

# KBRA PUBLIC FINANCE CREDIT RATINGS APPROACH

NOVEMBER 2019



# A RATING AGENCY... REIMAGINED

## **Born out of the financial crisis with the mission of:**

Restoring trust in credit ratings by establishing new standards for assessing risk and setting new standards of excellence and integrity in credit analysis.

- Responsive
- Transparent
- Accurate
- Forward looking
- Not prescriptive
- Test convention
- Markets-aware
- Research-driven
- Open-minded
- Easy to work with

# KBRA BY THE NUMBERS

## CERTIFICATIONS

### KBRA

- Registered as an NRSRO with the SEC
- Designated as a DRO for Structured Finance products by the OSC
- Designated as a Credit Rating Provider by the NAIC
- Certified as a CRA with ESMA
- Recognized as an ECAI by the EBA and OSFI
- Recognized by the USDA's Rural Utilities Service
- Accepted by the Department of Transportation (DOT) & TIFIA

### KBRA Europe

- Registered as a CRA with ESMA
- Recognized as an ECAI by the EBA

## 370+

KBRA has employees in New York, Maryland, and Pennsylvania.

KBRA Europe has 13 employees in Dublin.

## SECTOR COVERAGE

- ABS
- CMBS
- Corporates
- Financial Guaranty Institutions
- Funds
- Insurance
- Project Finance
- Public Finance
- REITs
- RMBS
- Single-Family Rental
- Sovereigns
- Structured Credit (CLOs)

## 35,446

TOTAL RATINGS ISSUED

## 69

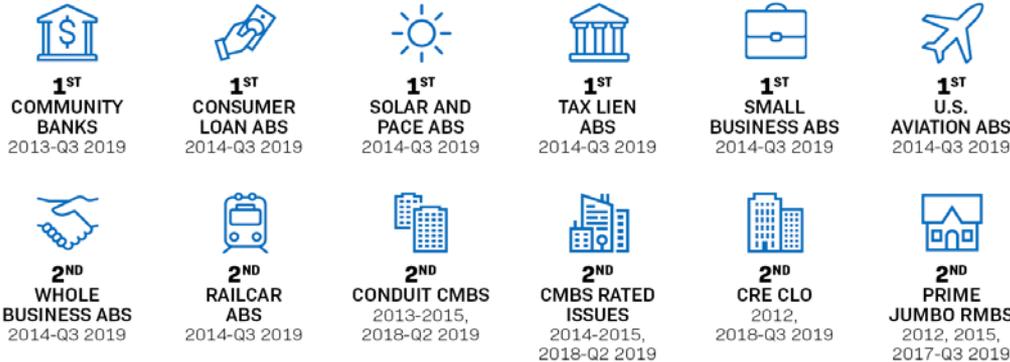
CRITERIA & METHODOLOGIES

## 1,000+

TOPICAL RESEARCH REPORTS

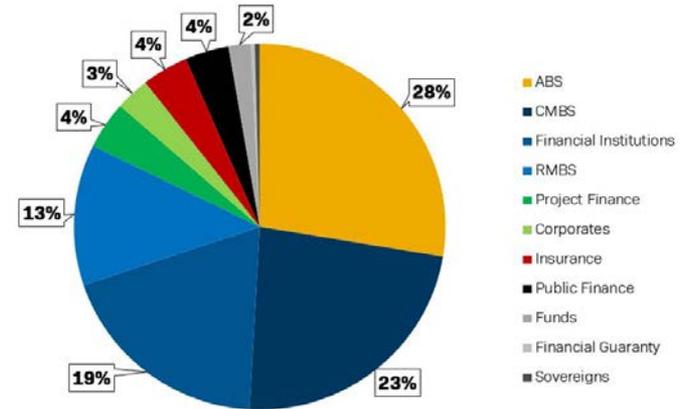
## MARKET RANKINGS

Source: Asset Backed Alert, Bloomberg, & Commercial Mortgage Alert



## DEALS/ISSUERS RATED

By sector; As of 11/2019



# PUBLIC FINANCE RATINGS

## Municipal Market Accepts KBRA

- We now rate over \$311 billion of municipal debt
- Average KBRA rated transaction size is \$398 million, or 10x the muni market average
- There is no market pricing distinction between KBRA and the other rating agencies
- Investors, bankers and financial advisors value our detailed reports
- We monitor new issue pricing to understand investor sentiment

