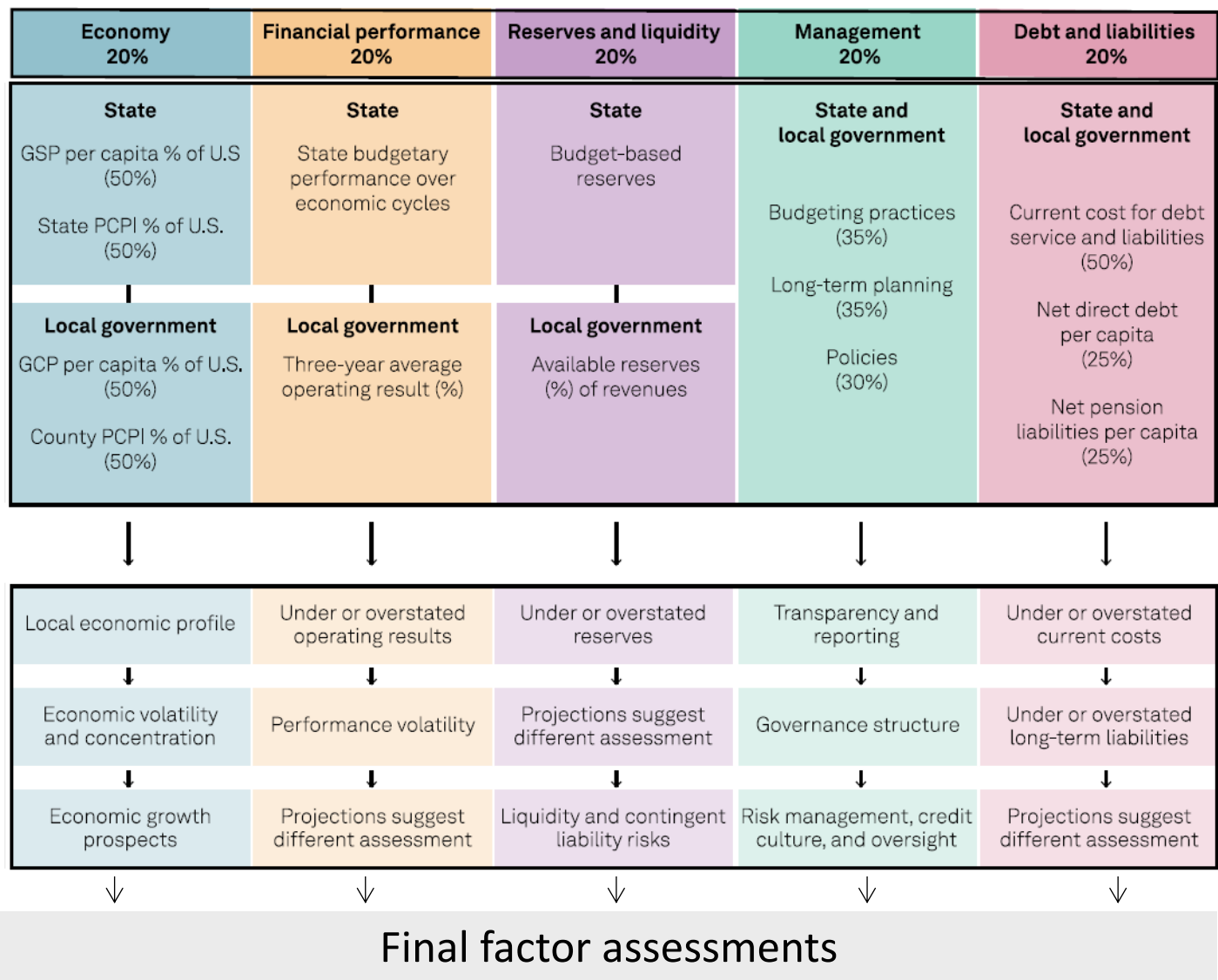
## Transparency and accountability (25%)

The comparability of a government's relevant financial information

# Framework For Establishing The Individual Credit Profile (ICP)

Step 1: Establish initial assessment

Step 2: Apply qualitative adjustments



GSP--Gross state product. GCP--Gross county product. PCPI--Per capita personal income.

