

**Association of Metropolitan Water Agencies
2011 Annual Meeting
October 18, 2011
Newport, RI**

**Standard & Poor's Views on
“Prospects for Bond Financing”**

Geoffrey Buswick

Managing Director and Lead Analytical Manager
U.S. Public Finance Infrastructure
Standard & Poor's Ratings Services

Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.
Copyright (c) 2008 Standard & Poor's, a division of The McGraw-Hill Companies, Inc. All rights reserved.

Introduction to S&P USPF Infrastructure (IFR)

- **One of three operating divisions in U.S. Public Finance**
 - Infrastructure
 - State & Local Government
 - Municipal Enterprise
- **USPF IFR performs roughly 1,500 credit exercises per year (both live deal and reviews)**
 - Review cycles credit exercises are as important as new deals
- **The USPF IFR management team:**
 - Peter Murphy, Senior Director & Analytic Manager
 - James Breeding, Director & Analytic Manager

U.S.A. Sovereign Rating Action

- **On August 5th, Standard & Poor's lower the U.S. sovereign credit rating to AA+ and kept the negative outlook.**
- **Among other criteria factors, the downgrade reflects:**
 - Debt Trajectory
 - Political Climate & our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges
 - Discretionary Spending Growth Scenarios
- **From our Ratings Definitions, a AA+ rating indicated the obligor's capacity to meet its financial commitment is very strong.**