## Experience Matters

- KBRA senior analysts average 29 years of experience in public finance
- We assign analysts with experience commensurate with a credit's complexity
- KBRA targets large, complex issuers and transactions that deserve in-depth analysis
- We rate to credit, not to headlines. It takes senior analysts to know the difference

# PUBLIC FINANCE RATINGS

Questions that issuers should be asking FAs and bankers:



Who is shaping my story?



Has the credit analyst spent enough time evaluating the factors in my credit report?



What positive credit factors are not being evaluated in my credit report?



Does my credit report fully reflect who we are as a bond issuer?

# ANALYTIC APPROACH

- Credit ratings are intended to reflect both the probability of default and the severity of loss in the event of default
- Each credit is unique and requires an in-depth analysis of its legal, financial and structural merits, including a bankruptcy analysis
- Rating methodologies describe the approach for assignment of credit ratings that perform in accordance with published rating definitions

Rating Methodologies for Florida School District Debt Obligations	
Certificates of Participation (COPS)	Aspects of U.S. Local Government GO Rating Methodology and U.S. State Annual Appropriation Obligation Rating Methodology
Half-Cent Sales Surtax Revenue Bonds	U.S. Special Tax Revenue Bond Rating Methodology
TANS/TRANS	U.S. State and Local Government Short Term Cash Flow Note Rating Methodology
General Obligation	U.S. Local Government General Obligation Rating Methodology

# LOCAL GOVERNMENT G.O. FACTORS

**MANAGEMENT STRUCTURE  
AND POLICIES**

**DEBT BURDEN AND  
CONTINUING OBLIGATIONS**

**FINANCIAL PERFORMANCE  
AND LIQUIDITY POSITION**

**MUNICIPAL RESOURCE BASE**

# MANAGEMENT STRUCTURE AND POLICIES

## Financial Management Team

- ⑩ Depth, experience, stability, track record
- ⑩ Ongoing financial operations and strategic planning
- ⑩ Relationship with School Board
- ⑩ Consideration of ESG factors/resiliency planning

## Financial Management Procedures and Policies

- ⑩ Quality of budgeting, revenue forecasting and fiscal monitoring
- ⑩ Long-term financial and capital planning
- ⑩ Debt and investment management
- ⑩ Liquidity and reserve policies

## State Statutory Framework

- ⑩ Districts operate within the framework established by Florida statutes, State BOE, and elected School Board
- ⑩ Taxing authority
- ⑩ State-level limits or caps on local revenues and expenditures and debt
- ⑩ Voter approval requirements for tax increases
- ⑩ Statutory limitations to growth in property assessments

# DEBT BURDEN AND CONTINUING OBLIGATIONS

## Debt Burden

- ⑩ Direct and overlapping debt ratios

## Financing Structures

- ⑩ Debt amortization
- ⑩ Structural and legal protections governing debt
- ⑩ Evaluation of liquidity risk: variable rate debt, derivative products in context of budget flexibility

## Capital Improvement Plans

- ⑩ Future capital needs and plans for additional debt
- ⑩ Identification of specific capital projects and sources of funding

## Other Fixed Costs

- District's share of FRS net pension liability and impact on long-term obligations under GASB Nos. 68 & 71
- Fixed costs as % of expenditures
- OPEB liability under GASB No. 75

# FINANCIAL PERFORMANCE AND LIQUIDITY

## Basis of Operations

- ⑩ Modified accrual basis of accounting for budget and operations
- ⑩ Evaluation of financial projections based on current budget
- ⑩ Budgetary performance

## Operating Results

- ⑩ Historical and current financial operations
- ⑩ Diversity, stability and growth trend of revenue sources
- ⑩ Expenditure flexibility – what are key expenditure drivers?
- ⑩ Structural budget balance
- ⑩ Stress testing
- ⑩ No one size fits all

