U.S. Public Finance Structured Finance Rating Criteria

Master Criteria

Scope

This criteria report describes Fitch Ratings' approach to rating new and existing structured U.S. public finance transactions. These bonds involve credit substitution in the form of either third-party credit enhancement or use of a financial asset separate from the credit risk of the bond issuer. Credit substitution is used to insulate the investor against default by the issuer, as well as any risks associated with its bankruptcy, and the mechanics of the transaction should not impede access to the support provider or deposited asset.

The criteria outlined in this report are used in conjunction with the relevant applicable criteria listed under Related Criteria.

Where credit substitution fulfills our criteria, these bonds may be assigned Fitch long- and short-term ratings, which reflect the credit quality of the enhancement provider or the deposited asset. More detailed discussion of the application of these criteria to new and existing ratings can be found in the sector-specific criteria for each product.

Key Rating Drivers

The assignment of a rating is conditioned on the presence of each of the following factors. As such, there is equal weighting among the key rating drivers.

Key Support Provider or Deposited Asset: The primary source of bondholder security is shifted from the public finance bond issuer to the support provider or to a deposited asset. Assuming other criteria are met, credit substitution can be achieved.

Mechanics and Structure Examined: Relevant documents are reviewed to assess if the credit support is sufficiently sized or the deposited asset generates sufficient cash flow at any given time to make the required payments. Any expiration, termination or substitution of the support or asset or other structural change should not have an adverse effect on the bond rating without an opportunity for the investor to first be paid in full. The mechanics and timing of the various obligations of the relevant parties should be coordinated to allow efficient and timely access to the credit support.

Termination of the Support: Credit support is usually provided for a specified term. As a result, Fitch's credit-enhanced rating on supported debt is withdrawn or revised upon expiration, termination or substitution of the support, and any change in the support may result in a change in the rating.

Legal Issues of Bankruptcy and Enforceability: Investors should be insulated from the credit concerns of the debt issuer, including the ramifications of its bankruptcy. The support must be a legal, valid and binding obligation enforceable against the support provider.

Table of Contents

This report updates the report titled "U.S. Public Finance Structured Finance Rating Criteria," published on Feb. 28, 2020.

Related Criteria

U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria (December 2020)

U.S. Public Finance Letter of Credit-Supported Bonds and Commercial Paper Rating Criteria (February 2021)

U.S. Public Finance Tender Option Bond Rating Criteria (May 2020)

U.S. Public Finance Prerefunded Bonds Rating Criteria (December 2020)

Analysts

Joseph Staffa
+1 212 908-0829
joseph.staffa@fitchratings.com

Ronald McGovern
+1 212 908-0513
ronald.mcgovern@fitchratings.com

Linda Friedman
+1 212 908-0727
linda.friedman@fitchratings.com

Mario Civico
+1 212 908-0796
mario.civico@fitchratings.com

Key Support Provider or Deposited Asset

Credit-supported structures attempt to substitute the credit and/or liquidity risk of the support provider for that of the debt issuer. The rating Fitch will assign to the bond is linked to the rating of the support provider, assuming the criteria discussed below are met. Any fluctuations in the credit quality of the support provider will be directly reflected in the rating of the bonds. By utilizing irrevocable letters of credit, guaranties, swap agreements, receivables purchase agreements and standby bond purchase agreements issued by commercial banks and other financial institutions to enhance their fixed- or variable-rate capital market transactions, municipalities, not-for-profit organizations and for-profit corporations are able to shift the primary source of bondholder security from themselves to the support provider.

In structures in which multiple credit supports are present, each covering only its portion of the debt obligation on a several but not joint basis, the bond rating will reflect the weakest of them. In certain structures where third-party credit support is added to a rated obligor or obligation, each covering the full debt obligation, the long-term bond rating may receive an uplift of one or two notches.

In certain limited circumstances, when a third party is providing a liquidity facility, the short-term rating assigned to the bonds may not be equivalent to the short-term rating of the support provider but capped by the underlying obligor's long-term rating (see "U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria").

In those structures in which repayment of the bond obligation is dependent on the cash flow from a deposited asset, the rating of the bond obligation is linked to the rating of the deposited asset, assuming credit substitution criteria described below are met. The rating addresses the asset's capacity to cover debt service on the bonds at the rating level of the deposited asset.

