Criteria | Governments | U.S. Public Finance

Methodology For Rating U.S. Governments

September 9, 2024

This report does not constitute a rating action.

This article presents S&P Global Ratings' criteria for determining a stand-alone credit profile (SACP) and assigning issuer credit ratings and issue credit ratings to U.S. governments, which include U.S. states, counties, municipalities, school districts, and special government districts. These criteria apply only to U.S. governments not in scope of other issuer credit rating (ICR) criteria.

Although the scope of activities may vary, governments share the following characteristics:

- Leadership is elected or is appointed by others who are elected;
- The entity provides public services and/or public infrastructure; and
- The entity is supported directly or indirectly by taxes and fees levied on residents or funds transferred from other levels of government.

For information about the initial publication of this article as of Sep 9th, 2024, including key changes, the impact on ratings, and superseded criteria, see "New U.S. Government Rating Methodology Published," Sept. 9, 2024.

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Methodology Overview

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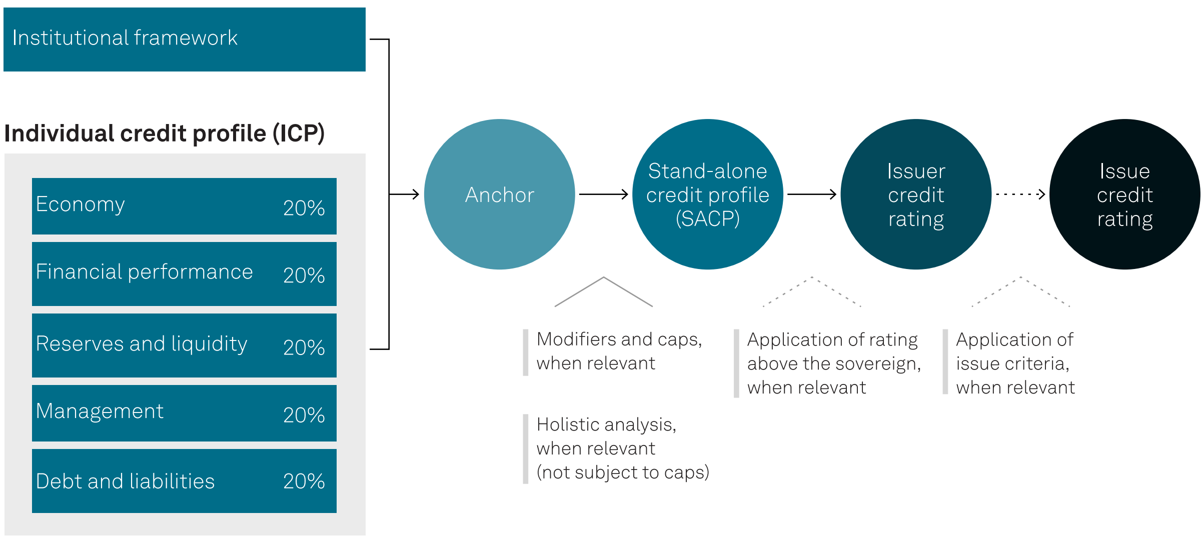
We determine the ICR on a government according to the following steps (depicted in chart 1):

1. Assess the institutional framework (IF)
2. Establish the individual credit profile (ICP) based on the equally weighted average of five factors (economy, financial performance, reserves and liquidity, management, and debt and liabilities)
3. Combine the IF and the ICP to establish the anchor (see table 1)
4. When relevant, adjust the anchor for credit-specific modifiers, caps (see table 2), and our holistic view of the government to establish the stand-alone credit profile (SACP)
5. When relevant, apply our methodology for rating U.S. governments above the sovereign

Chart 1

Framework for rating U.S. governments



Both the IF and the ICP are assessed on a '1' to '6' scale. The final assessment for the IF is rounded to a whole number, whereas the final assessment for the ICP is not rounded.

Table 1 indicates how the IF and ICP are combined to determine the anchor. Table 1 uses lowercase letters to highlight that the outcomes are not ratings themselves but rather indicative credit levels suggested by the IF assessment and ICP.

Table 1

Determining the anchor

--Institutional framework assessment--	--Individual credit profile--										
	1	1.5	2	2.5	3	3.5	4	4.5	5	5.5	6
1	aaa	aaa	aa+	aa	aa-	a+	a	a-	bbb	bb+	bb-
2	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb-	bb	b+
3	aa+	aa	aa-	a+	a	a-	bbb	bbb-	bb+	bb-	b
4	aa-	a+	a	a-	bbb+	bbb	bb+	bb	bb-	b	b-
5	a	a-	bbb+	bbb	bbb-	bb+	bb-	b+	b	b-	b-
6	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-	b-	b-

If the ICP is not a whole number or a midpoint between two whole numbers, the anchor would fall within ranges outlined in table 1. For instance, if a government is operating in an IF of '2', with an ICP of '2.2', the table outcome would be between 'aa' and 'aa-'. In these cases, we determine the anchor by considering:

- The position within the range (that is, whether the ICP is at the high or low end of the range); and
- The expected future performance of one or several of the five ICP credit factors; or
- Any credit characteristics that may be over or understated in our analysis; or
- A peer comparison.

The next step is to apply any relevant modifiers, caps, and our holistic analysis to reach the SACP. Table 2 provides the modifiers and caps that improve or worsen the anchor. In general, individual modifiers improve or worsen the anchor by only one rating level. When the application of several modifiers or caps is warranted, we improve or worsen the anchor by the cumulative effect of those modifiers and then take into account the cap that would result in the lowest rating.