# Management

## Step 1: Establish initial assessment

| State and local government | 1   | 2  | 3   | 4   |
|----------------------------|---|--|---|---|
| Budgeting practices        | Budgets are forward-looking with robust monitoring    | Budgets are realistic with sufficient monitoring | Budgets are limited in scope with informal monitoring | Budgets are unrealistic and lack monitoring |
| Long-term planning         | Robust culture of long-term planning                  | Some long-term planning                          | Informal long-term planning                           | No long-term planning                       |
| Policies                   | Robust, well-defined policies with thorough reporting | Basic policies with regular reporting            | Informal policies exist with little or no reporting   | No policies or policies not followed        |

## Step 2: Qualitative adjustments

### Transparency and reporting adjustment

Considers management's timely and effective disclosure of information

### Governance structure adjustment

Considers whether the relationship between management and governing bodies or issues with the processes for making decisions or executing reforms could worsen initial assessment

### Adjustment for risk management, credit culture, and oversight

Considers management's risk tolerance, oversight, or track record in adequately planning and monitoring the government's operations



# Debt And Liabilities

## Step 1: Establish initial assessment

|                                       | 1    | 2         | 3           | 4           | 5           | 6      |
|---------------------------------------|------|-----------|-------------|-------------|-------------|--------|
| State                                 |      |           |             |             |             |        |
| Current cost for debt and liabilities | <3   | 3-6       | 6-9         | 9-12        | 12-15       | >15    |
| Net direct debt per capita            | <500 | 500-1,500 | 1,500-2,500 | 2,500-3,500 | 3,000-4,500 | >4,500 |
| Net pension liabilities per capita    | <500 | 500-1,500 | 1,500-2,500 | 2,500-3,500 | 3,000-4,500 | >4,500 |
| Local government                      |      |           |             |             |             |        |
| Current cost for debt and liabilities | <8   | 8-14      | 14-20       | 20-25       | 25-30       | >30    |
| Net direct debt per capita            | <500 | 500-1,500 | 1,500-2,500 | 2,500-3,500 | 3,000-4,500 | >4,500 |
| Net pension liabilities per capita    | <500 | 500-1,500 | 1,500-2,500 | 2,500-3,500 | 3,000-4,500 | >4,500 |

## Step 2: Qualitative adjustments

### Adjustment for under- or overstated current costs

Considers if initial assessment should be adjusted because current costs for debt and liabilities are over- or understated and would align with a different initial assessment

### Adjustment for under- or overstated long-term debt and liabilities

Considers if initial assessment should be adjusted because long-term debt and liabilities are over- or understated and would align with a different initial assessment

### Adjustment for projections that suggest different assessment

Considers whether prospective changes to current costs and long-term debt and liabilities would result in a different initial assessment