Fitch identifies the events upon which a payment obligation under the bonds would arise through a review of the relevant legal documentation, and a determination is made as to whether those payment obligations are fully covered by the credit support or deposited asset. These payment obligations can be regular debt service, redemptions, tender purchases or acceleration of the bonds.

The rating of the credit support provider or the supporting asset is determined in accordance with the Fitch criteria for that sector (e.g. bank ratings). That rating determination is then applied in the analysis of the structured security.

Mechanics and Structure

Sufficiency of Coverage or Funds

Sizing, Mechanics and Availability of the Support Commitment

To establish that the credit support is sufficient to cover the amount, frequency and timing of the bond payment obligations when needed, Fitch examines the bond documents. Fitch also reviews the credit support document to ascertain if it obligates the provider to furnish sufficient funds to make all required payments of principal, interest, premium (if any) and purchase price due to bondholders in a full and timely manner.

The stated amount of the credit support should be sufficient to cover the full principal amount of the bond issuance, premium (if any) and amount of interest that can accrue during the longest interest accrual period addressed by the credit support at the maximum interest rate that may apply to the bonds, as set out under the bond documents. There is no universal interest coverage amount built into the credit support; the sizing of the interest component varies from transaction to transaction because the variables needed to calculate it are derived from the documents that govern the particular transaction.

Facilities that provide liquidity to fund bond purchases should cover full principal plus accrued interest to the purchase date. Where deposited bonds are the cash flow-generating asset, the maximum interest rate formula should adequately limit the interest that is payable to investors to an amount that can be generated by the regularly scheduled debt service on the deposited asset (see "U.S. Public Finance Tender Option Bond Rating Criteria," available on Fitch's website at www.fitchratings.com).

Term and Termination of Coverage or Support

Termination Events

Fitch's rating on supported debt will be withdrawn or revised upon expiration, termination or substitution of the support. Upon the occurrence of either the stated expiration date or any of the early termination events, which are specified in the support documentation, bondholder security is altered and the support provider's rating no longer applies. Similarly, the removal of a deposited asset or its redemption (if the asset is an underlying bond) would alter the credit quality of the bond being rated. This leaves the bondholder exposed to a loss of credit quality, unless such a termination also results in a mandatory redemption of the bond being rated.

Structural Protections

Changes to the structure of the bond transaction (particularly, events affecting the credit enhancement) causing a change in the rating of the bonds, which are not the result of a change in the credit quality of the provider itself, are reviewed by Fitch to ascertain whether bondholders are given notice of the changes and have an opportunity to cash out of the bonds by way of a redemption or tender paid by the existing provider. These changes to the transaction would include the stated expiration date or any early termination event that might be triggered.

A credit support provider may also maintain the right to exit the bond transaction upon an event of default under the reimbursement agreement with the bond obligor. Any termination of the support as a result of an obligor default should occur only after a mandatory redemption or tender and payment by the support provider.

Alternatively, liquidity support may be immediately terminated without an opportunity for the investor to first receive payment from the provider if the liquidity commitment of the bank is linked to certain events of credit deterioration of the obligor or to invalidation of the debt (see "U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria" on Fitch's website at www.fitchratings.com).

In structures with a deposited asset, the asset's removal or redemption should result in a redemption of the bond, since there would be insufficient cash flow to provide payment to bondholders.

Substitution of the support at the borrower's election could have an adverse effect on the bond rating, depending on the credit quality of the new provider or the terms of the new support. This type of change in support usually also leads to a mandatory tender, especially if the substitute provider results in a reduction or withdrawal of the rating then assigned to the bonds, so that bondholders are not exposed to the credit of a new and possibly lower rated provider without an opportunity to tender the bond and be paid in full.

Coordination of Responsibilities

Fiduciary Access to Support

To achieve credit substitution, it is essential that the mechanics and timing of the various obligations of the relevant parties be clearly coordinated to allow efficient and timely access to the credit support. The relevant bondholder fiduciary needs clear instructions in the bond documents to access the credit support to make timely payments to bondholders. Directions to the bond trustee in the trust indenture are reviewed by Fitch to determine if they reflect the provisions of the support document and instruct the trustee to draw on it without first seeking any indemnification or imposing any other conditions. The support document itself is examined to determine whether it clearly describes draw and payment timing.

Coordination of Obligations

Bond documents should have clear provisions describing any chain of activity or responsibilities of the various parties within the transaction, so that timing and obligations are coordinated and bondholders are paid in full and on time.