Table 2

Modifiers and caps

Factors that generally worsen or improve the anchor	
For local governments, effective buying income is generally greater than 150% of the U.S.	Improve by 1 notch
For local governments, small population of less than 5,000 without an offsetting economic strength	Worsen by 1 notch
A management assessment of '5' or worse	Worsen by 1 or more notches
An excessive debt or liability burden relative to its economic base or operations	Worsen by 1 or more notches
Risk of materialization of large contingent liabilities not reflected in financial information	Worsen by 1 or more notches
Rapidly rising or unexpected risks	Worsen by 1 or more notches

Factors that generally cap the SACP	
Management assessment of '6'	Cap at 'bbb' category
Management demonstrates a current lack of willingness to pay annual appropriation debt, or support a moral obligation pledge in full or on a timely basis	Cap at 'bbb' category
Management and reserves and liquidity assessments of '6'	Cap at 'bb' category
There is a perceived change in the willingness to honor unconditional or guarantee debt in full or on a timely basis, or we believe the organization may be actively considering a bankruptcy or receivership filing	Cap at 'b' category

A holistic analysis is the final step in determining a government's SACP. It captures a broader view of stand-alone creditworthiness. When relevant, the holistic analysis can have a one-notch impact up or down and is not limited by any credit-specific caps or modifiers. Such an adjustment is based on factors not already incorporated in the determination of the anchor, including our forward-looking view of an issuer's credit factors, a peer ratings analysis, or strengths or weaknesses that are not fully reflected in the application of the criteria.

The modifiers and caps cannot lower the anchor below 'b-'. In addition, use of holistic analysis cannot lower the anchor below 'b-'. For SACPs and ratings below 'B-', see "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," Oct. 1, 2012, and "S&P Global Ratings Definitions," June 9, 2023.

When determining the ICR, if the SACP of a government is higher than the U.S. sovereign rating, we would apply "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," published Nov. 19, 2013, to determine the ICR. Otherwise, the ICR is based on the SACP.

When determining the issue credit rating, we review the legal structure of the debt issuance. As part of this analysis, we evaluate the security pledge and covenants to determine the issue credit rating or whether other criteria apply. If the pledge is sufficiently broad, we assign an issue credit rating equivalent to the ICR. For more information, see "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," Nov. 20, 2019, and "Priority-Lien Tax Revenue Debt," Oct. 22, 2018.

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Key Credit Factors

Institutional Framework

The IF is the set of formal rules and laws, practices, customs, and precedents that shape the environment in which governments operate. Our assessment is mostly qualitative. We consider track record and future changes that are likely to shape the framework.

The IF assessment includes three subfactors:

- Predictability (25%): the ability of a government to forecast its revenues and expenditures
- Revenue/expenditure balance and system support (50%): the ability of a government to finance the services it provides, and the degree of ongoing and exceptional support from a higher-level government
- Transparency and accountability (25%): the comparability of a government's relevant financial information

We assess each of the IF subfactors on a preponderance basis according to the conditions outlined in tables 3, 4, and 5. Then we combine the assessments using the weights indicated above to arrive at the initial assessment.

In exceptional situations, where an IF factor assessment of '5' or '6' is warranted, we assess based on the severity of the effect of that factor.

State constitutions and laws broadly dictate the terms under which U.S. governments operate; therefore, we assess the IF by state and government type. See “Related Publications” for more information on institutional framework portfolio assessments for local governments. Special districts generally receive the same IF assessment as municipalities in the same state. When the legal or practical environment for a specific local government differs from the norm in its state, we will assess accordingly.

Our assessment of predictability and revenue and expenditure balance also considers a government’s level of reliance on own-source revenue compared with shared revenue. System support is assessed in combination with revenue/expenditure balance and becomes more important in our assessment when revenue/expenditure balance is constrained. For example, local governments with a very strong revenue/expenditure balance, but no evidence of exceptional systemwide support, may receive a strong assessment when they are unlikely to need support. On the other hand, local governments with weaker revenue/expenditure balance might receive uplift in their score if there is very strong system support.

Table 3

Institutional framework: Predictability subfactor assessment

1	2	3	4	5-6
State does not have voter initiatives	State has some voter initiative activity, but this has not historically negatively affected operations or limited flexibility	State has an active voter initiative process that has affected revenues and/or expenditures, resulting in diminished flexibility	Voter initiative process is highly active and has substantially impaired operations of governments	The system is very volatile, with ongoing large-scale transformations, making revenues and expenditures highly unpredictable
The disbursement pattern and rules/framework governing shared revenues and own-source revenues are stable and predictable	Some history or expectation of changes to the disbursement pattern or the rules/framework governing own-source revenues and/or shared revenues, but there is sufficient time for planning and adjustment	Frequent or severe changes to the disbursement pattern or the rules/framework governing own-source revenues and/or shared revenues, but there is sufficient time for planning and adjustment	Frequent or severe changes to the disbursement pattern or the rules/framework governing own-source revenues and/or shared revenues to the detriment of governments	Frequent and severe changes to the rules/framework governing own-source revenues and/or shared revenues to the substantial detriment of governments

Table 4

Institutional framework: Revenue/expenditure balance and system support subfactor assessment

