Article Title: Criteria | Governments | U.S. Public Finance: U.S. Federal Future Flow Securitization Methodology Data: (EDITOR'S NOTE: —On April 18, 2022, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) 1. This article describes S&P; Global Ratings' methodology for rating obligations secured by future U.S. federal cash flows. This article aims to help market participants better understand our approach to reviewing transactions where pledged federal cash flows are derived from the U.S. government or U.S. government-related entities. This article is related to our criteria article "Principles of Credit Ratings," published on Feb. 16, 2011. I. SUMMARY OF THE CRITERIA 2. Federal cash flows support various obligations issued in the capital markets. These obligations are neither debt of the U.S. government nor of U.S. government-related entities. The receipt of such monies depends on statutory formulas or the local fulfillment of program or project requirements. These cash flows support a range of securities, including those issued for the General Services Administration and other federal leases, various Veterans Administration projects, federal highway grant anticipation revenue vehicle (GARVEE) bonds, military housing bonds, and bonds secured by federal impact aid, among others. 3. The criteria provide a consistent framework for determining the maximum possible rating that various types of federal revenue securitizations may obtain. The application of other criteria specific to the related project or program result in the final issue rating (see "Related Criteria and Research" section below). These other criteria address additional risks such as construction risk, debt service coverage, bankruptcy risk, and lease risk that can lower the final rating relative to the maximum possible rating resulting from the criteria. 4. To determine the maximum possible rating, the criteria use the average of nine factors. Two of the factors relate to the specific federal department, agency, committee, or other government-related entity (hereafter called "the federal entity") managing the project or program. The remaining seven factors relate to the specific program or project cash flows. Federal entity-specific factors include the creation and duration of the federal entity and its history of funding by the U.S. government. Program- or cash flow-specific factors include program or project establishment or approval, authorization for contractual obligation, project or program funding specification, renewal and reauthorization risk, geographic concentration and population impact, local control of federal cash flows, and allotment risk. Scores for each factor range from '1' (strong) to '4' (very weak). All factors receive equal weight when they are averaged to determine the overall score, which correlates with rating levels shown in table 1. 5. One condition limits the maximum possible rating to below that suggested by table 1. A local control of federal cash flows score of 'weak' or 'very weak' limits the rating to no higher than the issuer credit rating (ICR) of the local entity receiving the federal monies. The chart summarizes this framework. II. SCOPE OF THE CRITERIA 6. The criteria apply to all issue ratings on debt secured by future congressional appropriations of cash flows from U.S. government agencies, departments, or related entities. They do not apply to actual debt obligations of the U.S. government, its departments or agencies, or to the debt of any other government-related entity of the U.S. They also do not apply to obligations guaranteed by these entities. 7. This paragraph has been deleted. 8. This paragraph has been deleted. 9. This paragraph has been deleted. III. METHODOLOGY A. Overall Framework For Rating Issues Secured By Federal Cash Flows 10. As an initial step in assigning a rating to various types of federal revenue securitizations, the criteria provide a consistent framework for determining the maximum possible rating. In most cases, project- or program-specific criteria pieces may further lower but not raise the final rating through the assessment of more specific risks such as construction risk, bankruptcy risk, debt service coverage, lease provisions, and other transaction terms (see "Related Criteria and Research" section below). 11. The criteria limit ratings on obligations secured by federal cash flows to below the rating of the U.S. government for two reasons. First, consistent with our public finance criteria for appropriation obligations, the annual appropriation nature of the federal cash flows limit the rating on the federal issue to no higher than one notch below that of the U.S. sovereign rating (see "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019). The second reason relates to the securitization of federal revenues which requires the consent of the federal entity as per the Federal Assignment of Claims Act. The rating of the issue can't match or exceed the rating level of the U.S. government without such consent, and such formal consent typically does not exist, thereby preventing the possibility of a true sale opinion. 