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Fitch: US Sovereign Negative Outlook Reflects Pressures Shared by USPF Issuers

Fitch Ratings-New York-05 August 2020: US Public Finance (USPF) ratings are broadly affected by the same macroeconomic factors that precipitated the recent Rating Outlook Revision to Negative from Stable for the United States Sovereign Rating, says Fitch Ratings. However, most USPF ratings are not directly tied to the US Sovereign Rating and will not be immediately affected by the change in the US Outlook. Fitch expects the economic shock brought on by the coronavirus pandemic, which led to the deepest post-war recession, to cause a significant drop in GDP, contracting by 5.6% in 2020 and recovering by 4% in 2021. Failure to contain the virus and renewed lockdowns remains a risk and would further weigh on unemployment, financial stability and growth potential.

Federal actions to curb the nation's very high debt burden by curtailing spending might address Fitch's primary concern about the sovereign rating but would create challenges for states and healthcare systems that rely on federal funding for certain programs. State spending tightening in response could, in turn, affect aid to local governments. Medicaid comprises a significant share of state spending, much of which is provided by federal funding. Not-for-profit healthcare institutions derive a large portion of their revenues from Medicare and Medicaid, and changes to these programs' funding or rate setting can affect hospital budgets and ultimately ratings.

Public finance housing sectors have exposure to the potential delay or curtailment of federal funds such as US Department of Housing and Urban Development (HUD) rental housing or interest rate subsidies and capital grants, military housing payments, and Housing Finance Agency (HFA) mortgage insurance payments.

Fiscal challenges at the federal level could ultimately affect grant anticipation revenue vehicle (GARVEE) bond ratings, particularly if the Highway Trust Fund does not receive needed funding in September when the program is up for renewal. Ratings for standalone GARVEEs are derived in large part from the strength, stability and reliability of the programmatic framework of the federal surface transportation funding program.

USPF ratings are not capped by the US Sovereign Rating unless the repayment is tied to federal government agencies or instruments. The Rating Outlooks of a limited number of ratings with direct linkages to or dependence on the Sovereign Credit will be revised to Negative, unless there are mitigants that reduce US sovereign exposure. These are: 1) pre-refunded municipal bonds where escrowed funds deposited with a trustee to advance refund the bonds are invested in US government obligations. Ratings on these bonds depend on the rating assigned to those securities, which are generally US treasuries or other bonds directly guaranteed by a US federal agency; and 2) tax-exempt housing bonds currently rated 'AAA' and secured entirely, or predominately, by Fannie Mae and Freddie Mac mortgage-backed securities.

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