1	2	3	4	5-6
Revenue structure allows for revenue to match expenditures leading to sustained or increased operating flexibility	Revenue structure allows for revenue to match expenditures	Revenue structure is constrained and expenditures outpace revenue growth in some years	Revenue structure is constrained and expenditures outpace revenue growth in most years	Revenue structure is not sufficient to cover essential services and infrastructure needs
Ability to raise own-source operating revenue without voter approval, and in the case of states, there is no extraordinary legislative threshold for approval	Some flexibility to raise own-source operating revenues without voter approval; limitations (such as property tax caps) restrict flexibility, but still allow for most governments to raise such revenues	No ability to raise own-source operating revenue without voter approval	No ability to raise own-source operating revenue, even with voter approval	No ability to raise own-source revenue for any purpose, including debt service, even with voter approval
Strong flexibility to reduce expenditures and no significant unfunded or partially funded mandates exist	Less flexibility to reduce expenditures, or intermittent unfunded expenditure mandates exist; however, governments are able to maintain balanced operations	Intermittent unfunded expenditure mandates exist that lead to imbalanced operations in some years	Significant, ongoing unfunded or partially unfunded expenditure mandates that pressure the average government's budget	Significant, ongoing unfunded expenditure mandates that overwhelm the average government's budget
Demonstrated track record of robust systemwide support from higher-level government to balance revenues and expenditures in exceptional situations that is formalized or established in statute	Systemwide support from higher-level government in exceptional situations is established in statute but there is a limited track record; or there is a demonstrated track record of systemwide support from higher-level government in exceptional situations, but it is not formalized or established in statute	Higher-level government provides some monitoring or support in exceptional situations, but there is no established framework for support	No evidence of higher-level government monitoring, no evidence of support in exceptional situations, and has an ability to file for bankruptcy without higher-level government approval	Risk of negative intervention from the higher-level government

Table 5

Institutional framework: Transparency and accountability subfactor assessment

1	2	3	4	5-6
Timely, annual generally accepted accounting principles compliant audited financial statements	Annual audited accrual or modified accrual financial statements	Biennial audited accrual or modified accrual financial statements	Cash-basis reports provide the sole source of financial information in most years	Financial statements are limited to basic information; accounting standards are weak and inconsistent

Individual Credit Profile

After analyzing the institutional framework, we then assess the five key credit factors that make up a government's individual credit profile (see chart 2).

Chart 2

Establishing the individual credit profile (ICP)

	Economy 20%	Financial performance 20%	Reserves and liquidity 20%	Management 20%	Debt and liabilities 20%
Step 1: Establish initial assessment	**State** GSP per capita % of U.S (50%) State PCPI % of U.S. (50%)	**State** State budgetary performance over economic cycles	**State** Budget-based reserves	**State and local government** Budgeting practices (35%) Long-term planning (35%) Policies (30%)	**State and local government** Current cost for debt service and liabilities (50%) Net direct debt per capita (25%) Net pension liabilities per capita (25%)
	Local government GCP per capita % of U.S. (50%) County PCPI % of U.S. (50%)	**Local government** Three-year average operating result (%)	**Local government** Available reserves (%) of revenues		
Step 2: Apply qualitative adjustments	Local economic profile	Under or overstated operating results	Under or overstated reserves	Transparency and reporting	Under or overstated current costs
	Economic volatility and concentration	Performance volatility	Projections suggest different assessment	Governance structure	Under or overstated long-term liabilities
	Economic growth prospects	Projections suggest different assessment	Liquidity and contingent liability risks	Risk management, credit culture, and oversight	Projections suggest different assessment

GSP--Gross state product. GCP--Gross county product. PCPI--Per capita personal income.
Source: S&P Global Ratings.

Each factor is equally weighted at 20% and composed of an initial assessment and qualitative adjustments to derive the final factor assessment. Initial assessments typically use data from the most recent reported year.

We assess factors on a forward-looking basis. In particular, quantitative indicators falling at or near the cut-off points presented in the applicable text and tables can receive a better or worse assessment through the application of qualitative adjustments if trends are improving or worsening, and those trends point to a different assessment in the near future, generally the next one to two years.

The adjustment of the initial assessment for each qualitative factor is generally up to two assessment categories but could be more in exceptional circumstances. We also may adjust the initial assessment by half points in the debt and liabilities factor.

Each of the qualitative adjustments within the five factors of a government's ICP includes several examples for when the adjustment might apply. These examples are not exhaustive, and the methodology allows for the adjustments to be made in atypical cases not outlined in the examples.

When economic or demographic data to determine any of the initial assessments is unavailable, we first seek to assess using a proxy, if available; if not, we typically assume a '6' initial assessment.

For financial analysis, we seek to use data as reported under generally accepted accounting principles (GAAP). However, the criteria allow for other forms of financial information when GAAP basis statements are not available.

Economy

The initial economy assessment considers income levels and economic output.

For states, the initial assessment considers the following subfactors:

- Real gross state product (GSP) per capita as a percent of the U.S. real gross domestic product (GDP) per capita (50%)
- State nominal per capita personal income (PCPI) as a percent of the U.S. nominal PCPI (50%)

For local governments, the initial assessment considers the following subfactors:

- Real GCP per capita as a percent of the U.S. real GDP per capita (50%)
- County nominal PCPI as a percent of the U.S. nominal PCPI (50%)

In limited circumstances where a rural local government spans multiple counties, the initial economic assessment will likely rely on the county with the largest population concentration within the service area. For urban local governments that span multiple counties, the initial economic assessment may rely on the metropolitan statistical area (MSA; for instance, New York City).

Each of the initial subfactor assessments is determined based on thresholds outlined in table 6 on a scale of '1' to '6'. Then the subfactor assessments are combined using the weights indicated above to arrive at the initial assessment. To determine the final economy assessment, we then consider adjustments to the initial assessment for:

- Local economic profile;
- Economic volatility and concentration; and
- Economic growth prospects.

Table 6

Economy: Initial assessment

Government type	Metric	Assessment					
		1	2	3	4	5	6
States	Real GSP per capita as a % of U.S. real GDP per capita	>110	110-95	95-85	85-75	75-65	<65
States	State nominal per capita personal income (PCPI) as a % of the U.S. nominal PCPI	>100	100-90	90-80	80-75	75-70	<70
Local governments	Real GCP per capita as a % of U.S. real GDP per capita	>110	110-95	95-85	85-75	75-65	<65
Local governments	County nominal PCPI as a % of the U.S. nominal PCPI	>100	100-90	90-80	80-75	75-70	<70

Economy: Local economic profile adjustment

Considers local government demographics, wealth, and income characteristics influencing revenue-generating capacity or expenditure demands.