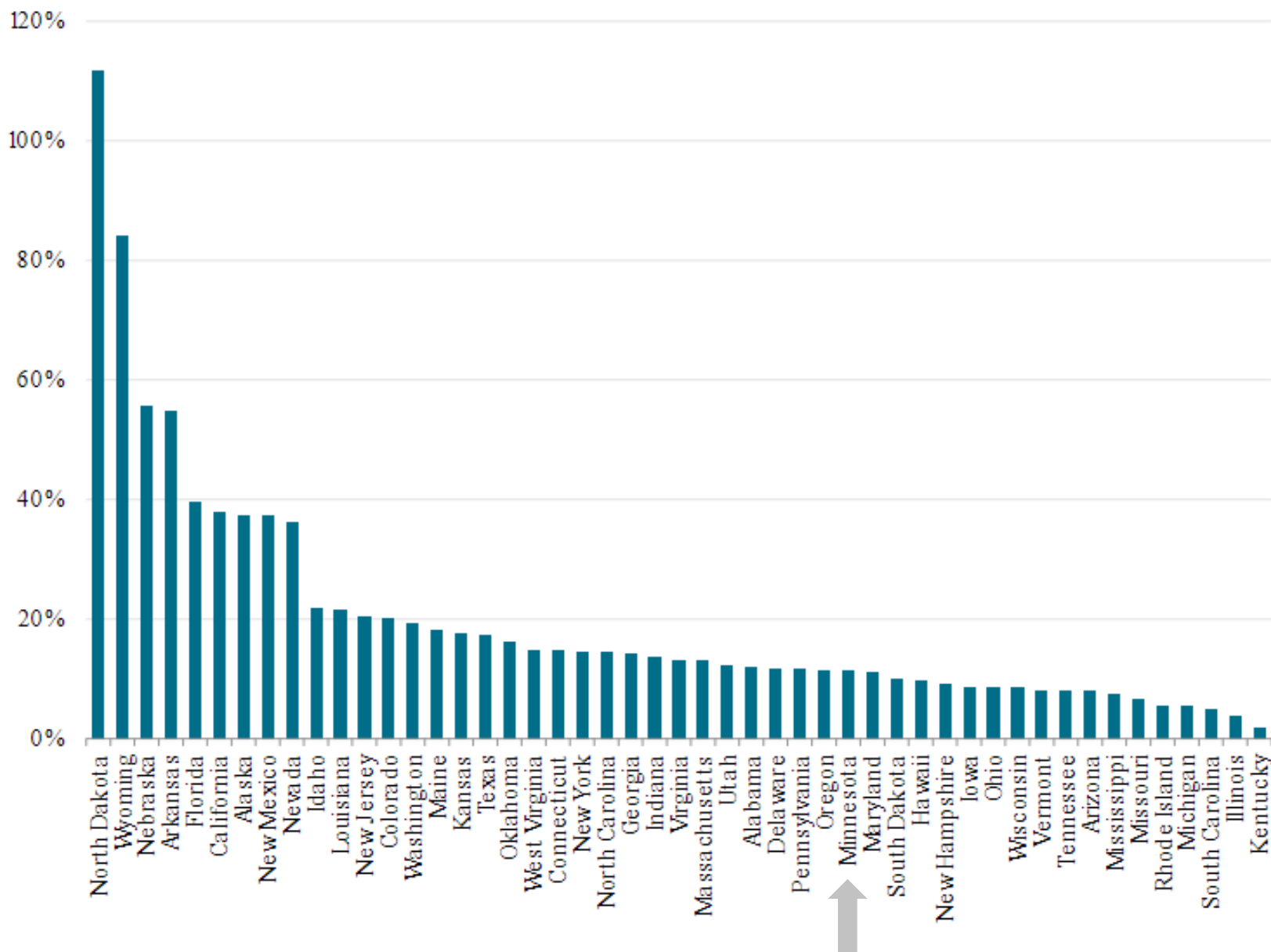
# State medians by rating category

| Rating   | Rating category |        |        |         |         | All states |
|--|-----------------|--------|--------|---------|---------|------------|
|  | AAA             | AA+    | AA     | AA-     | A       |            |
| Median IF score                                    | 1               | 1      | 1      | 1       | 1       | 1          |
| Median ICP score                                   | 1.44            | 1.8    | 2.12   | 2.385   | 2.865   | 1.82       |
| GSP per capita                                     | 62,598          | 61,814 | 54,348 | 70,839  | 65,673  | 61,655     |
| State PCPI   | 65,087          | 67,377 | 60,474 | 71,523  | 68,766  | 66,102     |
| Reserves as a % of budgeted revenue                | 11.35%          | 12.05% | 19.07% | 15.93%  | 11.42%  | 15.55%     |
| Operating results as a % of revenue                | 9.35%           | 6.30%  | 6.50%  | 4.15%   | 4.75%   | 8.00%      |
| Management assessment                              | 1               | 1.33   | 1.35   | 1.68    | 1.83    | 1.35       |
| Net direct debt per capita*                        | 531             | 1,621  | 880    | 1,704   | 1,587   | 1,008.5    |
| Net pension liability per capita*                  | 499             | 857.5  | 1,377  | 1,377.5 | 3,401   | 947        |
| Net direct debt and pension liabilities per capita | 1,258           | 2,406  | 2,696  | 3,081   | 9,438.5 | 2,199      |
| State aggregate funded ratio (%)                   | 82              | 72     | 72     | 76      | 48      | 75         |
| Current costs as a % of revenue                    | 3.64%           | 3.88%  | 5.24%  | 6.19%   | 11.25%  | 4.10%      |

