Moody's Credit Review

Presentation to the
Senate Budget and Taxation Committee

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

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What They Did

- Moody's Investors Service has placed on review for possible downgrade the Aaa ratings of the states of Maryland, New Mexico, South Carolina, Tennessee, and Virginia

- This action was taken in connection with Moody's placing the Aaa government bond rating of the United States on review for downgrade

The Reasoning Behind It

- In Moody's view
  - The five states selected are those most vulnerable to changes in the U.S. government rating; and
  - The states have above average exposure to several sovereign risk factors which relate to
    - macroeconomic sensitivity;
    - capital markets reliance; and
    - dependence on federal revenues
    - not sufficiently offset by financial resources available to counteract those risks

Specific Factors Applied

- Volatility of employment as a result of federal government financial actions;
- Federal government employment as a percent of total employment;
- Federal procurement contracts as a percent of gross state product;
- Medicaid as a percent of total state expenditures;
- Amount of variable rate debt outstanding (a risk if credit liquidity is curtailed); and
- Amount fund balance available to mitigate adverse budgetary impacts.

How Maryland Compares

Risk Factors	Maryland	Virginia	New Mexico	South Carolina	Tennessee
Employment Volatility	Above Average	Above Average	Below Average	Average	Above Average
Federal Employment	Above Average	Above Average	Above Average	Below Average	Above Average
Variable Rate Debt	Low	Low	High	High	High
Federal Procurement	Above Average	Above Average	Above Average	Above Average	Average
Medicaid	Average	Below Average	Above Average	Above Average	Above Average
Fund Balance	Below Average	Below Average	Above Average	Below Average	Below Average

Impact on Pending Bond Sale

- Bonds being sold are AAA rated by all three rating agencies
- Schedule
  - retail sale date moved from last Friday to yesterday
  - competitive sale schedules to take place tomorrow
- Retail sale
  - Sold $71 million of $100 million reserved, balance will be added to competitive sale
- Impact on price in competitive sale unclear but rates are low and as of last night, four underwriters had signed up to bid
  - Refunding of $200 million cancelled for now

What Happens If Federal Debt Cap Is Not Increased?

- If debt ceiling is not increased before 8/2/11
  - federal government will become solely reliant on incoming revenues to fund government operations;
  - revenues equal roughly to 60% of expenditure obligations;
  - potential for immediate direct impact on persons and businesses, depending on implementation; and
  - huge risk to global financial system because the dollar and U.S. bonds are so widely held

What Happens If Federal Debt Cap Is Not Increased?

- No precedent for a federal default, but according to NCSL, the following *COULD* occur:
  - The U.S. could pay obligations in the order in which they are received;
  - The U.S. could pay obligations in the order in which they are received and could make these payments proportionate to anticipated revenue; and
  - The U.S. could prioritize what obligations would be paid, and it could simultaneously create an “unpaid” account(s) for obligations not fully paid.

What Happens If Federal Debt Cap Is Not Increased?

- NCSL notes the following potential impact on states:
  - States could or could not be paid or reimbursed (in whole or in part) for costs;
  - Unlike a federal government shutdown, the federal government and its agencies can continue to pay obligations and incur new ones
    - put states in the precarious position of relying solely on decisions made by the federal government; and
  - Under the 1974 federal Impoundment Control Act, the President is authorized to submit requests to Congress to defer spending or rescind budget authority.

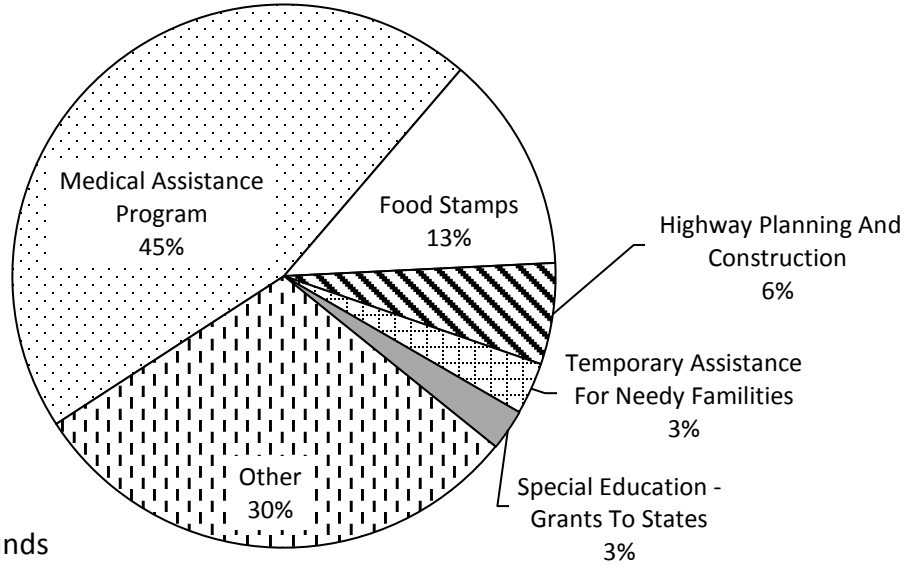
Three Possible Outcomes

- Federal and downgrade default, no plan
  - All heck breaks loose, State credit hurt
- Downgrade, no default, limited plan
  - Moderate disruption, State credit challenged
- No downgrade, no default, big deficit reduction
  - Market stability, State credit still challenged
- Bottom line:
  - States lose with default, downgrade or deficit reduction
  - Right now we are looking at one, the other, or both

So Where Are We Vulnerable?

Top Five Federal Fund Sources

Fiscal 2012 Allowance



Total: $9.1 Billion
Note: Excludes ARRA Funds