Examples:

- Local government effective buying incomes are significantly higher or lower than the county and the U.S.; see chart 3 (improve or worsen)
- Local government has strengths not captured by incomes and economic output metrics, such as significant secondary home market (improve)
- A stabilizing institutional influence, which offsets understated economic metrics (improve)

Economy: Economic volatility and concentration adjustment

Considers the concentration and volatility of state or local government economies over cycles.

Examples:

- Economic activity is highly concentrated, with over 30% concentration in volatile industries (worsen)
- Top 10 taxpayers of a local government comprise more than 25% of the tax base (worsen)
- Expected material shift in industry composition (improve or worsen)

For more information on how we define volatile industries, please see the associated glossary definition; for a list of industries we consider volatile, please see table 14 in the Glossary

Economy: Economic growth prospects adjustment

Considers the projected economic growth patterns and other economic circumstances that could affect future revenue-generating capacity.

Examples:

- Local, county, or state population declines of greater than 5% over 20 years (worsen)
- Significantly improving or worsening employment or tax base trends (improve or worsen)

Chart 3

Income adjustment considerations for municipalities, school districts, and special districts

Effective buying income (% of county)	Effective buying income (% of U.S.) 0%-100%	100%-120%	>120%
>135%	Improve by 2 points	Improve by 2 points	Improve by 2 points
120%-135%	Improve by 1 point	Improve by 1 point	Improve by 1 point
90%-120%	No change	No change	No change
75%-90%	Worsen by 1 point	No change	No change
0%-75%	Worsen by 2 points	Worsen by 1 point	No change

Source: S&P Global Ratings.

Financial Performance

The financial performance initial assessment considers the annual operating results of a government over time.

For states, we consider budget-based and GAAP financial performance. States typically prepare financial statements each year using GAAP, which includes accruals. However, the budget development, appropriations, budget monitoring, and reserves are expressed on a budgetary basis, which is more closely aligned with a cash basis presentation. Budget-based financial information is a primary focus of our financial review because it shows how state finances are managed day-to-day. However, we also analyze the GAAP audited financial statements and variations between GAAP and budget-based financial disclosure to gain a more complete understanding of a state's financial condition.

For local governments, our initial assessment is generally based on the average annual operating result of the three most recent years, but also looks back at historical performance over economic cycles.

Initial assessments for states and local governments are determined based on considerations outlined in table 7 on a '1' to '4' scale. To determine the final financial performance assessment, we then consider adjustments to the initial assessment for:

- Under or overstated operating results;
- Performance volatility; and
- Projections that suggest a different initial assessment.

Final assessments of '5' or '6' are reached through the application of qualitative adjustments. Generally, governments exhibiting structural imbalance would not receive a final assessment better than '5', and if there is no credible plan to correct, no better than '6'.

Table 7

Financial performance: Initial assessment

Government type	Metric	Assessment			
		1	2	3	4
States	State budgetary performance over economic cycles	Surplus performance achieved during economic expansion and budget balance during economic decline will be less than 50% reliant on one-time measures	Balanced operating results achieved during economic expansion and budget balance during economic decline may be more than 50% reliant on one-time measures	Balanced operating results may be achieved during economic expansion and budget balance during economic decline may be more than 75% reliant on one-time measures	Limited focus on structural budget balance, regular deficits carried through into future fiscal years
Local governments	Three-year average operating result (%)	>3	3-0	0-(3)	<(3)

Financial performance: Adjustment for under or overstated operating results

Considers if financial performance is over or understated and would align with a different initial assessment.

Examples:

- For local governments, nonrecurring revenues or expenses obscure operating result (improve or worsen)
- Deferred expenditures or payment delays on a cash basis that overstate operating results (worsen)
- For local governments, financial restatements that obscure operating results or projections (worsen)

Financial performance: Performance volatility adjustment

Considers if financial performance is subject to unpredictability and would align with a worse initial assessment.

Examples:

- Revenue structure and/or tax policies introduce a high degree of volatility or cyclicality to financial performance
- Weak performing enterprise or other internal service funds that may require general operating fund support
- For local government, volatile or declining school enrollment with potential for significant revenue impacts

Financial performance: Adjustment for projections that suggest different initial assessment

Considers whether prospective changes to current financial performance would result in a better or worse initial assessment.

Examples:

- For local governments, operating revenues or operating expenses projected to increase or decrease from current levels (improve or worsen)
- Lack of political willingness or practical limitations to raise revenues or reduce services/expenditures (worsen)
- Significant event risk that could materially increase expenses without corresponding revenue source (worsen)

Reserves And Liquidity

The reserves and liquidity initial assessment considers the level and stability of a government's reserves and liquid assets.

For states, our initial assessment is based on the budgetary reserve targets as a percentage of annual revenue or spending combined with a track record of funding to the target and replenishing reserves over economic cycles.

For local governments, our initial assessment is based on the available reserves as a percentage of revenue.

For states, initial assessments are determined on a preponderance basis using considerations outlined in table 8 on a scale of '1' to '4', with final assessments of '5' or '6' reached through the application of qualitative adjustments. For local governments, initial assessments are determined based on thresholds outlined in table 9 on a scale of '1' to '5', with final assessments of '6' reached through the application of qualitative adjustments.

To determine the final reserves and liquidity assessment, we then consider adjustments to the initial assessment, for:

- Under or overstated reserves;
- Projections that suggest a different initial assessment; and
- Liquidity and contingent liability risks.