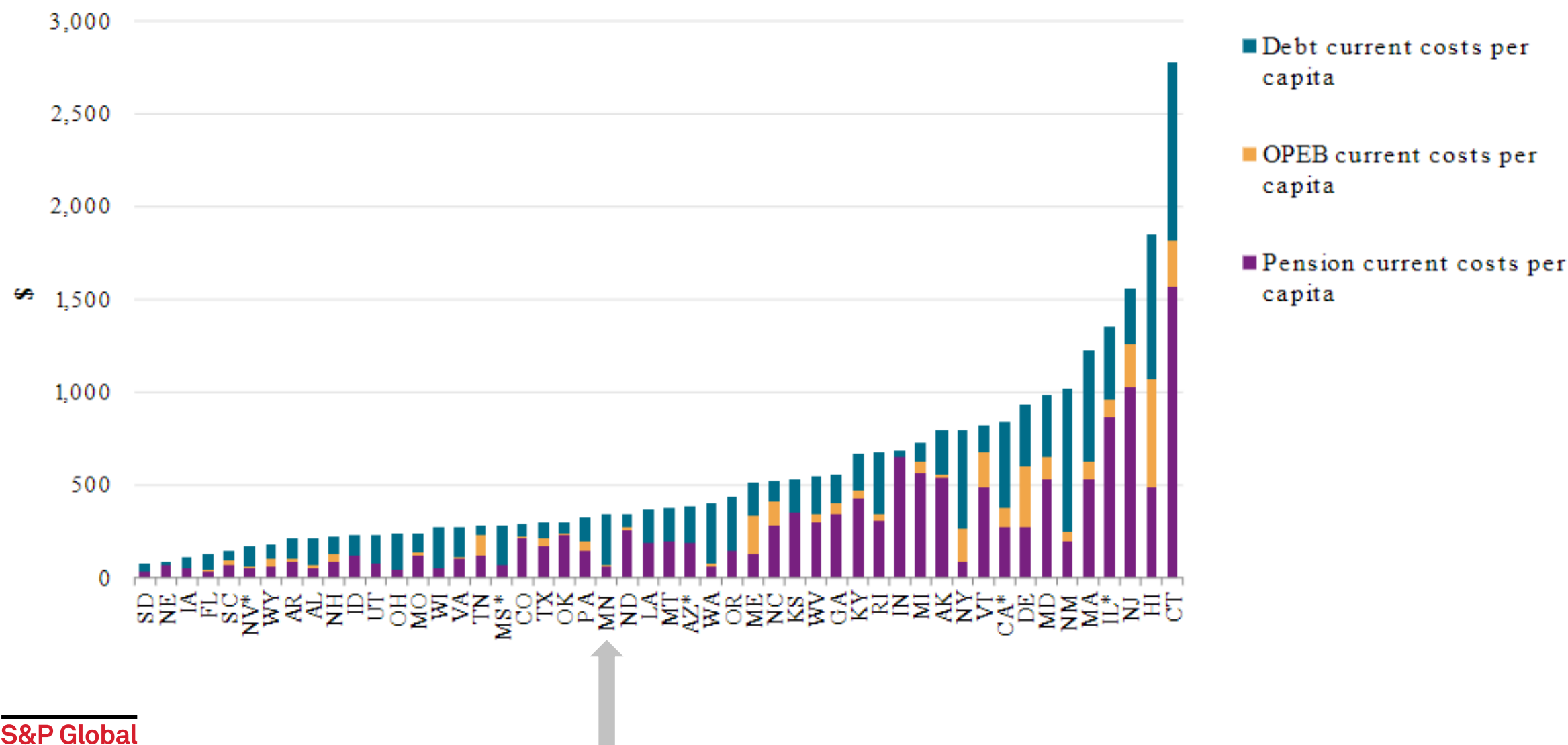
\*Based on the 2023 annual comprehensive financial reports where available, when unavailable the ratings are based on 2022 data. IF--Institutional framework. GSP--Gross state product. PCPI--Per capita personal income.