IFR Rating Actions Directly Linked to Sovereign

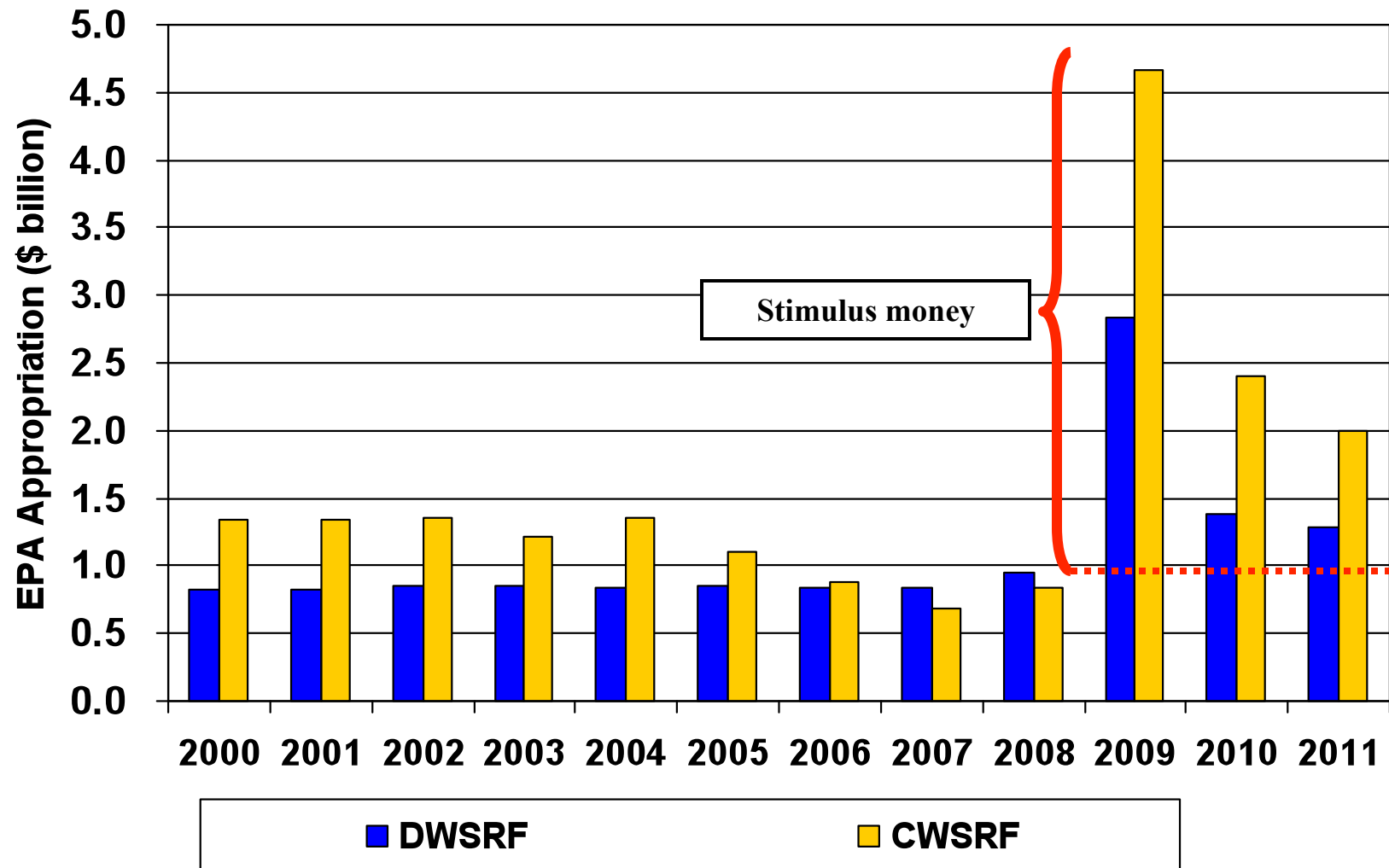
- **USPF IFR direct actions:**

- Tennessee Valley Authority (TVA) to AA+, negative outlook
- Energy Northwest (ENW), Wash. and the several nonfederal debt obligations of Bonneville Power Administration (BPA), Ore. to AA-, stable outlook

