Article Title: Criteria | Governments | U.S. Public Finance: Assigning Issue Credit Ratings Of Operating Entities Data: (EDITOR'S NOTE: —On April 24, 2023, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) 1. These criteria provide additional transparency related to S&P; Global Ratings' assignment of issue credit ratings on U.S. public finance debt instruments of operating entities, including the assignment of issue credit ratings at the level of the issuer credit rating (ICR); and on subordinated obligations of these entities. These criteria relate to our criteria article "Principles Of Credit Ratings," published Feb. 16, 2011. I. SCOPE OF THE CRITERIA 2. These criteria apply to long-term issue credit ratings ("issue credit ratings") on obligations issued for U.S. public finance operating entities, such as utilities, local governments, and universities ("operating entities"). The criteria do not apply to rating sales tax, single-family and multifamily mortgage-backed, appropriation debt, and other issue-specific obligations, which are rated with various issue-specific criteria (see paragraph 14 for examples). II. SUMMARY OF THE CRITERIA 3. For operating entities, determination of an issue credit rating starts with our view of the general creditworthiness of the obligor, which may be expressed as an issuer credit rating (ICR), followed by analysis of the legal structure and covenants of the debt instrument. 4. We generally assign an issue credit rating at the same level as the ICR to obligations (a) benefiting from pledged revenues that we consider central to the entity's purpose (see examples in the Appendix) and (b) the covenants of which, in our view, support creditor security at the senior debt level. In some cases, sector-specific criteria may provide additional guidance on legal considerations that may impact the issue credit rating. 5. We generally assign an issue credit rating that is one or more notches below the ICR to obligations for which either or both of conditions (a) or (b) in the previous paragraph is not met. 6. Unless conditions in the next paragraph are met, subordinated debt of operating entities that have an ICR of 'BBB-' or higher, are typically rated one notch lower ("rating differential") than the ICR. The rating differential for entities with ICRs of 'BB+' or lower may be up to two notches. The determination of a one- or two-notch differential is primarily based on the amount of debt outstanding on liens senior to it. 7. The rating differentials described in paragraph 6 do not hold, and subordinated debt is rated at the ICR level if it benefits from sufficient additional security, such as a pledge of another revenue stream not pledged to senior-lien holders, certain situations where the senior lien is closed, and where certain springing-lien provisions are present (as described in paragraphs 25-27). 8. Mortgage liens and other liens on assets will generally not result in a rating higher than the ICR. U.S. public finance ratings do not incorporate post-default recovery prospects (for example, in bankruptcy). Similarly, we generally will not notch an issue up from its ICR when the senior lien is closed, because the ICR already incorporates the ability to pay all obligations, including senior and subordinate liens. 9. This paragraph has been deleted. 10. This paragraph has been deleted. III. METHODOLOGY A. Relationship of issue ratings to ICRs 11. The majority of published U.S. public finance ratings are issue credit ratings, which apply to a specific debt obligation, while a minority of published U.S. public finance ratings are ICRs, which address the general creditworthiness of the obligor. In some cases, the same obligor may have both issue credit ratings and a public ICR, but this is not typical. As we explain below, the issue credit rating may be equal to, or differ from, our view of general creditworthiness of the issuer, which we interchangeably refer to as the ICR in this article. 12. Issue credit ratings are generally arrived at through one of two methods, depending on the debt and issuer type: Application of criteria to an operating entity, where the entity's general creditworthiness (which may be expressed by an ICR) is the starting point for the issue credit rating analysis, or Application of issue-specific criteria, which apply to obligations where there is not an operating entity whose general creditworthiness is central to the issue credit rating evaluation. 13. Examples of criteria applying to operating entities are "U.S. Local Governments General Obligation Ratings: Methodology And Assumptions," "U.S. And Canadian Not-For-Profit Acute Care Health Care Organizations," and "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions." Ratings determined under these examples are in scope of these criteria. 14. Examples of issue-specific U.S. public finance criteria are "Priority-Lien Tax Revenue Debt," "Methodology For Rating U.S. Public Finance Rental Housing Bonds," and "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness." Ratings determined under these examples are not in scope of these criteria. 