| <u>Minnesota</u>         |                 |
|--------------------------|-----------------|
| <u>2023*</u>             |                 |
| AAA                      | Rating          |
| 1                        | IF Score        |
| 1.45                     | ICP score       |
| 66,804                   | GSP per capita  |
| 71,819                   | State PCPI      |
| 29.9%                    | Reserves %      |
| 37.7%                    | Op results %    |
|                          | Management      |
| 1                        | assessment      |
| 1,292                    | Net direct debt |
|                          | Net pension     |
| 421                      | liability pc    |
|                          | Net debt &      |
| 1,713                    | pension pc      |
|                          | State           |
| 82.3%                    | aggregate       |
|                          | Current cost    |
| 3.3%                     | as % of rev     |
|                          |                 |
| *Our last published data |                 |

# Available reserves as a percentage of revenue (FY24)



# U.S. state current costs per capita (FY23)



\* The 2023 annual comprehensive financial reports are unavailable for AZ, CA, IL, MS & NV, so 2022 data used.

# U.S. States: What We're Watching



## Federal policy

Changing federal policies can have effects on states, both positive and negative. We're watching Medicaid policy decisions closely.



## Labor costs

Facing shortages in the past few years, states successfully attracted workers through increased wages. These costs now need to be funded in budgets.



## Tax structures

States have been cutting taxes for years. As the economy decelerates, will revenue forecasts hold?



## Demographics

An aging population, changing migration patterns, and immigration policies can drive future revenue and state service delivery changes. Social costs might pressure other parts of the budget.



## Event risks

Credit pressures from geopolitical events, cyber attacks, and extreme weather persist. Tackling affordability challenges and curbing the cost of insurance are now common budgetary challenges.

Source: S&P Global Ratings.

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# Appendix

- Details on ICP components

# Economy

## Step 1: Establish initial assessment

|                               | 1    | 2      | 3     | 4     | 5     | 6   |
|-------------------------------|------|--------|-------|-------|-------|-----|
| <b>State</b>                  |      |        |       |       |       |     |
| Real GSP % of U.S.            | >110 | 110-95 | 95-85 | 85-75 | 75-65 | <65 |
| State nominal PCPI % of U.S.  | >100 | 100-90 | 90-80 | 80-75 | 75-70 | <70 |
| <b>Local government</b>       |      |        |       |       |       |     |
| Real GCP % of U.S.            | >110 | 110-95 | 95-85 | 85-75 | 75-65 | <65 |
| County nominal PCPI % of U.S. | >100 | 100-90 | 90-80 | 80-75 | 75-70 | <70 |

## Step 2: Qualitative adjustments

### Local economic profile adjustment

Considers local government demographics, wealth, and income characteristics influencing revenue-generating capacity or expenditure demands

### Economic volatility and concentration adjustment

Considers the concentration and volatility of state or local government economies over cycles

### Economic growth prospects adjustment

Considers the projected economic growth patterns and other economic circumstances that could affect future revenue-generating capacity

# Financial Performance

## Step 1: Establish initial assessment

|  | 1  | 2  | 3   | 4   |
|--|--|--|---|---|
| State  |  |  |   |   |
| State budgetary performance over economic cycles | Surplus performance achieved during economic expansion and budget balance during economic decline will be less than 50% reliant on one-time measures | Balanced operating results achieved during economic expansion and budget balance during economic decline may be more than 50% reliant on one-time measures | Balanced operating results may be achieved during economic expansion and budget balance during economic decline may be more than 75% reliant on one-time measures | Limited focus on structural budget balance, regular deficits carried through into future fiscal years |
| Local government                                 |  |  |   |   |
| Three-year average operating result (%)          | >3   | 3-0  | 0-(3)   | (3)   |