12. The maximum possible rating level for a federal cash flow-secured obligation will result from an average of nine factors. The first two factors relate to characteristics of the federal entity providing the cash flows. These two factors measure the importance of the federal entity within the structure of the federal government by looking at the creation and duration of the federal entity and its funding history. The remaining seven factors apply to characteristics of the specific project or program cash flows. For each factor, scores range from '1' (strong) to '4' (very weak). 13. All factors receive equal weight when averaged to determine the overall score, which relates to the maximum rating levels shown in table 1. In most cases, the maximum rating level will equal that shown in table 1. If the project or program exhibited clear strengths or weaknesses relative to other projects or programs scored at that level, the maximum possible rating will differ by one notch relative to that shown in table 1 to reflect the identified difference. The final rating, however, is capped at one notch below the rating of the U.S. government, as explained in paragraph 11. The criteria round outcomes to the nearest tenth of a decimal point. 14. One condition limits the maximum possible rating to below that suggested by the table 1. A local control of federal cash flows score of 'weak' or 'very weak' limits the rating to no higher than the ICR of the local entity receiving the federal monies. Table 1 Maximum Possible Rating Level For Federal Cash Flow-Secured Obligations OVERALL SCORE INDICATIVE RATING LEVEL FOR FEDERAL CASH FLOW ISSUES 1-1.2 1 notch below U.S. ICR 1.3 2 notches below U.S. ICR 1.4-1.5 3 notches below U.S. ICR 1.6-1.8 4 notches below U.S. ICR 1.9-2.2 5 notches below U.S. ICR 2.3-2.4 6 notches below U.S. ICR 2.5-2.6 7 notches below U.S. ICR 2.7-2.9 8 notches below U.S. ICR 3 9 notches below U.S. ICR 3.1-3.4 10 notches below U.S. ICR 3.5-4.0 11 notches below U.S. ICR The maximum possible rating level will be within one notch of the rating level shown above, with one-notch adjustments resulting from comparisons to projects and programs with the same range of scores. Additional factors may further lower but not raise the final rating relative to the maximum possible levels shown (see paragraphs 10 and 14). B. Federal Entity--Specific Factors 15. All funding comes from congressional appropriations (federal cash flow), but the importance of the federal entity will affect the cash flow that supports debt service. The nature of the federal entity, the federal entity's time in existence, and the entity's federal cash flow funding history drive our view of this risk. The creation and duration of the federal entity constitute the first score, while federal cash flow funding history constitutes the second. 1. Creation and duration of the federal entity 16. The first federal entity specific factor is the creation and duration of the federal entity. Table 2 details the scoring criteria for this measure. Table 2 Creation And Duration Of The Federal Entity 1 (Strong) The federal entity exists as a major department of the federal government or part of a major department. Neither history nor current conditions suggest that the entity could be merged or privatized. For example, military branches that reside under the auspices of the Department of Defense fall under this category. 2 (Moderate) The federal entity exists for a specific purpose, and merger or envelopment by another federal entity is unlikely. The federal entity stands as an independent agency of the federal government formed through legislation. For example, the Architect of the Capitol meets this definition. 3 (Weak) Congress or the administration recently created or designated the federal entity. The entity has multiple important functions, but has yet to clarify its precise organization and manner of performing these functions. 4 (Very Weak) Congress or the administration recently created or designated the federal entity. It does not play a major role or could function as an independent private corporation. It has a singular and very specific role. For example, the privatization of mortgage finance could fall into this area, if accomplished. 17. This assessment begins with the legislation which formulated the existence of the federal entity. Factors assessed include when the federal entity was formed, why it was formed, and its purpose and history. To analyze organizational stability, the criteria further consider whether the entity's duties have changed over time and whether the government could easily privatize the entity's functions or move them to another department. 2. Funding history of the federal entity 18. The second federal entity specific factor is the funding history of the federal entity. Table 3 details the scoring criteria for this measure. Table 3 Funding History 1 (Strong) The entity has received stable or growing federal funding for over 30 years, with any downward one-year drops totaling less than 3%. 