Table 8

Reserves and liquidity: Initial assessment for states

Government type	Metric	Assessment			
		1	2	3	4
States	Budget-based reserves	There is a formal budget-based reserve target relative to annual revenue or spending that is above 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is a formal budget-based reserve target relative to annual revenue or spending that is between 4% and 8%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is a formal budget-based reserve target relative to annual revenue or spending that is between 1% and 4%. In addition, there is a demonstrated track record of restoring the reserve following depletion	There is no formal budget reserve target, or reserves are funded at less than 1% over time, or there is no process for accumulating reserves. No additional reserve funds are identified or available

Table 9

Reserves and liquidity: Initial assessment for local governments

Government type	Metric	Assessment				
		1	2	3	4	5
Local governments	Available reserves % of revenues	>15%	15%-8%	8%-4%	4%-1%	<1%

Reserves and liquidity: Adjustment for under or overstated reserves

Considers if reserves are over or understated and would align with a different initial assessment.

Examples:

- Significant additional reserves that are available for general operating expenditures (improve)
- For local governments, cash accounting masks short-term liabilities and reserves are less than 30% (worsen)
- For states, cash or budgetary basis accounting does not reflect available reserves (improve or worsen)
- High level of receivables unlikely to be collected (worsen)

Reserves and liquidity: Adjustment for projections that suggest a different initial assessment

Considers whether prospective changes to reserves would result in a better or worse initial assessment.

Examples:

- For local governments, significant increase or decrease in projected reserves (improve or worsen)
- Deficits in other funds, not reflected in payables, that will likely require a significant draw from operating fund (worsen)

Reserves and liquidity: Liquidity and contingent liability risks adjustment

Considers whether liquidity pressures could worsen initial assessment.

Examples:

- Low nominal reserves are susceptible to liquidity risk; we weaken by one point when reserves are consistently less than $2 million and by two points when consistently less than $1 million
- Access to external liquidity is highly questionable, considering both capital market and bank sources
- Liquidity is weak, volatile demands on cash, and/or significant cash flow borrowing
- Government is meeting certain obligations only by deeply delaying payment on other non-debt obligations
- Exposure to non-remote contingent liquidity risk, including bank loans and direct placements

Management

The initial management assessment considers three subfactors:

- Budgeting practices (35%): Considers revenue and expenditure assumptions and budget adjustments and updates
- Long-term planning (35%): Considers long-term financial and capital planning
- Policies (30%): Investment management policies, debt management policies, and reserve and liquidity policies

We determine each of the initial subfactor assessments on a preponderance basis based on the conditions outlined in tables 10, 11, and 12, which are assessed on a scale of '1' to '4'. We then combine the subfactor assessments using the weights indicated above to arrive at the initial assessment.

To determine the final management assessment, we then consider adjustments to the initial assessment for:

- Transparency and reporting;
- Governance structure; and
- Risk management, credit culture, and oversight.

A final management factor assessment worse than '4' is reached through the application of qualitative adjustments. A final management assessment near '5' could indicate a challenging management and governance environment or a management team that is understaffed, or lacks relevant skills or experience. A final management assessment near '6' generally indicates our view of issues related to leadership competency, knowledge, or credit culture.

Table 10

Management: Budgeting practices subfactor assessment

1	2	3	4
Budgets are forward-looking with robust monitoring	**Budgets are realistic with sufficient monitoring**	**Budgets are limited in scope with informal monitoring**	**Budgets are unrealistic and lack monitoring**
Budgets utilize comprehensive planning techniques and are based on forward-looking and realistic assumptions	Budgets utilize standard planning techniques and are based on realistic assumptions	Budgets are based on limited historical data and assumptions may be optimistic	Assumptions are unrealistic, resulting in continued mismatch of budget to actual performance
Budget performance is shared with stakeholders and adjustments are made regularly to address for changes throughout the year	Budget monitoring is less formalized and is not consistently shared with all stakeholders; while deviations from budget are identified, adjustments are not always made	Budget monitoring is informal; deviations from budget are not identified in real-time and adjustments are rarely made	Budgets are not updated or reviewed throughout the year

Table 11

Management: Long-term planning subfactor assessment

1	2	3	4
Robust culture of long-term planning	**Some long-term planning**	**Informal long-term planning**	**No long-term planning**
Multiyear financial and capital plans are based on realistic assumptions that support long-term structural balance and strategic decision-making	One multiyear financial or capital plan exists and is based on historical trends that help to inform financial decision-making	Multiyear financial or capital plan may exist but assumptions are optimistic	No multiyear planning exists. Budgeting is done annually with no long-term strategy to identify shortfalls
Plans are regularly updated and both demonstrate clear funding for projects	Plans are regularly updated but funding is only partially identified	Plans are not regularly updated and capital funding is not identified	Planning is done when needed

Table 12

Management: Policies subfactor assessment

1	2	3	4
Robust, well-defined policies with thorough reporting	**Basic policies with regular reporting**	**Informal policies exist with little or no reporting**	**No policies or policies not followed**
Investment, debt management, and reserve and liquidity policies exist, are well defined, and reflect the operating environment of the government. Strong reporting and monitoring mechanisms exist and are functioning	Investment, debt management, and reserve and liquidity policies exist; however, they are basic or informal, but are widely communicated and followed with some regular reporting	Some policies exist, formally or informally, and are generally adhered to; however, there is limited reporting or link to the operating environment of the government	Absence of basic policies or clear evidence that policies are not followed

Management: Transparency and reporting adjustment

Considers management's timely and effective disclosure of information.

Examples:

- Key material financial or operational information is missing and/or is communicated with delays (worsen)
- Persistent challenges closing or reconciling financial accounts leading to delayed or inaccurate financial reporting (worsen)
- Exceptionally strong reporting on areas outside of standard financial reports that management uses to meaningfully reduce financial risk (improve)

Management: Governance structure adjustment

Considers whether the relationship between management and governing bodies or issues with the processes for making decisions or executing reforms could worsen initial assessment.