## Liquidity

- ⑩ Level of financial reserves and sources of liquidity
- ⑩ Unassigned balance in General Fund as % of expenditures
- ⑩ Days cash available

# MUNICIPAL RESOURCE BASE

## Population Trend (CAGR)

- Long term population growth
- Enrollment projections
- Age dependency ratio
- Educational attainment and poverty levels

## Income and Employment Trends

- Personal income per capita
- 10-15 year employment trend, unemployment rate
- Diversity of economic activity and employment

## Property Tax Base

- ⑩ Size, composition, growth trends and prospects
- ⑩ Level of property tax collections
- ⑩ Tax base vulnerability

## Full Market Value

- Historical trends in both assessed valuation and full market valuation
- Sensitivity to economic conditions
- Prospects for growth

# CERTIFICATES OF PARTICIPATION FACTORS

**LEGAL ENVIRONMENT**

**POLITICAL ENVIRONMENT**

**PROJECT ESSENTIALITY**

**APPROPRIATION PROCESS**

# CERTIFICATES OF PARTICIPATION FACTORS

## Master Lease Structure

- 10 Authorized by Florida Statutes
- 10 All-or-none appropriation
- 10 All legally available revenues are available, though not pledged, for COPs repayment
- 10 Bondholder remedies upon lease termination – ability to sell or re-let facilities

## Project Essentiality

- 10 Fundamental importance of K-12 education
- 10 Facilities under the Master Lease
- 10 School Board lease covenants – facilities maintenance and insurance
- 10 Insurance/condemnation proceeds – continued use of facilities

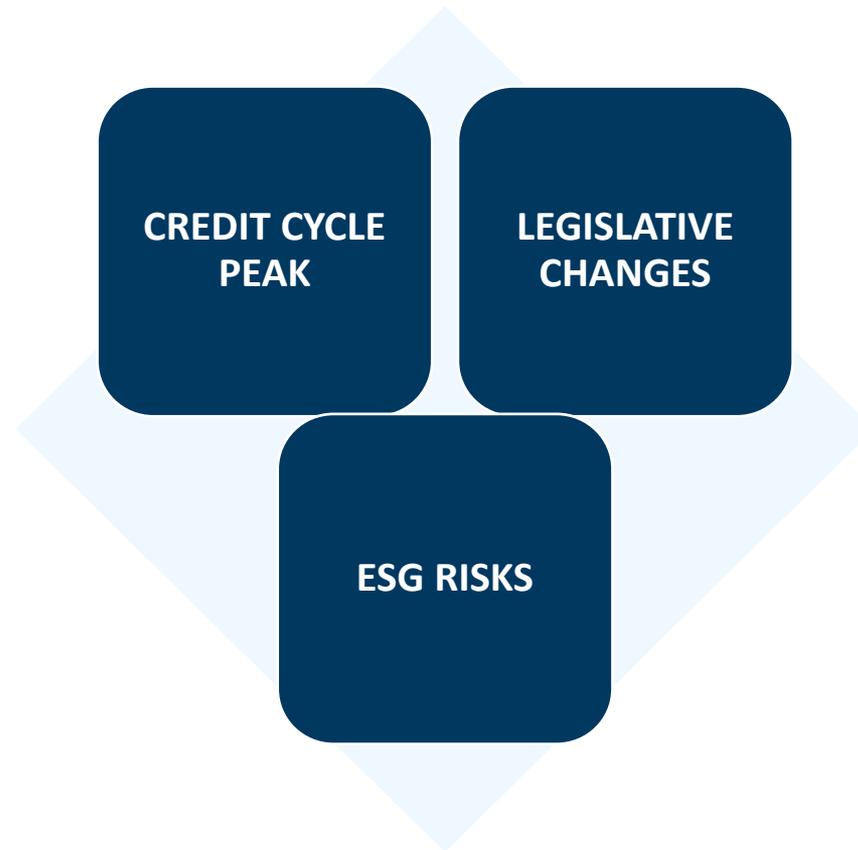
## Appropriation Process

- 10 Annual appropriation
- 10 Leases automatically renewed
- 10 Semiannual deposit of basic lease payment to Trustee
- 10 Assignment of Lease to Trustee

