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Fitch Ratings Proposes Rating Cap for Some U.S. Municipal Debt.

Link to Fitch Ratings' Report(s): Exposure Draft: U.S. Public Finance Tax-Supported Rating Criteria

Fitch Ratings-New York-23 July 2019: An unexpected decision by the United States Court of Appeals earlier this year has triggered a proposed change to how Chapter 9-eligible entities' special revenue debt is rated in the event of a municipal bankruptcy, according to a criteria exposure draft released today by Fitch Ratings.

While the rating impact of Fitch's proposed changes would be limited (less than 20 ratings to be affected), the magnitude of the First Circuit ruling back in March cannot be overstated. Despite a proven track record of special revenue debt being paid through prior municipal bankruptcies, the March ruling has effectively rendered legal protections for special revenue debt uncertain going forward.

"There's still a possibility that the First Circuit's decision could be overturned, but the fact that the decision has so far passed through two courts substantially erodes the ability to confidently say that any legal protection can provide full insulation from the operating risk of the related municipality," said Managing Director Amy Laskey.

As such, Fitch proposes a ratings cap for special revenue debt and true sale structures relative to a municipality's Issuer Default Rating (IDR) of up to six notches above the IDR depending on the strength of the legal security. The new proposal will not affect most local government security ratings, which will remain either lower than or capped at the related government's IDR. Fitch's proposed changes will also not affect U.S. state bond ratings since they are not Chapter 9-eligible.

In response to the First Circuit Court ruling, Fitch placed seven U.S. public finance ratings that were more than six notches higher than the IDR of the related local government on Rating Watch Negative earlier this year. Fitch expects to resolve those Rating Watches if the proposed criteria revisions are adopted. Depending on the level of feedback it receives from the market, Fitch intends to finalize its amended ratings approach to special revenue and true sale debt later this year.

Fitch's "Revised Approach to Local Government Special Revenue and True Sale Security Ratings" is available at www.fitchratings.com or by clicking on the above link.

Contact:

Amy Laskey
Managing Director
+1-212-908-0568
Fitch Ratings, Inc.
300 West 57th Street
New York, NY 10019

Arlene Bohner
Senior Director
+1-212-908-0554

Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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