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Moody's: Enterprise Risk, Contingent Liabilities Remain Major Credit Risk for some Local Governments.

New York, February 03, 2014 — Contingent liabilities for non-essential, non-core enterprises pose significant credit risk for a small group of US local governments, says Moody's Investors Service in the report "Contingent Liabilities and Enterprise Risk Continue to Weigh on US Local Governments." Enterprise risk arises when a local government provides debt guarantees for projects unrelated to core operations.

"Only a small percentage of local governments take on contingent liabilities for nonessential enterprises. But for those that do, the effects on those governments' credit quality can be devastating," says Josellyn Yousef, the Moody's Assistant Vice President — Analyst who wrote the report.

Moody's explains that non-essential, non-core enterprises are much riskier than general government and essential public services because of their limited abilities to increase revenues in a competitive market environment.

While contingent liabilities are not a new phenomenon, guaranteeing the debt of non-essential enterprises became more frequent during the 2008-09 economic downturn and sluggish recovery, says Moody's. Since the downturn, a number of non-essential enterprises have led to stress for some local governments, most notably Harrisburg, PA, which guaranteed $310 million of debt of a struggling waste-to-energy incinerator that first defaulted in 2009.

While there have only been twelve local government defaults since 1970, one-third of them have been sparked by a failure of some non-essential enterprise with guaranteed debt, says Moody's. Such enterprises have included sports and entertainment facilities, nursing homes, real estate developments and fiber-optic telecommunications systems.

A sluggish economic recovery will continue to strain many nonessential enterprises and weaken the balance sheet position of the local governments associated with them, says Moody's.

Local governments generally do not report contingent liabilities on their balance sheets, although recently adopted Government Accounting Standards Board changes will improve disclosure and make it easier to identify governments at risk. Moody's includes contingent liabilities for non-essential, non-core enterprises in a local government's direct debt figures and debt ratios.

Moody's evaluates the credit risk from contingent liabilities through examining three drivers: the likelihood of the enterprise's need for financial support, the local government's financial ability to cover the debt service and the local government's willingness to meet contingent obligations.

Some examples of where enterprise risk has created severe stress for a local government as discussed in the report include Wenatchee, WA, which pledged its full faith and credit to unrated BANs issued to build a sports and entertainment arena , Port of St. Lucie FL, which guaranteed debt to build a state-of-the-art film studio, and Strafford County NH, which provided subsidies for a nursing home.

For more information, Moody’s research subscribers can access this report at https://www.moodys.com/research/Contingent-Liabilities-and-Enterprise--isk-Continue-to-Weigh-on-US–PBM_PBM162885.

Global Credit Research – 03 Feb 2014