2 (Moderate) The entity has received federal funding for at least 20 years and most, if any declines, in annual funding levels have been between 3% and 5% 3 (Weak) A federal funding history of between five and 20 years exists, or funding has shown a more-than 5% change from year to year. 4 (Very Weak) The entity has a federal cash flow funding history of less than five years or a limited expected life span. If expected future trends suggest a weaker score relative to that suggested by historical performance, the funding history score equals the weaker score. 19. At least 10 years of appropriation history to the federal entity provide a basis for a long-term opinion as to where the entity ranks in the overall appropriation of federal funds. In general, the stronger the appropriation history, the greater the likelihood that it will continue. Specifically, the criteria consider the duration and stability of appropriations and their overall growth. Expected future funding trends different from historical performance may weaken but not improve the score. C. Project Or Program Factors 20. Because the stability or durability of a specific program or project can differ from that of the managing federal entity, the criteria consider project- or program-specific factors, including: The nature of the project or program's establishment and approval; The authorization for contractual obligation; Project or program funding specification; Renewal and reauthorization risk; Geographic concentration and population impact; Local control of federal cash flows (the extent to which the local or regional entity receiving the federal cash flows could use them for purposes other than debt service); and Allotment risk, which measures the degree to which the federal cash flow depends on the local entity meeting operating requirements. 1. Program or project establishment and approval 21. The first project or program factor is the program or project establishment and approval. Table 4 details the scoring criteria for this measure. Table 4 Program Or Project Establishment And Approval 1 (Strong) Each of the following conditions exists: The program or project has received approval from the highest level of the federal entity. The Office of Management and Budget (OMB) has also reviewed the program or project and analyzed its costs. Congress, after such review, has approved the project or program by passing specific legislation specifying its implementation and provided the necessary funds to support the project or program. 2 (Moderate) The program or project has received full departmental and OMB approval, but no specific congressional legislation addresses the implementation of funding for the program or project. In addition, the federal entity’s operating budget provides the funding. 3 (Weak) The program or project lacks specific formal approval by the entity's highest governing official, but it has received the required approvals to be funded within the federal entity’s operating budget. OMB has not reviewed the project and no specific congressional approval exists. 4 (Very Weak) The program or project has not received formal federal entity approval and concerns exist that it may not be funded as part of the federal entity’s operating budget in each budgetary period. 2. Authorization for contractual obligation 22. The second project or program factor is the authorization for contractual obligation. Table 5 details the scoring criteria for this measure. Table 5 Authorization For Contractual Obligation 1 (Strong) A long history (greater than 15 years) of bonds issued in the capital markets backed by the program- or project-specific cash flows exists and specific federal or state legislation supports this practice. 2 (Moderate) Authority to obligate federal cash flows related to the project or program comes from legislation enacted within the last 15 years. Accordingly, a limited record of such financings exists. 3 (Weak) A long history exists (greater than 15 years) of a specific project or program’s cash flows being used to support state or local bonds. The federal entity is aware of the securitization of these federal cash flows, but no legislation specifically authorizes this practice. 4 (Very Weak) A less-than 15-year history of the project or program’s specific cash flows being used to support debt exists. No federal authorization exists and limited recognition of this practice exists at the federal level. 23. Clear authorization and ability to contractually obligate federal cash flows provides additional clarity as to the link between the federal cash flows and the lease or bond financing. Legislation specifying such authorization and an established history of using this authorization provide the highest clarity as to this capacity. 3. Project or program funding specification 24. The third project or program factor is project or program funding specification. Table 6 details the scoring criteria for this measure. Table 6 Project Or Program Funding Specification 1 (Strong) The federal entity's overall budget bill includes the cash flow without specifying the federal cash flow as a line item. 2 (Moderate) The federal entity's overall budget bill includes the federal cash flow specifying it as a line item. 3 (Weak) A separate bill or act provides federal cash flow funding for the project, instead of residing within a federal entity budget. 