Article Title: Criteria | Governments | U.S. Public Finance: Contingent Liquidity Risks In U.S. Public Finance Instruments: Methodology And Assumptions Data: (EDITOR'S NOTE: —On April 22, 2021, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) 1. S&P; Global Ratings is clarifying its methodology and assumptions for evaluating contingent liquidity risk present in financial instruments of U.S. public finance obligors. We are publishing this article to help market participants better understand our approach to evaluating these risks when assigning U.S. public finance ratings. This article is related to our criteria article "Principles Of Credit Ratings", which we published on Feb. 16, 2011. 2. U.S. public finance obligors face potential heightened liquidity risk from financial instruments with payment provisions that change upon the occurrence of certain events. These "triggers" can result in the acceleration of debt payment provisions. They can also heighten liquidity needs for obligors if the provisions permit investors to tender debt following prescribed events. In addition to debt instruments, triggers are also present in derivatives, such as swaps, and other financial instruments where termination or similar events can lead to near-term settlements of all amounts due based on market or specified conditions. Other examples of instruments with triggers include letters of credit, extendable products, variable-rate demand bonds, direct purchase obligations, and revolving credit agreements. From a ratings perspective, the contract provisions and the obligor's current performance relative to those conditions will dictate the extent to which potential payment events resulting from these triggers are included in the liquidity assessment of rated entities. No distinction is made between triggers that automatically result in these potential claims and those that give investors rights to demand such amounts. This article clarifies the treatment of these potential obligations in the rating process for long-term ratings, regardless of whether these instruments are held as debt or investments. I. SCOPE OF THE CRITERIA 3. These criteria apply to all U.S. public finance issue and issuer credit ratings. II. SUMMARY OF CRITERIA 4. Provisions in some financial instruments create potential additional claims on the liquidity of U.S. public finance obligors upon the occurrence of events or conditions specified in the instrument's terms. If these conditions are already present or if stress equivalent to that necessary to cause a two-notch downgrade of an obligor's rating would create such conditions, the liquidity analysis in sector-specific criteria includes these potential obligations as an actual claim or use of liquidity. Accordingly, this could weaken our assessment of the obligor's liquidity. In addition, the management assessment in sector-specific criteria considers the extent to which management understands these risks and has plans or policies to mitigate them. 5. This paragraph has been deleted. 6. This paragraph has been deleted. III. METHODOLOGY A. Ratings-Related Triggers 7. Many triggers found in financial instruments relate to ratings on the obligor and other contract counterparties. Similar to the approach taken in "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers", (Dec. 16, 2014), this methodology includes the potential exposure under the instrument as an actual claim on liquidity if a downgrade (in the case of U.S. public finance, we assume a downgrade of two notches) of either the obligor or its counterparty would result in a breach of the trigger. Absent explicit written changes to the terms of the instrument in advance of a demand for payment, this assumption will hold even if the obligor receives its lender's or counterparty's assurances that it will not avail itself of termination or acceleration rights under the instrument. Amounts due to public finance obligors from such triggers, however, are not included as potential liquidity sources until the obligor has exercised its rights to receive such funds and receives them. B. Other Triggers 8. In addition to ratings-based triggers, there may be other contract provisions with potential liquidity risks. They could be tied to many events, such as legal findings, operational developments, or ratio tests measuring liquidity, financial performance, or leverage. Accordingly, it is impossible to specify a unique threshold for every conceivable item, although sector-specific criteria may provide greater detail. To approach different risks in a consistent manner, the criteria consider the likelihood that any additional contingent risks will be realized relative to the likelihood of the two-notch downgrade referenced for rating triggers. The criteria include any resulting claims on liquidity in the liquidity analysis if the likelihood of breaching any other individual trigger is equal to or greater than the likelihood of the two-notch downgrade, even if the event itself does not result in a two-notch downgrade. C. Meeting Contingent Claims 9. Obligors often address such potential claims in three primary ways through: the use of internal liquidity, the use of pre-established liquidity lines, and access to the capital markets. In cases where internal liquidity or line availability is reduced as a result of these claims, sector-specific criteria for liquidity detail the manner in which ratings may be affected. An issuer planning on using market access to meet contingency claims faces the risk that market conditions might not be favorable at the required time. A longer time period between the triggering event and the date when the obligor must pay the resulting claim provides some protection against potential market disruptions. Because suddenness is frequently an attribute of contingent claims and because capital market access requires some planning and coordination, the criteria usually assume no ability to fund claims through capital market access within 180 days. 10. Some factors could necessitate extending the 180-day threshold, including: A rapid deterioration of the credit in question, An already noninvestment-grade rating, Additional potentially difficult actions required before an issuance could occur, such as passage of a difficult budget, rate or fee adjustments, or completion of adequate disclosure where audit completion is significantly delayed, or Widespread market disruptions or closures that are expected to continue. 