## Political Environment

- 10 History and acceptance of Master Lease COPs
- 10 No current legal challenges
- 10 Revenues subject to Legislative risk

# FLORIDA SCHOOL DISTRICT CREDIT FOCUS



# CREDIT CYCLE PEAK

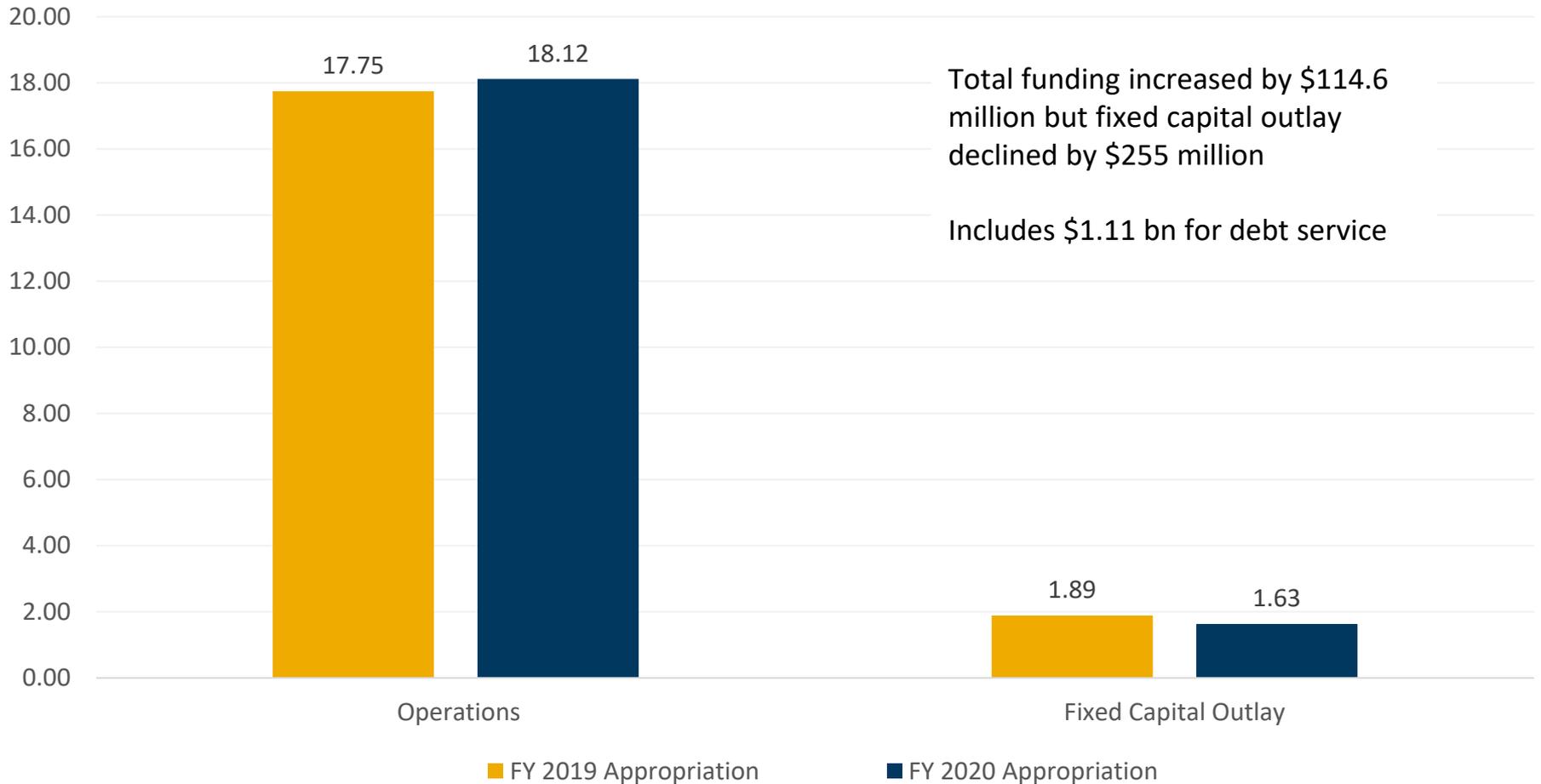
- The past decade of economic expansion was the longest in U.S. history
- Most measures of Florida economy had reached or surpassed their prior peaks by close of FY 2018-2019
- Population growth continues to be primary driver of Florida's economic growth
  - Long-term growth rate 1970-1995: > 3%
  - Average projected growth rate 2018-2022: 1.6%
- August 2019 Florida Estimating Conference projects GDP growth to decline to 2.5% in FY 2020 and continue slowing in the near term to 1.8% in FY 2023-2024<sup>1</sup>
- Longer term GDP growth is expected to average 2.0%<sup>1</sup>
- "Odds of a recession between now and the November 2020 election are 25 percent. Consumers are in an excellent position to carry this record expansion through the 2020 election. Hyper focus on the behavior of the yield curve and the trade spat with China ignores the strong position the U.S. consumer is in right now and should continue to be (in) over the next 18 months." *Sean Snaith, University of Central Florida, Director, Institute for Economic Forecasting, September 2019*