Preservation of Needed Funds

Investment Risk

Once a payment is made under the credit support, the trustee applies the funds to make bond payments. In the event the trustee holds proceeds for bondholders that have not presented their bonds for payment, such funds must be preserved. Therefore, these funds should be held uninvested or, if invested, the funds should be invested so as to be available to make full and timely payment when needed.

Liens on Necessary Funds

Any moneys from a third-party support that may be used to pay bondholders should be held in funds and accounts separate from the trustee's other accounts, as well as other moneys held for the bond transaction, so as to avoid any claim the proceeds are funds of the bond issuer in a bankruptcy proceeding. Funds also need to remain free from any liens for fees of the trustee, the tender agent or the remarketing agent, that create priority over the bondholder's right to receive payment.

Legal Issues

Bankruptcy Concerns

Credit deterioration of the debt issuer/obligor (obligor) should not pose any risk to bondholders in a credit-supported bond in which there has been a substitution of the provider's credit for that of the obligor. This includes the risk of the obligor's bankruptcy or insolvency and the possibility that any of the obligor's moneys, which may have been used to make bond payments, might be disgorged or returned to the obligor's bankruptcy estate as a preferential payment to be redistributed to other creditors. In some structures, this risk is expressly covered by the support provider, which agrees to replace the funds that were returned to the bankruptcy estate.

Concerns about the bankruptcy or insolvency of the obligor are non-existent where the support provider makes payments to meet required bond payments without regard to funding provided by the obligor. Such funds are not considered funds of the debtor in a bankruptcy proceeding.

In structures where the obligor is not a municipality and in which the support is available only to the extent the obligor fails to make bond payments, Fitch is concerned about the bond payments already made by the obligor with its own money. If the obligor subsequently files for bankruptcy within the applicable preference period, there is a risk that those funds might be recovered from the investor by a bankruptcy court as a preference payment. The prevalent solution has been to age or season the obligor's funds in an account with the trustee for the duration of the relevant bankruptcy preference period before they are used to pay bondholders. This defeats an essential element of a preference, which is that the payment to the creditor (or bondholder) must have been made within the preference period. Aging ensures the bondholder will not receive funds from the obligor within the preference period. Where use of a financial asset is the basis of the structure, bankruptcy preference risk is removed because the issuer is a business or common law trust. Assuming the aforementioned criteria are met in those cases, Fitch may assign the rating of the support provider to the bonds.

Enforceability

Since the credit or liquidity provider is a central funding source for bondholders, it is critical that the support document may be relied on as a legal, valid and binding obligation of the provider. The provider may be creditworthy, but it must also be obligated to make payments as needed. Fitch seeks an opinion stating that the support is enforceable against the provider in accordance with its terms, except in the event of a bankruptcy (or other form of insolvency) of the provider only. It is important that the enforceability opinion be based on the laws of the state under which the support is governed. If the provider is a non-U.S. entity, Fitch seeks an enforceability opinion from both foreign and domestic counsel.

Surveillance

The ratings of third-party credit enhancement providers or relevant underlying assets are central elements in determining the rating of the debt securities benefiting from their support. Ratings for these entities are monitored by the sector analysts in accordance with their respective surveillance schedules. Any direct support counterparty rating changes will be reflected in the debt security ratings.

Rating Assumption Sensitivity

The ratings are tied to the ratings that Fitch maintains on the banks providing the credit enhancement or liquidity support and will reflect all changes to those ratings. Ratings assigned to bonds that rely on underlying bonds or other assets deposited into a trust will reflect all rating changes to those deposited assets. See sector-specific criteria for more detailed sensitivities for the various debt obligations.

Data Sources

The key rating assumptions, and the data used in the ratings analysis, are based on the legal precedent of relevant instrument and program documentation that contractually obliges a third party to provide credit and/or liquidity for the debt securities within certain terms and conditions. Sources can include issuers and legal counsels' explanations to Fitch and their program public offering documents' disclosure of documentation terms and conditions, which confirms Fitch's understanding of the contractual support mechanisms and any limitations.

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or issuer-by-issuer basis and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Limitations

Ratings, including Rating Watches and Outlooks assigned by Fitch, are subject to the limitations specified in Fitch's Ratings Definitions page at www.fitchratings.com.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.