## Step 2: Qualitative adjustments

### Adjustment for under- or overstated operating results

Considers if financial performance is over- or understated and would align with a different initial assessment

### Performance volatility adjustment

Considers if financial performance is subject to unpredictability and would align with a worse initial assessment

### Adjustment for projections that suggest different assessment

Considers whether prospective changes to current financial performance would result in a better or worse initial assessment



# Reserves And Liquidity

## Step 1: Establish initial assessment

| State                 | 1   | 2  | 3  | 4   |
|-----------------------|---|--|--|---|
| Budget-based reserves | There is a formal budget-based reserve target relative to annual revenue or spending that is above 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion | There is a formal budget-based reserve target relative to annual revenue or spending that is between 4% and 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion | There is a formal budget-based reserve target relative to annual revenue or spending that is between 1% and 4%. In addition, there is a demonstrated track record of restoring the reserve following depletion | There is no formal budget reserve target, or reserves are funded at less than 1% over time, or there is no process for accumulating reserves. No additional reserve funds are identified or available |

| Local government                 | 1   | 2    | 3   | 4   | 5  |
|----------------------------------|-----|------|-----|-----|----|
| Available reserves % of revenues | >15 | 15-8 | 8-4 | 4-1 | <1 |

## Step 2: Qualitative adjustments

### Adjustment for under- or overstated reserves

Considers if reserves are over- or understated and would align with a different initial assessment

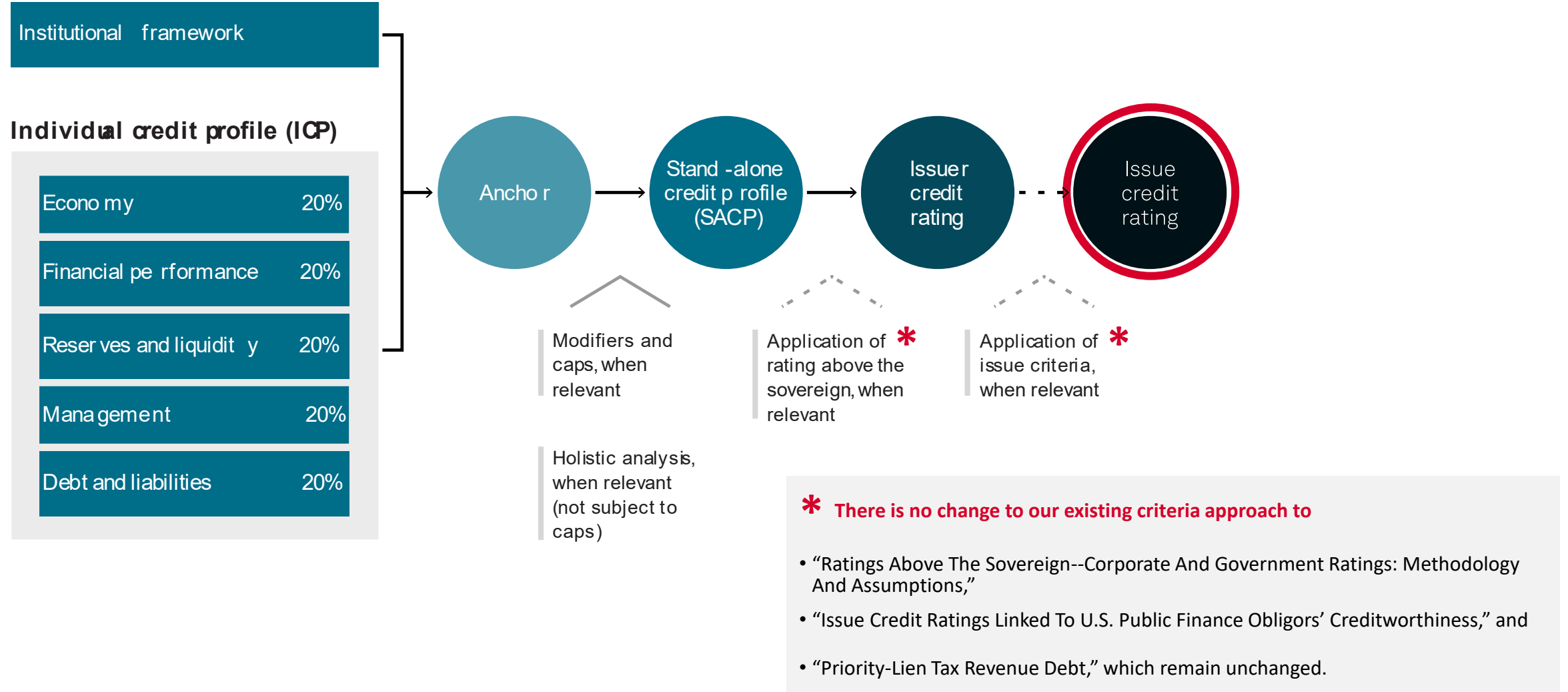
### Adjustment for projections that suggest a different assessment