Examples:

- Recent history of distress, where management or oversight entity lacks track record
- Political gridlock or ongoing turnover in essential positions adversely affecting operations
- Lack of independence or conflicts of interest between governance body and management

Management: Adjustment for risk management, credit culture, and oversight

Considers management's risk tolerance, oversight, or track record in adequately planning and monitoring the government's operations.

Examples:

- Financial operations or debt and liability profile is overly complex relative to management controls (worsen)
- Preparedness for acute or chronic evolving risks, such as extreme weather, natural disasters, or cyber security events (improve or worsen)
- Evidence of deficient internal controls and oversight, such as late payments or persistent audit findings (worsen)
- Presence of unusual financial or legal challenges, such as fraud or other criminal activity (worsen)
- Public discussions of bankruptcy filing in the near term (worsen)

Debt And Liabilities

The debt and liabilities initial assessment considers three subfactors:

- Current cost for debt service and liabilities (50%)
- Net direct debt per capita (25%)
- Net pension liability (NPL) per capita (25%)

Current cost is measured by a government's annual debt service, pension, and other postemployment benefits (OPEB) expenditures divided by total governmental revenue. Net direct debt is determined by calculating gross direct debt and then subtracting offsetting debt. The NPL is calculated by subtracting the fund's plan fiduciary net position from the total pension liability as reported in a government's financial statements under Governmental Accounting Standards Board (GASB) standards. When a government has multiple plans, we generally add the NPL, but not net pension assets, of all the plans and compare the sum to its population to determine the NPL per capita.

When defined-benefit plan data is limited or unavailable, we may incorporate other sources of information, such as recent actuarial reports and cost-sharing plan information. When plan liability data is completely unavailable, we typically assume an initial subfactor assessment of '6'.

We determine each of the initial subfactor assessments based on thresholds outlined in table 13. We then combine the subfactor assessments using the weights indicated above to arrive at the initial assessment. Initial subfactor assessments are determined on a scale of '1' to '6'.

To arrive at the final debt and liabilities assessment, we then consider adjustments to the initial assessment for:

- Under or overstated current costs;
- Under or overstated liabilities; and
- Projections that suggest a different initial assessment.

For more information on how we define net direct debt, please see Appendix 1: Debt Statement Analysis

Table 13

Debt and liabilities: Initial assessment

Government type	Metric	Assessment					
		1	2	3	4	5	6
States	Current cost for debt service and liabilities % of revenues	<3	3-6	6-9	9-12	12-15	>15
States	Net direct debt per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,500-4,500	>4,500
States	Net pension liabilities per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,500-4,500	>4,500
Local governments	Current cost for debt service and liabilities % of revenues	<8	8-14	14-20	20-25	25-30	>30
Local governments	Net direct debt per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,500-4,500	>4,500
Local governments	Net pension liabilities per capita	<500	500-1,500	1,500-2,500	2,500-3,500	3,500-4,500	>4,500

Debt and liabilities: Adjustment for under or overstated current costs

Considers if initial assessment should be adjusted because current costs for debt and liabilities are over or understated and would align with a different initial assessment.

Examples:

- Debt amortization below 20% over 10 years or refinancing maneuvers that significantly backload debt service payments (worsen)
- Debt amortization above 80% over 10 years, significantly front-loading debt service payments (improve)
- Actual pension payments significantly above or below actuarial recommendation or minimum funding progress threshold while considering our discount rate guideline and pension contribution methods such as amortization period, length, and basis (improve or worsen)
- Large one-time current costs such as debt refunding and excess pension contributions (improve)

For more information on how we evaluate the adequacy of actual pension payments, please see the glossary definitions for:

- Actuarial Recommendation
- Discount Rating Guideline
- Minimum Funding Progress
- Pension & OPEB Contribution Methods

Debt and liabilities: Adjustment for under or overstated long-term debt and liabilities

Considers if initial assessment should be adjusted because long-term debt and liabilities are over or understated and would align with a different initial assessment.

Examples:

- For local governments, tax-secured debt has demonstrated consistently sufficient self-support from utilities, including water, sewer, solid waste, and electric utilities (improve)
- Understated population, leading to overstated liabilities per capita, such as a significant secondary home market (improve)
- Low net direct debt and net pension liabilities relative to total governmental funds revenue, which offsets elevated liabilities on a per capita basis (improve)
- Elevated net OPEB liabilities per capita that are viewed as inflexible based on the state constitution, statutes, contract terms, or practical limitations (worsen)
- Governments with elevated net pension liabilities per capita (greater than $1,500 per capita), and pension discount rates that could increase future liabilities (worsen)

Debt and liabilities: Adjustment for projections that suggest different initial assessment

Considers whether prospective changes to current costs and long-term debt and liabilities would result in a different initial assessment.

Examples:

- Significant medium-term debt plans (worsen)
- Escalating or declining debt service schedule or exposure to interest-rate risk or instrument provisions that could increase annual payment requirements (improve or worsen)
- Guaranteed debt, moral obligations, public-private partnerships, or other securitizations not already reflected in net direct debt that could materialize (worsen)
- Recent modifications to pension or OPEB benefit structure, funding policy, or other changes that will significantly alter future liabilities or costs (improve or worsen)

Appendix 1: Debt Statement Analysis

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To measure a government's net direct debt burden, we start by assessing its gross direct debt, which includes:

- General obligation bonds;
- Short-term debt or commercial paper;
- Other tax-secured obligations such as sales, gas, or excise tax obligations;
- Capital and operating lease obligations, including subscription-based information technology arrangements;
- Annual appropriation debt;
- Moral obligation secured debt;
- Tax increment and special assessment secured obligations;
- Pension obligation bonds;
- Enterprise or revenue–based debt; and
- Public-private partnership (PPP) obligations.

For certain obligations where there may be a conduit authority that issues the debt for the obligor, we would include all debt where the government is the obligor, regardless of the issuer.

