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Fitch Rtgs: Rating Sensitivities will Indicate Vulnerability to Special Revenue Bond Ruling

Fitch Ratings-New York-11 April 2019: In response to the March 26, 2019 ruling by the United States Court of Appeals for the First Circuit regarding the bondholder protections provided by special revenue status under Chapter 9 of the U.S. bankruptcy code, Fitch Ratings has developed rating sensitivities corresponding to the likelihood and severity of potential rating changes resulting from a final court ruling upholding the decision. Fitch will consistently incorporate the appropriate sensitivity into each rating action commentary released until the court ruling is finalized.

Ratings for which the sensitivities are relevant are utility and tax-supported ratings that are higher than but within six notches of the related government's Issuer Default Rating (IDR). Fitch has placed ratings more than six notches above the IDR on Rating Watch Negative, indicating the expectation that they would be downgraded if the decision limiting the protections afforded by special revenue status were to stand. For more information, see "Fitch Places Seven USPF credits on Rating Watch Negative Pending Court Decision," dated April 11, 2019.

Fitch's criteria allow for rating bonds secured by pledged special revenues distinct from and higher than the IDR. While special revenues offer substantial protections in the event of a bankruptcy filing, the ruling creates uncertainty about full and timely payment of special revenue obligations during the bankruptcy of the associated government.

The following rating sensitivity will be included in RACs for special revenue ratings between one and three notches above the IDR:

"The rating is unlikely to be affected by a recent ruling by the United States Court of Appeals for the First Circuit regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case."

The following rating sensitivity will be included in RACs for special revenue ratings between four and six notches above the IDR:

"The rating may be affected by the recent appeals court ruling regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case. However, a final decision consistent with the First Circuit's ruling may result in security ratings closer to the IDR."

The following rating sensitivity will be included in RACs for California school districts with ratings above the IDR that are not currently on Rating Watch Negative because of the ruling:

"The rating may be affected by the recent appeals court ruling regarding the protections provided to holders of bonds secured by pledged special revenues. Fitch believes those protections warrant a distinction in ratings above the IDR regardless of the outcome of the case. However, a final decision consistent with the First Circuit's ruling may result in security ratings closer to the IDR. Given state

constitutional and statutory restrictions, Fitch believes potential rating changes would be modest."

Fitch will not include a rating sensitivity related to the ruling for special revenue ratings that are below or equal to the IDR, or for ratings on stand-alone enterprise systems that are not related to a general government, as those ratings are unaffected.

Fitch believes U.S. airport ratings are unlikely to be affected by the ruling, even if made final, as federal laws specific to airport enterprises provide protections against revenue diversion to the general government. See "Fitch Rtgs: U.S. Airport Debt Shielded from Muni Bankruptcy Risk." Therefore, no rating sensitivity related to the ruling will be applied to those credits.

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