15. We assign certain issue credit ratings by first determining the general creditworthiness of the obligor, which may be expressed as an issuer credit rating (ICR), then applying issue-specific criteria to determine the relationship between the general creditworthiness of the operating entity and the issue credit rating. For example, in rating appropriation-backed obligations, the starting point is the application of the relevant operating entity criteria, such as "U.S. State Ratings Methodology," to determine the general creditworthiness of the obligor, after which the "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria apply to determine the issue credit rating. In this example, the application of "U.S. State Ratings Methodology" criteria to determine the general creditworthiness of the state is in scope of these criteria, while the application of the "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria to determine the issue credit rating is not. 16. For operating entities, the starting point of the analysis is the general creditworthiness of the obligor. In applying criteria to operating entities, we determine whether the two rating types – ICR and issue credit rating - differ from each other. When the issue credit rating differs from the ICR, we will generally note the factors that cause a rating differential between the two rating types. For the remainder of this article, we use references to 'ICR' or 'general creditworthiness' interchangeably. The sector criteria for a given type of operating entity may not specifically reference an ICR and we may not publish ICRs for each entity. 17. If a U.S. public finance obligor provides (a) a security pledge of revenues that fund activities we consider central to its purpose, and (b) debt covenants which, in our view, support creditor security at the senior debt level, we generally equalize the issue credit rating of obligations which benefit from these strengths with the ICR. Sector-specific criteria within public finance may outline additional legal structure and debt covenant assessments. We also discuss these considerations in "Methodology: Definitions And Related Analytical Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations," published Nov. 29, 2011. 18. To meet condition (a) in the previous paragraph, pledged revenues of operating entities must fund activities that are central to the entity's core business and are typically, but do not have to be, the majority of the entity's revenue stream. Examples by sector of security pledges that we consider central enough to qualify for an issue credit rating at the same level as the ICR are provided in the Appendix. 19. If condition (a) or (b) in paragraph 17 is not met, for example if pledged revenue is narrow or not central, typically because the obligor has pledged measurable portions of its revenue to other debt instruments, bondholders do not benefit from the full credit strength that the ICR reflects. In this case, we typically assign an issue credit rating one or more notches below the ICR. The number of notches below the ICR depends on the amount of revenue and debt that is not part of the rated debt pledge. 20. Mortgage liens and other liens on assets generally do not support issue credit ratings higher than the ICR. U.S. public finance ratings do not incorporate an opinion about postdefault recovery prospects (for example, in bankruptcy) on an issuer basis due to the paucity of cases from which to generate such projections, and the unpredictability associated with postdefault municipal experience. 21. Issue credit ratings will generally only be higher than the ICR with some form of enhancement, such as a letter of credit, bond insurance, guarantee of a third party, or access to collateral or revenues of a party outside the rated entity (such as support from an endowment fund not consolidated with the entity). B. Subordinated debt and notching 22. While we do not project postdefault possibilities in our analysis, several classes of creditors may have access – and some of them may have a prioritized access - to a single pledged revenue stream. This section addresses issue credit ratings on obligations which have an inferior lien on the same revenue stream as other obligations; we call the former "subordinated debt" and the latter "senior debt". 23. Given the differences in priority of access, and unless conditions in paragraphs 25-27 are met, for obligors whose ICR is 'BBB-' or higher, we typically rate subordinated debt (whether it has a second, third or even more subordinated lien) one notch below the ICR. 24. For issuers with ICRs that are 'BB+' or lower, unless conditions in paragraphs 25-27 are met, we typically rate subordinated debt two notches below the ICR. In some cases, the differential can be one notch. The determination of a one- or two-notch differential is primarily based on the amount of debt outstanding on each lien. A relatively large amount of senior-lien debt would more likely result in a two- notch differential, while a smaller senior-lien debt amount would more likely result in a one-notch differential. If such notching result in a subordinate rating in the 'CCC' category or below, the subordinate rating will be governed by our view of its risks under "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," and may not follow the same pattern of notching for higher-rated subordinate obligations. 