For capital appreciation bonds, we use the accreted value presented in the government's audited financial statements.

We then subtract offsetting debt from gross direct debt to calculate the government's net direct debt. Offsetting debt is an analytic judgment and will not necessarily match statutory calculations of self-support. Typically, we deduct the following:

- Tax anticipation notes, revenue anticipation notes, and tax and revenue anticipation notes;
- State aid reimbursements for well-defined, long-standing programs;
- Federally supported grant anticipation revenue vehicles (GARVEE);
- Enterprise debt secured by revenues only;
- Moral obligation debt that has not required any contribution to the debt service reserve fund from the morally obligated party; and
- Revenue or nontax-secured PPP obligations.

Bonds that are supported by special assessments, sales tax, gas tax, or tax increment financing revenues are not considered offsetting and are included in the net direct debt of the issuer.

Tax-secured enterprise debt that is fully or partially self-supporting is included in the net direct debt of the issuer. However, the initial debt and liabilities assessment could be improved through a qualitative adjustment if self-support for utilities, such as water, sewer, solid waste, and electric utilities, is consistently sufficient.

When calculating current costs, we remove any pass-through federal revenues and annual debt service relating to offsetting debt that distorts the ratios.

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Appendix 2: Glossary

Term	Definition
Actuarial recommendation	Typically the actuarially determined contribution, the actuarial recommendation is the contribution amount recommended by the actuary to fully fund liabilities over a reasonable amount of time.
Annual appropriation debt	Debt issued by a government on which the debt service payment is contingent on the governing legislative body annually appropriating sufficient funds for payment in its budget. Annual appropriation obligations come in various forms and can include lease-backed obligations and nonlease-backed obligations such as nonlease appropriation bonds, service contract bonds, and moral obligations.
Available reserves	The annual dollar amount of non-obligated reserves a government has in its operating funds at fiscal year-end, which can include budget stabilization funds. For entities that report on a cash basis, the criteria use cash balances instead of fund balances.
Current cost for debt service and liabilities	The sum of annual governmental funds' debt service (principal and interest), actual employer pension contributions, and actual employer OPEB contributions, relative to total governmental revenue.
Discount rate guideline	In our view, a sustainable discount rate guideline for a typical plan is about 6.00%, subject to change based on current market conditions. This rate reflects our view of the expected asset return based on an average plan in the U.S. before consideration of unique attributes or risk tolerances of a given government. We expect the discount rate to not only align with expected performance of the target asset portfolio, but also reflect prudent and informed decision-making on how much market volatility and liquidity risk, or budgetary stress, a government can absorb due to contribution volatility. A target asset portfolio correlated with a higher return may lead to lower contributions, but it contains more risk and, therefore, exposure to greater cost volatility.
Effective buying income	Personal income (wages, salaries, interest, dividends, profits, rental income, and pension income) minus federal, state, and local taxes and nontax payments (such as personal contributions for social security insurance).
Guarantee debt	Debt on which the principal and interest payments are the responsibility of the government (as the guarantor) if the borrower that is primarily liable fails to repay the debt. When a government is servicing the debt it has guaranteed, then we include the guaranteed amount as gross direct debt. When the guaranteed amount is not included in gross direct debt, we may assess it as a contingent liability.
Higher-level government	In our institutional framework assessment, the higher-level government for states is the federal government. For local governments, the higher-level government is typically the state government.
Local government	Includes counties, municipalities, school districts, and special districts. We consider municipalities to include cities, towns, townships, villages, and boroughs. Special districts can include library districts, park districts, fire districts, and forest preserve districts among others.
Metropolitan Statistical Area	Geographic designations delineated by the federal government that contain a core urban area with a population of 50,000 or more. MSAs consist of one or more counties that include the core urban area as well as any adjacent counties that are highly integrated.
Minimum funding progress (MFP)	We consider MFP to be a typical minimum adequate contribution for a given year. Defined as follows, with information typically coming from the audit-reported statement of changes in NPL: MFP = SC + IC + NPL/30. Service cost (SC) = Costs accrued during the year. NPL = NPL at beginning of year. Unfunded interest cost (IC) = Interest accrued during the year on the NPL. Typically, interest cost is reported as interest on the total pension liability (TPL), so we then multiply reported interest cost by 1 minus end-of-year funded ratio.
Moral obligation pledge	Represents a commitment by a government to seek future appropriations for payment of debt service or replenishment of a debt service reserve fund should it fall below its required level.
Net pension liability	Measure of pension liability based on GASB reporting standards. NPL is calculated by subtracting the fund's plan fiduciary net position from the TPL.
Offsetting debt	Debt that is subtracted from the government's gross direct debt to calculate its net direct debt. See Appendix 1: Debt Statement Analysis for the types of debt that are typically eligible for off-set.
Operating expenditures	The dollar amount of recurring costs from the operating funds of the government. Operating expenditures include costs related to the government's administration and its provision of services to its population. They sometimes include recurring intergovernmental transfers or assistance to other public bodies.