11. Conversely, the criteria allow for the assumption that some obligors may be able to gain market access in less than 180 days. Assuming that none of the conditions in the previous paragraph exist, obligor characteristics that may lead to this assumption are: Characteristics consistent with a market risk profile score of 'low' as calculated in "Bond Anticipation Note Rating Methodology", published Aug. 31, 2011 (the BAN criteria) or, A long-term credit rating in one of the highest two categories, no recent history of late budget adoption, and characteristics consistent with at least a neutral market risk profile score as defined in the BAN criteria. D. The Problem With Generalizing Contract Provisions 12. It is important to realize that the effect of contract provisions on ratings may differ considerably among public finance sectors. First, because different sectors often have differing levels of liquidity, some sectors or issuers may be less able to mitigate contingent liquidity risks through internal liquidity alone. A greater reliance on market access or committed lines could result for these entities. Second, because internal liquidity, rating levels, and other factors can change over time, contract provisions that originally did not add to liquidity stress could do so at a later date. These dependent and dynamic effects render the concept of a "generally risky" provision or a "generally safe" provision less meaningful. E. Opportunity For Further Management Assessment 13. Although the methodology outlined incorporates contingent liquidity risk through the standard liquidity framework of sector-specific criteria, the existence of such provisions also creates the opportunity to better understand management as part of the sector-specific criteria's management assessment. Specifically, the assessment of debt management is informed by an obligor's understanding of the risks management faces from contingent liquidity provisions, the reasons behind management's choice in accepting them, and the extent of plans to mitigate these risks. IV. REVISIONS AND UPDATES This article was originally published on March 5, 2012. These criteria became effective on March 12, 2012. Changes introduced after original publication: Following our periodic review completed in 2016, we updated the contact list and criteria references in the text and in the "Related Criteria And Research" section. In addition, we deleted outdated sections in paragraphs 1, 5, and 6, which were related to the initial publication of our criteria and no longer relevant. Following our periodic review completed on March 16, 2017, we updated the criteria references in the "Related Criteria And Research" section. Following our periodic review completed on March 15, 2018, we replaced the "Data Related To The Original Publication And Previous Republications" section with the "Revisions And Updates" section and updated the contact information. On April 23, 2019, we republished this criteria article to make nonmaterial changes. We updated the contact information and updated the criteria references in the "Related Criteria And Research" section. On May 5, 2020, we republished this criteria article to make nonmaterial changes to update the contact information. On April 22, 2021, we republished this criteria article to make nonmaterial changes. We clarified language about our assumption in paragraph 7. We also updated the contact information and criteria references in the "Related Criteria And Research" section. V. RELATED CRITERIA AND RESEARCH Superseded Criteria Debt Derivative Profile Scores, March 27, 2006 Related Criteria Global Not-For-Profit Transportation Infrastructure Enterprises: Methodology And Assumptions, Nov. 2, 2020 Methodology For Rating U.S. Public Finance Rental Housing Bonds, April 15, 2020 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 Solid Waste System Financings, Jan. 29, 2018 U.S. Public Finance Charter Schools, Jan. 3, 2017 Housing Finance Agencies And Social Enterprise

Lending Organizations, Dec. 27, 2016 U.S. State Ratings Methodology, Oct. 17, 2016 U.S. Public Finance Waterworks, Sanitary Sewer, And Draining Utility Systems: Rating Methodology And Assumption, Jan. 19, 2016 Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016 Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014 Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014 U.S. Local Governments General Obligation Ratings: Methodology and Assumptions, Sept. 12, 2013 Bond Anticipation Note Rating Methodology, Aug. 31, 2011 Principles Of Credit Ratings, Feb. 16, 2011 Methodology And Assumptions: Rating Unlimited Property Tax Basic Infrastructure Districts, March 17, 2009 Applying Key Rating Factors To U.S. Cooperative Utilities, Nov. 21, 2007 Higher Education, June 19, 2007 Senior Living, June 18, 2007 Non-Traditional Not-For-Profits, June 14, 2007 Human Service Providers, June 13, 2007 Private Elementary And Secondary Schools, June 13, 2007 GO Debt, Oct. 12, 2006 Related Research S&P; Evaluated $5.1 Bil. Of U.S. Public Finance Bank Loans In 2015: Issuers' Liquidity Positions Helped To Support Ratings, March 9, 2016 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.