4 (Very Weak) Regardless of where funding resides, a history of significant funding reductions exists for the project or program. 25. Revenue streams more easily identified and separable from other appropriations may carry greater risk of reduction or elimination under budgetary stress. Federal cash flows included and generally inseparable from a department's overall budget enjoy the most protection, while projects or programs confined to a single legislative bill can be most vulnerable. 4. Renewal and reauthorization risk 26. The fourth project or program factor is the renewal and reauthorization risk. Table 7 details the scoring criteria for this measure. Table 7 Renewal And Reauthorization Risk (see paragraphs 27 and 28) 1 (Strong) Each of the following is true: No renewal risk exists. Authorization for the project- or program-specific cash flow extends to the life of the bonds or terms of the lease. Specified funding levels suffice to cover debt service on the bonds and annual operating expenses. 2 (Moderate) Renewal risk exists, but the project or program exhibits significant importance to the basic function and purpose of the federal entity; or renewal risk exists and the nature of the authorizing legislation suggests renewal. 3 (Weak) Renewal risk exists, and no history exists for renewal of the program or project cash flows; or renewal risk exists and the project or program serves an auxiliary function within the federal entity. 4 (Very Weak) Renewal risk exists and there is a history of similar projects or programs being terminated for convenience. 27. Long-dated financings can extend beyond initial congressional funding periods, requiring additional reauthorizations to service the debt. The Office of Management and Budget (OMB) classifies or scores a project or program as a capital expenditure or an operating expense of the related federal entity. Obligations scored as capital items carry less risk because the federal cash flow funding stream supporting the obligations remains valid as a contractual obligation and can't be renegotiated through the term of the financing. Accordingly, most capital leases will receive a score of '1'. In contrast, projects or programs scored as operating expenses by OMB carry a shorter contractual period and typically receive a score no higher than '2'. They must be renewed and carry the risk that changes in market rents or facility and program needs of the federal entity at the time of renewal may affect the financing. 28. Where renewal or reauthorization risk exists, defined terms set at the beginning of the financing that govern funding details upon renewal may add further security, such as specifying that the new rent paid on a renewed federal lease shall be at least equal to the debt service paid on the outstanding related debt. 5. Essentiality: Geographic concentration and population impact 29. The fifth project or program factor is essentiality, which is defined by geographic concentration and population impact. Table 8 details the scoring criteria for this measure. Table 8 Essentiality: Geographic Concentration And Population Impact (see paragraph 30) 1 (Strong) The federal cash flow serves a major portion of the U.S., defined as at least two-thirds of the states or at least one-half of the U.S. population or serves a national interest. For programs, the federal cash flow is widespread and for a specific project it is measured against the department's mission. 2 (Moderate) The federal cash flow serves a specific geographic region or group representing at least 15% of the U.S. population. 3 (Weak) The federal cash flow is limited in nature, affects less than 15% of the U.S. population, or a state, or U.S. territory. 4 (Very Weak) The federal cash flow is very limited in nature and serves either a singular congressional district or a limited geographic area within a state or U.S. territory. 30. The degree to which a project or program affects a large or small part of the population determines essentiality. While programs generally directly affect a higher percentage of the population compared to individual projects, the nature of the project's impact in addition to the geographic location also play a role. For example, all states benefit from U.S. federal transportation program funding, whereas, only a small portion of the population will have direct involvement with an individual government building. However, a specialized research facility that represents the sole method for addressing the nation's scientific objectives would enjoy strong essentiality. Likewise, a military base that serves a strategic national interest would receive a score of '1', whereas a base that serves a purely regional role would receive a lower score. 