1. Florida Legislature Office of Economic and Demographic Research, Revenue Estimating Conference, August 2019

# FLORIDA EDUCATION FUNDING

## 2019-2020 Education Budget - State Funds before vetoes (\$millions)

Source: Florida DOE 2019 Policy and Budget Update, June 2019



# FLORIDA EDUCATIONAL FACILITIES FUNDING

**2002 Class Size Amendment**

**2008 LOML Reduced to 1.75 mills; Save our Homes Portability**

**2009 LOML Further Reduced to 1.50 mills; .25 Optional Millage for capital in lieu of discretionary operating millage**

**2011 Class Size Limits Expanded**

**2012 75% Limit on LOML Revenues for Pre-2009 LPAs Waived**

**2016 Statewide Open Enrollment**

**2017 Distribution of LOML to Charter Schools; Schools of Hope**

**2018 Revisions to HB 7069 Relating to Sharing of LOML**

**2019 Public Safety Mandate, Construction Cost Limits**

## Legislative Trends

- State to local funding shift
- Exemptions to ad valorem taxation
- Restriction of certain revenues for debt service
- Diversion of education funds to vouchers and charter schools
- Long-term impact of HB 7069 as revised by CS/HB 7055 unknown

# ENVIRONMENTAL, SOCIAL, GOVERNANCE RISK

## ESG Factors Relevant to Public Finance

 <b>Environmental</b>	 <b>Social</b>	 <b>Governance</b>
<ul style="list-style-type: none"> <li>▪ Climate change adaptation</li> <li>▪ Regulatory risks</li> <li>▪ Land use planning</li> <li>▪ Clean water</li> <li>▪ Energy efficiency</li> <li>▪ Waste management</li> <li>▪ Air pollution</li> <li>▪ Natural disasters</li> <li>▪ Severe weather events</li> <li>▪ Resource depletion</li> </ul>	<ul style="list-style-type: none"> <li>▪ Education</li> <li>▪ Public health</li> <li>▪ Labor practices</li> <li>▪ Population and demographic changes</li> <li>▪ Employment</li> <li>▪ Income</li> <li>▪ Public safety</li> <li>▪ Housing</li> <li>▪ Poverty</li> </ul>	<ul style="list-style-type: none"> <li>▪ Management structure</li> <li>▪ Revenue-raising flexibility</li> <li>▪ Transparency and accountability</li> <li>▪ Policies and practices</li> <li>▪ Financial monitoring</li> <li>▪ Budgetary control</li> <li>▪ Forward-looking practices</li> <li>▪ Long-term planning</li> <li>▪ Cybersecurity</li> <li>▪ Commitment to pension funding</li> </ul>