Term	Definition
Operating fund	Primary governmental fund that accounts for the core administrative and operational tasks of the government. It is typically the general fund, but sometimes we include other funds if we believe they are core to the government's ongoing operations. We do not consider capital project funds to be operating accounts because they do not reflect operating performance.
Operating result	Operating revenues minus operating expenditures, and the net of transfers in and out, as a percent of operating revenues
Operating revenues	The dollar amount that a government receives on a recurring basis from its operating funds. Operating revenues are composed of taxes and nontax revenues, such as intergovernmental, fines, fees for services, rents, and other sources.
Own-source revenue	Revenues the government is authorized to levy/raise and collect such as taxes, fees, and user charges. This does not include intergovernmental transfers or other shared revenues.
Pension and OPEB contribution methods	*Amortization basis*: Level-dollar, or flat, amortization indicates a payment schedule where annual payments are unchanged from year to year. Level percent of payroll, or increasing amortization, indicates a payment schedule where annual payments rise each year in accordance with the associated growth assumption. We generally view an amortization period that assumes growth higher than inflation as weak. *Amortization length*: The number of years used in the calculation of an amortization payment. We view amortization payments defined over periods longer than 20 years as weak. *Amortization period*: Open amortization methods reset, or refinance, the entire unfunded pension liability annually and are projected to never fully pay it down; therefore, we view open amortization methods as weak. Closed amortization methods (including both declining and layered) spread the payment of unfunded pension liability over a defined period.
Self-supporting debt	Tax-secured debt that is supported by an enterprise such as water, sewer, solid waste, and electric utilities, where such support is consistently sufficient. This type of debt is included in the government's net direct debt, but the initial debt and liabilities assessment could be improved through a qualitative adjustment to reflect the utility support.
Shared revenue	Revenues that are collected and then distributed to a government in the form of intergovernmental transfers, grants, and direct aid.
State	Includes all 50 U.S. states as well as U.S. territories.
Structural imbalance	Mismatch between recurring operating revenues and operating expenditures. Characteristics of structural imbalance are: persistent operating deficits, reliance on one-time revenue, borrowing for ongoing operations, unplanned fund balance drawdowns.
Tax-secured debt	Tax-supported obligations include GO bonds, annual appropriation debt, and special tax bonds such as sales, personal income, and gas tax bonds.
Unconditional debt	Debt that is an absolute legal obligation of the government, payable from lawfully available funds, not subject to any conditions.
Volatile industries	A list of industries used to inform our economic volatility and concentration adjustment. To determine the list, we analyzed publicly available time series data from the Bureau of Labor Statistics on unemployment by industry. For each industry, we calculated volatility spreads using a statistical measure of variance for a common time period that covers multiple economic cycles. We then constructed a categorical measure to define volatile industries to accommodate our criteria framework. See table 14 for a list of industries we define as volatile.

Table 14

Volatile industries

Industry	North American Industry Classification Code
Mining, Quarrying, and Oil and Gas Extraction	21
Construction Industry	23
Other Services (except Public Administration)	81
Agriculture, Forestry, Fishing and Hunting	11
Accommodation and Food Services	72
Arts, Entertainment, and Recreation	71

Key Changes From Previous Criteria

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These criteria adopt largely the same factors of the previous criteria, while adopting a common scored framework to all U.S. governments. Key changes from previous criteria are as follows:

States

- Separated the IF assessment from the weighted factors of the government's ICP and gave it a greater weight within the framework. These changes improved comparability in our analysis of all local and regional governments globally.
- Relocated budget reserves and liquidity by moving the factor out of budgetary performance to a separate ICP factor. This highlights the role reserves and liquidity play in paying debt service and supporting operations during times of distress.

Counties and municipalities

- Increased the weighting of the IF assessment and relocated the IF analysis to stand apart from the weighted factors of the government's ICP. This improved comparability with our analysis of all local and regional governments globally.
- Updated the weights for each of the five key credit factors of the ICP to 20%. This included a change from the previous approach in which debt and contingent liabilities was 10% and economy was 30% of the analysis. This change improved comparability with our analysis of all local and regional governments globally.
- Reoriented our initial economy assessment to reflect broader regional indicators, including GCP and county per capita income, rather than specific scoring of taxable market values.
- Added annual pension and OPEB costs to our initial assessment within the debt and liabilities factor of the ICP. This elevated the importance of pension and OPEB costs in our analysis of a government’s fixed costs.
- Incorporated a more flexible approach to modifiers, caps, and adjustments, which allows us to better capture atypical credit characteristics.

School districts and special districts

- Introduced a scored framework that includes the same factors as the previous criteria. This improved comparability with our analysis of all local and regional governments globally.
- Introduced the IF assessment. This improved comparability with our analysis of all local and regional governments globally.

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Impact On Outstanding Ratings

There are approximately 10,700 public ratings in scope of these criteria, including 51 ratings on U.S. states and territories, 1,000 ratings on counties, 3,900 ratings on municipalities, 5,200 ratings on school districts, and 500 ratings on special districts. Across all ratings in scope of these criteria, we expect more than 95% will remain unchanged.

Assuming that the U.S. governments maintain their current credit characteristics, testing indicates that these criteria will likely result in the following:

- For U.S. state and territory ratings, all ratings will remain unchanged.
- For county ratings, approximately 2% could change, generally by one notch higher or lower.
- For municipality ratings, approximately 4% could change, generally by one notch higher or lower.
- For school district ratings, approximately 5% could change, generally by one notch higher or lower.
- For special district ratings, approximately 5% could change, generally by one notch higher or lower.

Related Publications

Fully superseded criteria

- U.S. State Ratings Methodology, Oct. 17, 2016
- U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, Sept. 12, 2013
- Key General Obligation Ratio Credit Ranges, April 2, 2008
- GO Debt, Oct. 12, 2006
- Debt Statement Analysis, Aug. 22, 2006
- Financial Management Assessment, June 27, 2006

Partly superseded criteria

- Priority-Lien Tax Revenue Debt, Oct. 22, 2018 (to remove the reference to criteria to be fully superseded, and to update the "broad and diverse" definition to match with the definition provided in Special Assessment Debt, April 2, 2018)

Related criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness, Nov. 20, 2019
- Contingent Liquidity Risks In U.S. Public Finance Instruments: Methodology And Assumptions, March 5, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Other publications

- S&P Global Ratings Definitions, updated from time to time
- Institutional Framework Assessments For U.S. Local Government Portfolios, updated from time to time
- RFC Process Summary: Methodology For Rating U.S. Governments, Sept. 9, 2024
- New U.S. Government Rating Methodology Published, Sept. 9, 2024

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