6. Local control of federal cash flows 31. The sixth project or program factor is the local control of federal cash flows. Table 9 details the scoring criteria for this measure. Table 9 Local Control Of Federal Cash Flows (see paragraph 32) 1 (Strong) Federal funds are pledged first for debt repayment and flow directly from the federal entity to the trustee. 2 (Moderate) The local government or other entity receives the federal funds but then immediately transfers them to a trustee. 3 (Weak) The local government or other entity receives and holds the funds for a time such that a local-level decision may affect the level of federal funding or the local entity may divert the federal cash flow to other projects. The likelihood of diversion or reduction may be minimal, but the possibility exists. 4 (Very Weak) The local control of federal cash flow is similar to ‘3’, but the likelihood a strong diversion or reduction exists. If the bankruptcy of a nongovernmental recipient of federal funds could impair the use of cash flows, the score equals 4. 32. While some manner of pledge to use the federal cash flow to pay debt service will generally exist in all federal-related financings, the degree to which local actions can affect this funding stream varies. An immediate direction of federal cash flows to a trustee without a local government or other entity first receiving these funds provides the strongest protection. Instances where the local government or other entity holds these funds for an extended period create additional risk. In cases where a nongovernmental entity receives the cash flows, the score equals '4' if a bankruptcy of the entity could impair the use of cash flows for debt service. 7. Allotment risk 33. The seventh project or program factor is the allotment risk. Table 10 details the scoring criteria for this measure. Table 10 Allotment Risk (see paragraph 34) 1 (Strong) The receipt of the federal cash flow is not dependent on the actions of the issuing or related entity 2 (Moderate) The receipt of the federal cash flow depends on basic, program-related service provisions. 3 (Weak) The receipt of the federal cash flow depends on highly specific operating performance thresholds being met that extend well beyond the basic mission and service provisions of the local entity. Distribution formulas make the level of federal cash flow received dependent on local factors that fluctuate at least annually. 4 (Very Weak) The receipt of the federal cash flow is similar to ‘3’, but there is evidence of the local or regional entity not meeting these thresholds. 34. While the local control of federal cash flows measure assesses the risk that a local entity may utilize the federal cash flows for some purpose other than debt service, the allotment risk measure assesses the extent to which local actions or conditions may result in the federal government not allotting the appropriated cash flows. The requirement that a local entity continues to exist and provides basic related services poses a moderate level of risk. Detailed, often project-specific operating performance thresholds or distribution formulas that link amounts received to local fluctuating characteristics pose a higher level of risk if the receipt of funds is conditional on these requirements. IV. REVISIONS AND UPDATES This article was originally published on March 12, 2012. These criteria became effective on March 12, 2012. Changes introduced after original publication: Following our periodic review completed in 2015, we updated the contact information. Following our periodic review completed in 2016, we updated the "Related Criteria And Research" list. Following our periodic review completed on March 2, 2017, we deleted paragraphs 7, 8, and 9, which were related to the initial publication of our criteria and no longer relevant. We also made a clarification in paragraph 13 and deleted paragraphs 35-64, which contained noncriteria text. Following our periodic review completed on March 2, 2018, we updated the contact information, updated criteria references, and corrected a typo. On April 17, 2019, we republished this criteria article to make nonmaterial changes to update the contact information. On April 27, 2020, we republished this criteria article to make nonmaterial changes to update criteria references. On April 9, 2021, we republished this criteria article to make nonmaterial changes to update the contact information. On April 18, 2022, we republished this criteria article to make nonmaterial changes. We updated contact information and criteria references and corrected a typo. V. RELATED CRITERIA AND RESEARCH Related Criteria Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021 Methodology For Rating U.S. Public Finance Rental Housing Bonds, April 15, 2020 Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness, Nov. 20, 2019 Principles Of Credit Ratings, Feb. 16, 2011 Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured Obligations, May 29, 2009 Public Housing Authority Debt, June 22, 2007 Federal Leases, June 18, 2007 Securitization Of U.S. Federal Impact Aid Revenues To School Districts, April 17, 2002