Considers whether prospective changes to reserves would result in a better or worse initial assessment

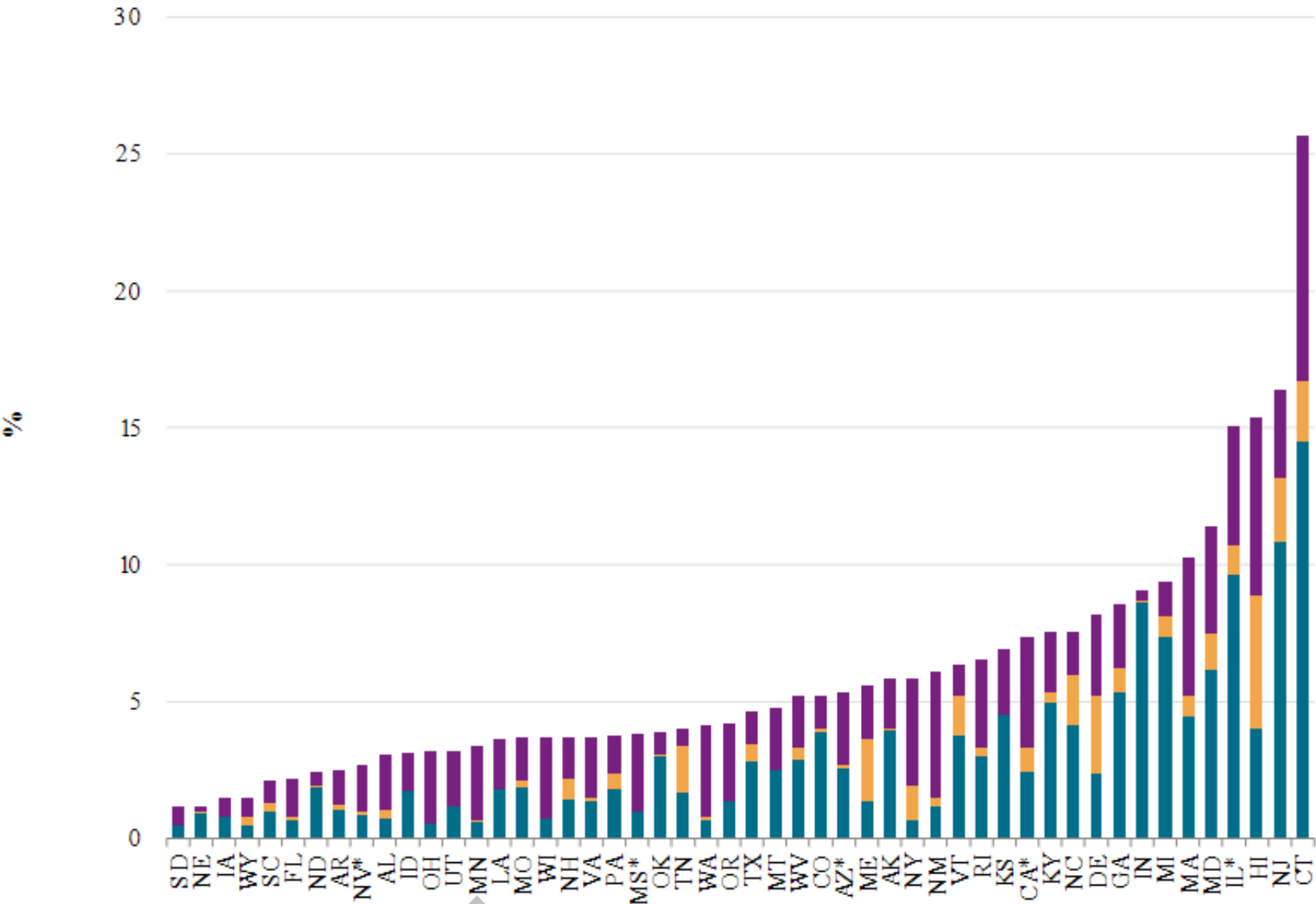
### Liquidity and contingent liability risks adjustment

