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S&P Credit Rating Model: Priority-Lien Tax Revenue Debt Rating Model (R)

This report does not constitute a rating action.

Purpose Of The Model

S&P Global Ratings uses the Priority-Lien Tax Revenue Debt Rating model (R) to analyze priority-lien tax revenue debt issued by U.S. municipal governments, state governments, or other U.S. public finance obligors where the pledged revenue stream is typically limited, in conjunction with its criteria "[Priority-Lien Tax Revenue Debt](#)," published Oct. 22, 2018. We consider bonds to have a priority lien when there is a specific statutory or contractual claim on pledged revenues that occurs prior to other claims on those revenues, except for the payment of other debt (or, in limited cases, certain fixed and nominal operating expenses) with a specific superior claim on the pledged revenues. The model is based on the criteria and is not a data-driven statistical model. This model was recoded in R from the previous Excel-based version, which is now retired.

The model helps in assessing rating factors and deriving ratings for both new issue and surveillance analyses of priority-lien tax revenue debt. Its usage enhances comparability across sectors and improves consistency in deriving ratings. Also, it is used to derive credit assessments or credit estimates for priority-lien tax revenue debt.

Summary Description Of The Model

The model uses a framework that is divided into two parts:

- Evaluation of the priority-lien revenue stream (expressed as a stand-alone credit profile or SACP); and
- Effect, if any, of the caps and overrides based on the creditworthiness of the related obligor, which are referred to as obligor's creditworthiness (OC) and revenue-sharing entity (RSE).

The first step is to evaluate the pledged revenue on a stand-alone basis to assign an SACP, beginning with an assessment of three key factors and weightings described in the criteria:

- Economic fundamentals (20%),
- Coverage and liquidity (50%), and
- Revenue volatility (30%).

For economic fundamentals as well as coverage and liquidity, we assess each factor as very strong (the strongest), strong, adequate, weak, or very weak (the weakest), equating to numeric assessments from 1 to 5, respectively. Revenue volatility is assessed as very low (the strongest), low, moderate, high, or very high (the weakest), equating to numeric assessments from 1 to 5, respectively.

The model derives initial assessments based on quantitative and qualitative inputs relative to each factor, which are detailed in the criteria and may be adjusted to arrive at a final assessment for each

factor. The indicative rating is then derived by calculating the weighted average score of the above-mentioned three key factors. Further, it establishes the SACP after applying positive or negative overriding factors, caps, and holistic analysis.

The next step is to analyze the linkage between the SACP and the OC. We do this to reflect our opinion that the pledged revenue stream is not separable from the credit fundamentals of the obligor's operations, and to ensure that the final rating accurately reflects the obligor's operating environment.

To reflect this relationship in the final rating, the linkage is effectuated through a cap. Any cap, resulting from the analysis of the linkage between the SACP and the OC, considers the impact of the operational risks of the obligor and the effect it could have on the full and timely payment of the priority-lien obligation debt service. While the priority-lien rating is not necessarily capped at the OC level, it is limited to four notches above the OC.

In addition, if the priority-lien revenue stream is exposed to the operating risk of an RSE and we believe that entity may affect the flow of shared revenue and that risk is not already incorporated in the OC, this linkage information can be used to lower the SACP or cap the priority-lien rating at the RSE level.

Assumptions Underlying The Model

The assumptions made in the model reflect the assumptions made in the criteria itself. Our methodology and assumptions may change periodically due to market and economic conditions, issuer- or issue-specific factors, or new empirical evidence affecting our credit judgment.

Key assumptions underlying the model are:

- Priority-lien ratings can be evaluated by the combination of economic fundamentals, coverage and liquidity, and revenue volatility;
- As specified in the criteria, certain important factors—known as modifiers and caps—are considered when assessing the overall risk of the entity. These modifiers and caps can be applied in case of increase or decrease in the entity's risk, and in some cases, may impose a rating cap that precludes ratings above a certain level; and
- There is a linkage between the SACP, and the OC and RSE.

Inputs To The Model

The model's inputs include data obtained from numerous publicly reported sources, information obtained through S&P Global Ratings' interaction with obligors, and analytical assessments as defined in the criteria. The specific inputs to the model include qualitative information, quantitative information, analytical opinions, selection of data periods used, and inputs from other published criteria.

Data Used In Model Development And Calibration

The data used in the model development includes all the inputs listed in the "Inputs To the Model" section. These data points were used to inform the model's development and to support testing through the development process.

The model reflects the criteria "Priority-Lien Tax Revenue Debt," and is not a statistical model calibrated to data in the traditional sense. We developed the priority-lien rating criteria framework to be consistent with the history of defaults in the sector, and the credit strength of the priority-lien sector compared with other sectors.

The Limits And Uncertainties Of The Model

The model's use is limited to priority-lien tax revenue debt issued by U.S. municipal governments, state governments, or other U.S. public finance obligors as described in the scope section of the criteria.

Related Criteria

[Priority-Lien Tax Revenue Debt](#), Oct. 22, 2018

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