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Fitch: Build IL Downgrade Contrasts State/Local Dedicated Tax Approach.

Fitch Ratings-New York-25 May 2018: Today's Build Illinois downgrade highlights Fitch Ratings' credit view that the framework for rating U.S. state dedicated tax bonds must differ from that for rating local government dedicated tax bonds because local government security structures fall under Chapter 9 of the U.S. Bankruptcy Code. In contrast, there is no bankruptcy framework for U.S. states, which means that evaluating the prospects for varying state security structures at a time of fiscal distress is by necessity somewhat judgmental.

The downgrade of Build Illinois sales tax revenue bonds reflects a change in Fitch's criteria for rating U.S. state dedicated tax bonds. In the revised criteria, Fitch specified more limited situations in which a state dedicated tax security can be rated without regard to the state's general credit quality. Additionally, the revised criteria include detail on circumstances in which a state dedicated tax security, while not considered distinct from the state's Issuer Default Rating (IDR), can be treated as stronger than but still linked to the state's general credit risk. Fitch determined that the structure of the Build Illinois bonds enhances the prospects for full and timely payment, allowing for a rating above the state's IDR, but does not meet the revised criteria for rating without regard to the IDR. (For more information, see "Fitch Downgrades Illinois' $2.5B Build Illinois Bonds to 'A-'; Outlook Negative" dated May 25, 2018.)

Fitch's approach to rating dedicated tax bonds of U.S. local governments was unchanged in the revised criteria.

The automatic stay under Chapter 9 applies with few exceptions to all tax-backed debts issued by a local government. A local government security's exposure to the government's general credit risk is therefore predictable under the provisions of the Code. The pledged revenues are either subject to the automatic stay, and the dedicated tax rating is capped by the IDR, or they are not, allowing for a dedicated tax rating distinct from the local government's IDR. Fitch does not 'notch up' from the IDR for local governments unless we can identify the likelihood of enhanced recovery prospects for bondholders, such as the presence of a statutory lien.

Both state and local dedicated tax bonds can be rated separately from and without regard to the IDR in limited situations in which Fitch believes that the nature of the dedicated revenue stream or the legal structure render remote the possibility of a successful impairment argument. For states, the security must be very clearly segregated from operations and have no nexus with general functions.

For local governments, Fitch's criteria outline four exceptions where a dedicated tax bond of a local government can be rated above the government's IDR: (1) bondholders are granted a lien on and pledge of revenue that Fitch concludes would be considered special revenues under Chapter 9 of the U.S. Bankruptcy Code; (2) the debt is issued pursuant to a specific state intercept program; (3) the debt is structured as a securitization specifically authorized by state law; or (4) Fitch can identify the likelihood of enhanced recovery prospects.

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