Considers whether liquidity pressures could worsen initial assessment

# Arriving At An Issue Credit Rating



# U.S. state current costs as a percentage of FY23 revenues



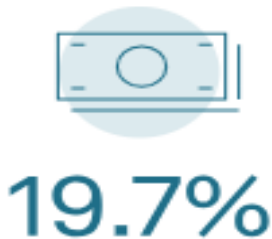
\* The 2023 annual comprehensive financial reports are unavailable for AZ, CA, IL, MS & NV, so 2022 data used.

# U.S. States: By The Numbers

State debt per capita virtually unchanged at around \$1,000 for past 15 years

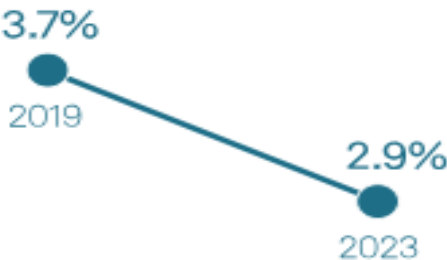


Average available reserve balance as % of revenues:



- 7 States with positive outlooks
- 1 State with a negative outlook

Median net debt service as a % of governmental expenditures  
2.9% in 2023, down from 3.7% in 2019



Aggregate state net pension liability per capita in 2023:



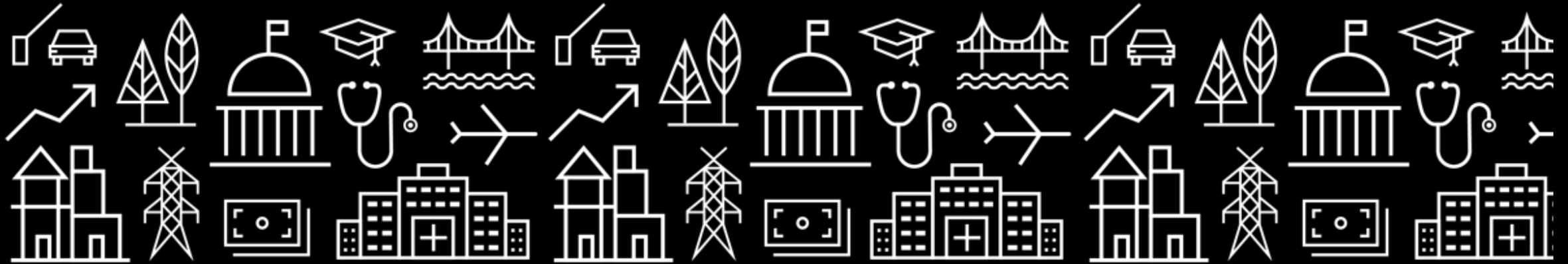
Medicaid enrollment as of August 2024:  
79.1 million compared with 71.3 million in July 2019



Down from March 2023 peak of 94.1 million, but 11.2% above February 2020 numbers

Sources: Centers for Medicare & Medicaid Services, Congressional Budget Office, U.S. Department of Treasury, S&P Global Ratings.  
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# Q&A



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