25. Situations where we may rate subordinated obligations at the same level as senior obligations include: Subordinate obligation holders are granted additional security such as a pledge of another revenue stream not pledged to senior-lien holders, if we believe such additional security improves the subordinate-lien holder's position sufficiently; or Senior liens that are closed, that is, no additional debt will be issued under the senior lien, and we consider the amount of debt outstanding under the senior lien as minimal. 26. In rare cases, a subordinated obligation may have "springing" provisions, which elevate it to the senior-lien level upon attainment of certain thresholds, such as a specified debt service coverage level. We treat such springing-lien obligation as a subordinated obligation and rate it in accordance with paragraphs 23-24 until we believe the conditions for elevating its lien to senior will be imminently met, at which time we will equalize its rating with that on senior-lien obligations, unless the conditions in paragraph 27 are met. 27. Where the springing-lien provision elevates the subordinate obligation to the senior lien upon an event of default, we believe the benefits of senior-lien status over subordinate obligations are no longer present, and we equalize the rating of the subordinate- and senior-lien obligations, assuming there are no other distinguishing features such as described in paragraphs 19 and 25. IV. APPENDIX 1– EXAMPLES OF PLEDGES 28. Examples of pledges that we consider central enough to equalize the issue credit ratings with the ICR follow. The examples are for illustrative purposes and are not intended to be exhaustive. Sector-specific criteria may provide additional guidance on debt covenants and the treatment of specific pledges: Not-for-profit education providers: unlimited student fees; general obligation of the not-for-profit education provider; available funds. Health care: patient revenues (gross or net); patient receivables; general obligation of a parent with full control of subsidiaries and unlimited ability to upstream revenue from subsidiaries. Utilities, transportation, and other infrastructure: system net revenues. Local, state, and other governmental entities, including districts rated under other sector-specific criteria: unlimited property taxes; limited property taxes (subject to "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019). Housing authorities and enterprises: general obligation of the entity; net revenues of the enterprise. V. REVISIONS AND UPDATES This article was originally published on May 20, 2015. These criteria became effective upon publication. Changes introduced after original publication: Following our periodic review completed on May 20, 2016, we updated the contact list and deleted outdated sections that appeared in paragraphs 9 and 10, which were related to the initial publication of our criteria and no longer relevant. Following our periodic review completed on May 17, 2017, we updated the contact list. Following our periodic review completed on May 17, 2018, we added the "Revisions And Updates" section, updated the contact list and criteria references, and made small editorial clarifications in paragraphs 4, 5, 7, and 15. On July 9, 2019, we republished this criteria article to make nonmaterial changes. Specifically, we updated a paragraph reference in paragraph 26. On July 7, 2020, we republished this criteria article to make nonmaterial changes. We updated our contact list and criteria references. On Jan. 13, 2022, we republished this criteria article to make nonmaterial changes. We updated our contact list and criteria references. On April 24, 2023, we republished this criteria article to make nonmaterial changes. We updated the first example in Appendix 1 to include not-for-profit education providers, rather than just higher education and universities when discussing the type of pledges typically associated with these institutions. We also clarified that the fourth example includes districts rated under other sector-specific criteria where unlimited property taxes and limited property taxes are assessed. VI. RELATED PUBLICATIONS Related Criteria Global Not-For-Profit Education Providers, April 24, 2023 Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness, Nov. 20, 2019 U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions, Sept. 27, 2018 U.S. And Canadian Not-For-Profit Acute Care Health Care Organizations, March 19, 2018 U.S. State Ratings Methodology, Oct. 17, 2016 U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, Sept. 12, 2013 Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012 Methodology: Definitions And Related Analytical Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011 Principles Of Credit Ratings, Feb. 16, 2011 Wholesale Utilities, May 24, 2005