# KBRA TEAM

**Karen Daly**, Senior Managing Director  
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- Over 25 years of experience in Credit Risk Management and Public Finance
- Previously at Municipal Infrastructure Funding, FGIC, Moody's
- Specializes in general obligation, revenue and tax backed debt, including utilities, transportation, higher education, and leasing

**Harvey Zachem**, Managing Director  
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- Over 25 years of experience in Public Finance and Credit Risk Management
- Previously at FGIC, HSBC, Moody's
- Specializes in general obligation debt, tax and revenue backed debt, infrastructure, transportation and cultural institutions

**Linda Vanderperre**, Senior Director  
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- 35 years of Public Finance experience,
- Previously at UBS, JP Morgan, Ramirez
- Specializes in general obligation, lease appropriation, revenue and tax backed debt, including transportation, infrastructure, higher education and appropriation credits

**Patty McGuigan**, Director  
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- 20 years of experience in Government Finance and Credit Risk management
- Previously at three state & local governments, Moody's and Fitch
- Specializes in general obligation, tax and revenue backed debt, utilities, infrastructure, transportation

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- Over 25 years of experience in credit ratings
- Previously at DSA Capital, Standard & Poor's
- Experience across all municipal asset classes

**Paul Kwiatkoski**, Managing Director  
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- 25 years of experience in Credit Risk Management & Financial Guaranty
- Previously at CIFG, Enhance Reinsurance, Moody's
- Specializes in Financial Guaranty

**Cindy Wu**, Senior Director  
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- 15 years of experience in Credit Risk Management
- Previously at Citigroup, National Australia Bank, Bank of America Merrill Lynch
- Experience across all municipal asset classes, with a focus on not for profit hospitals

# KBRA TEAM

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- Over 30 years of experience across investment banking and rating agencies
- Previously at Goldman Sachs
- Specializes in state and city governments, including infrastructure, transportation, housing, and higher-education

**Bill Baneky**, Managing Director, Business Development  
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- Over 20 years of municipal industry experience
- Previously at Deutsche Bank & The Bond Buyer
- Member of numerous municipal finance organizations including the NMFA, MAGNY, and the Council of Development Finance Agencies.

**Annie Tchu**, Director, Business Development  
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- 10 years of experience in Public Finance
- Previously at Dexia and S&P GMI
- Experience as a buy-side trader and municipal securities pricing analyst

**Kate Kennedy**, Senior Managing Director, Business Development  
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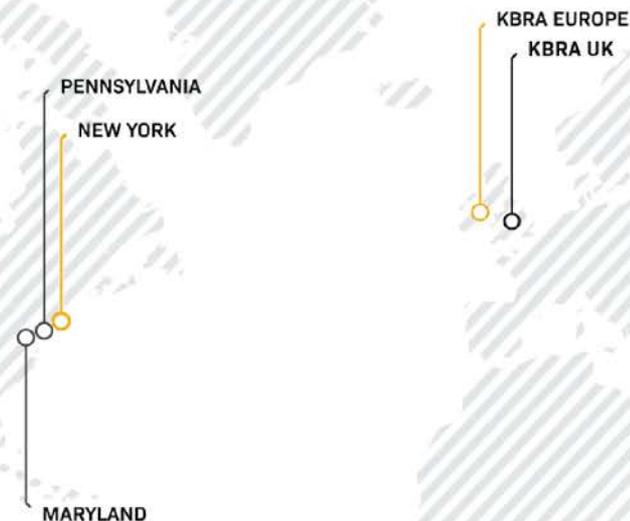
- Over 20 years of municipal industry experience
- Previously at Fitch Ratings
- Specializes in identifying, planning and executing strategic new investor development and business campaigns as well as maintaining strong relationships with the largest institutional investors.

**James Kissane**, Senior Director, Business Development  
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- Over 20 years of experience in Public Finance
- Previously at Interactive Data, ACA and MBIA
- Credit research and market pricing experience across various High Grade and High Yield sectors

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