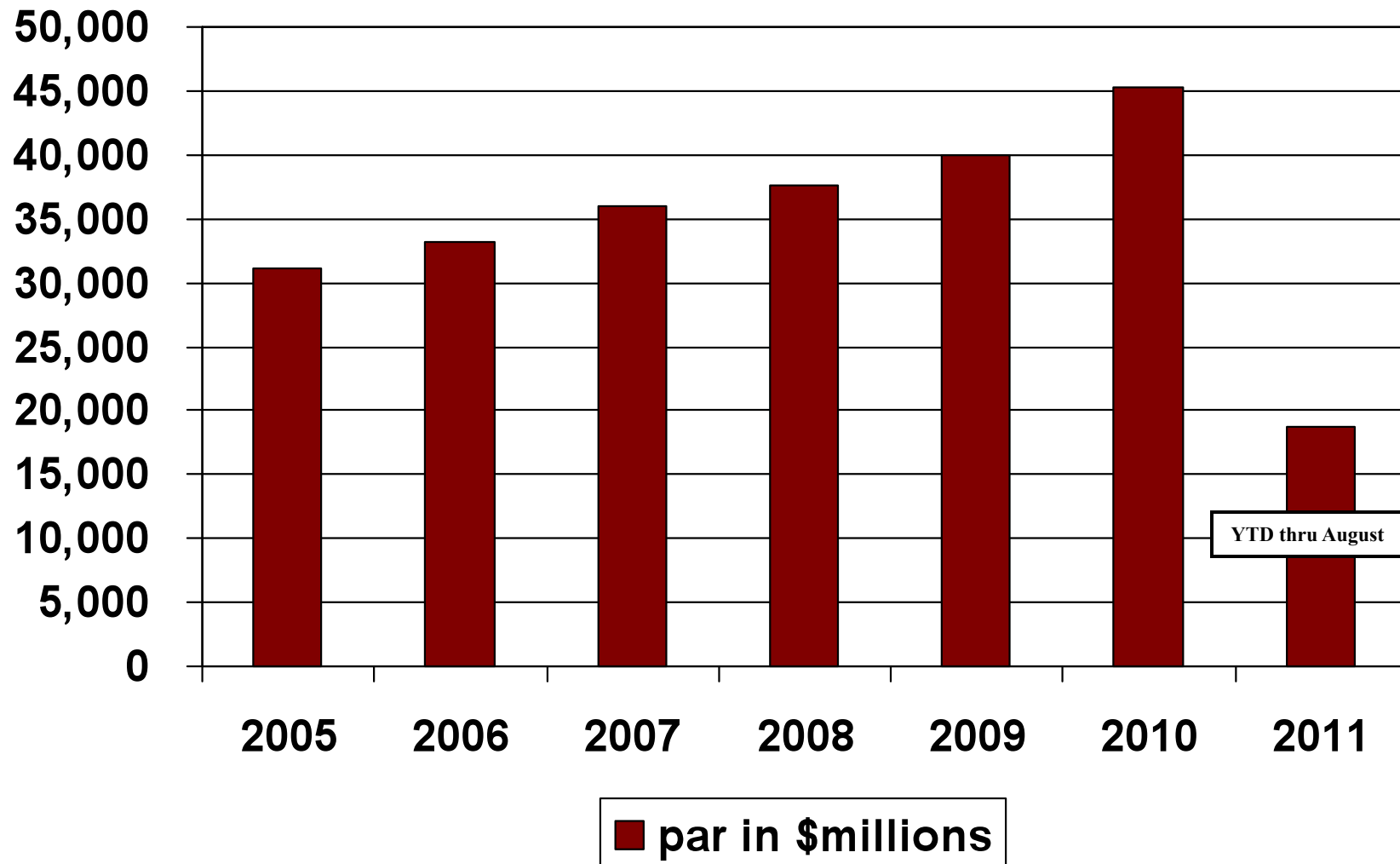
Recent Federal Actions and Discussions

- **BAB's and some other federal incentives went away on 12/31/2010**
 - Talk of resurrection, but at a different direct pay subsidy?
- **Bills to exclude water/sewer infrastructure investment from private activity bond cap have failed in the last two Congresses**
- **American Jobs Act of 2011**
 - Limit the value of tax-exempt interest to 28% for individuals with more than \$200,000 of taxable income and couples with more than \$250,000
- **Debt Reduction Act of 2011 (President's draft legislation to the super-committee)**
 - Impacts tax-exemption below the 28% level proposed above by requiring the OMB to establish annual ratios for debt as a percentage of GDP, causing automatic cuts in tax-exempt interest allowances

ARRA Aside, Federal Dollars Limited



Impact on the Capital Market: Utility Bond Trends



Source: The Bond Buyer

7. Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.

**STANDARD
& POOR'S**

No Shortage of Utility Infrastructure Needs

- **EPA: 2011 is a needs assessment survey year → last survey indicated >\$330 billion just for drinking water**
- **ASCE: water/wastewater report card is typically a grade of ‘D’ or worse**
- **In 2009 7.9% (i.e. 1 in 13) of all community drinking water systems reported some type of violation of EPA safe drinking water standards**
- **Headline risk – just a few that we’ve observed:**
 - **Lake Mead**
 - **Tri-State Water Wars**
 - **SSO’s/CSO’s**
 - **Chesapeake Bay**
 - **Mississippi River/Gulf of Mexico**
 - **Pension/OPEB, workforce succession**
 - **Drought, climate change and natural disasters vs. long-term supply**

Climatology, Hydrology and Long-Term Water Supply

- **In the U.S., most utilities make most of their revenues (often half or more) from Memorial Day to Labor Day**
- **Most common reason to miss budgeted DSC: temperate, rainy summertime**
- **Conversely, a hot, dry summertime can be great for net revenues, assuming adequacy of long-term water supply**
- **Standard & Poor's has always factored water supply into the rating**
 - New supplies can take decades to become operational

S&P Medians

U.S. Water and Sewer Credit Ratios: Medians By Rating Category

	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>
Population	240,000	99,639	29,796	19,274
Total customers	81,568	26,230	8,120	4,552
Per capita effective buying income as % of U.S.	120	100	83	79
Unemployment rate (%)	8.8	9	9.5	9.7
Concentration (%)	6.6	8.9	10.5	11.7
Water rate (\$)	25	26.66	30.71	29.47
Sewer rate (\$)	26.97	30.33	31.08	32.5
Days' cash	415	354	239	226
Debt to plant (%)	23.5	33	44	47.5
Debt to customer (\$)	194	148	166	324
Total debt service coverage (DSC) (x)	2.42	1.6	1.39	1.49
Senior-lien DSC (x)	2.35	1.76	1.4	1.21

Source: "How U.S. Municipal Water And Sewer Bond Ratings Correlate With Some Key Measures Of Issuers' Credit Quality"
Published Sept. 26, 2011

**STANDARD
& POOR'S**

Recessionary Recovery Observations

- Demand and O&M patterns are more often driven by weather than by economy, but not always
- Slower growth can actually help provide relief on parts of the capital budget, freeing up dollars to spend elsewhere
- S&P/Case-Shiller 20-City Home Price Index remains down 30.9% from its July 2006 peak and better than its recent low of negative 33.4% in March.
- S&P economists estimate the odds of any double-dip recession to be 40%, above the 35% prediction from August.

Alternative Financing

- **From 2007 to 2009, we saw a significant increase in the use of short-term debt and debt that used some type of liquidity provider**
- **Many liquidity support agreements are expiring in 2011 and 2012**
- **As a result, S&P has seen an increase in non-traditional options. For example:**
 - Bank loans
 - Direct purchase debt
- **S&P analysts will ask detailed questions about these arrangements, even if they were not rated**
 - Repayment risk, including event-driven contingent liabilities
 - What are the terms? How does that compare to existing debt?

S&P Lead USPF IFR Contacts

Geoffrey E. Buswick, Managing Director/Lead Analytical Manager,
US Public Finance Infrastructure Group
(617) 530-8311
geoffrey_buswick@standardandpoors.com

Peter Murphy, Senior Director/Analytical Manager,
US Public Finance Infrastructure Group
(212) 438-2065
peter_murphy@standardandpoors.com

James Breeding, Director/Analytical Manager,
US Public Finance Infrastructure Group
(214) 871-1407
james_breeding@standardandpoors.com