



SENATE BILL 474

State Intercept for Net Zero Schools



NC Senate Bill 474 and the proposed State Intercept Program-

Credit rating agencies define four types of State Credit Enhancement Programs:

(1) Intercept/Withholding, (2) Standing or Annual Appropriation, (3) State Guarantee, (4) State Permanent Fund. Our proposed legislation focuses on the first type - Intercept/Withholding. As indicated on the attached S&P report (list of states "Current List"), most of the 25 states with Credit Enhancement Programs including "Intercept/Withholding" programs have been rated AA or better with 6 having an AAA credit rating. The program being proposed for leased, net zero schools in NC provides the greatest benefit to school districts with no adverse effect on the state's credit rating. Specifics of S474 are as follows:

1. The LGC is required to evaluate and approve all leases with a term of 3 years or more
2. The County may opt-in to the intercept program, but the County is NOT required to participate in the intercept program
3. The state may only use UNRESTRICTED moneys to fund a default on the part of the county
4. The state is only obligated and allowed to intercept funds due the County or School system
5. (b2) (5) clearly states that "NOTHING IN THIS SECTION IS DEEMED OR CONSTRUED TO CREATE A DEBT OF THE STATE" ...

This program is expected to accomplish the following:

1. Lower the interest rate on leased, net zero schools in low wealth counties by approximately one-half percent (.5%)
2. On a \$25,000,000.00 project the intercept would conservatively save the County or School System approximately \$1,200,000
3. Encourage the development of "net zero" schools that generate more electricity than they use
On a \$25,000,000.00 project this will save the County approximately **\$16,000,000**
4. Produce better learning environments that improve test scores and encourage higher level learning

Because this program only applies to unrestricted money it will NOT divert money restricted for particular uses. It is not accurate to say "that this intercept would take money that would have gone to pay teachers." 115C-530(a) (3) has stated, since inception over 20 years ago, that counties MUST appropriate funds for operating leases. Payment of an operating lease is a legal and contractual obligation. There are many other obligations that counties have that are discretionary. If a County does not pay operating lease payments and unrestricted money from the state is intercepted to pay the lease payment the County would then take the money they appropriated to pay the lease payment and pay for the discretionary items that the intercepted money was supposed to pay. If the money to pay the lease payment is not appropriated then the County would be in violation of a state law which has successfully worked for over 20 years.

While there are state enhancement programs that rely on state credit backstops, the one proposed for NC is limited to withholding of state aid only.

If there is any question about the impact of a state intercept on the State's credit rating I suggest that the state send the proposed legislation to the 3 rating agencies and request a private letter ruling on the issue.

There are currently six states rated AAA by S&P with Credit Enhancement Programs including "Intercept/Withholding" programs similar to our proposing bill. Additionally, Moody's has four other AAA rated states with Credit Enhancement Programs. Here is the complete list of triple-A rated states:

Georgia

Indiana

Maryland

Missouri

New Mexico

South Carolina

Tennessee

Utah

Virginia

Wyoming

There are 15 other states with a credit rating of AA or better that have state Credit Enhancement Programs including "Intercept/Withholding" programs per the attached S&P report.

S&P currently rates 35 Credit Enhancement Programs in 24 states and of these 16 are "Intercept/Withholding" programs.

Robbie Ferris

From: Brent Jeffcoat <bjeffcoat@popezeigler.com>
Sent: Wednesday, May 01, 2013 8:51 PM
To: Robbie Ferris
Subject: Intercept, Ratings and S&P

When the current language was drafted, we did not run it past S&P. The main reason is that the nature of these transactions is likely to be a direct placement with banks or other institutional investors. We usually get ratings only on publicly offered deals; but, of course, that isn't always so. Further, the language as drafted results in a post-default intercept, not a pre-default intercept. Ratings agencies rate not only on the prospect of repayment but also on timeliness. Therefore, an intercept that doesn't kick in until a payment is late doesn't produce the same level of rating benefit as a pre-default intercept. However, in the institutional lending market, a grace period is not unusual, indicating that they are a less sensitive to short delay in payment. But, as you can see, this intercept provision isn't driven by a rating agency analysis.

When you mentioned a concern about the impact of intercept on the State, I was a little baffled. The concept of an intercept is that if a borrower whose obligations are covered by the intercept has a legal obligation to pay, then the intercept allows the State to make that payment and reimburse itself for those payments from amounts due from the State to the borrower. The goal is protect the creditworthiness of local governmental units or, in some cases, bond banks. The protection, however, is not an assumption of the liability by the State or a guarantee; instead, the protection is that the state can make the payments from amounts it would otherwise be paying to the borrower. In that sense, the State's obligation to make payments is not an additional commitment by the State. Instead it is just an arrangement where a payment that would be made by the State anyway is made to the lender rather than the borrower.

When I drafted legislation for South Carolina to create a pre-default intercept for schools, I had to familiarize myself with the ratings agency criteria. In doing that, I learned of intercept programs in other states and for other kinds of borrowings. So, as to the impact on the state, I figured that I could get a read on that from the rating agencies. The first one I called was S&P because the person who I had worked with on the SC legislation is still there. Ratings agencies do not make general pronouncements; instead they answer specific questions, usually from issuers. To get a definitive answer from S&P, the state would need to request a review through ratings evaluation services of S&P. But, my contact said that in his personal opinion the evaluation would likely take into account that any payment, not being a new obligation, would not likely adversely affect the state's rating.

I also asked for any analysis S&P had made of intercept programs. I shared that with you and it included both a listing of all intercept programs and a discussion piece outlining the ratings rationale. Later in the day, I made the similar calls to Moody's with similar results. I also shared with you the Moody's analysis of intercept programs.

I'd be happy to discuss any of this with anyone who has questions. I can't speak for every jurisdiction, but I can tell you that South Carolina has had both pre-default intercepts and post-default intercepts for a long time and no claim has ever been made. I suspect that SC's experience is representative of most other programs. That experience is another reason why ratings agencies are not likely to ding a state's credit rating. I could go on about systemic risk and lots of other things, but given North Carolina's close supervision of local government finance, I doubt that an intercept would be viewed as anything but a positive for the State as well as the local governments.

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**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2013**

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SENATE DRS15159-MH-61 (02/26)

Short Title: Net-Zero Energy Schools.

(Public)

Sponsors: Senators Meredith and Walters (Primary Sponsors).

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO PROVIDE FOR THE CONSTRUCTION, LEASING, AND OPERATION OF
3 NET-ZERO ENERGY SCHOOL FACILITIES THAT WILL PRODUCE RENEWABLE
4 ENERGY SUFFICIENT TO RETURN ENERGY BACK TO THE UTILITY GRID
5 EQUAL TO THAT CONSUMED BY THE SCHOOL.

6 The General Assembly of North Carolina enacts:

SECTION 1. G.S. 115C-530 reads as rewritten:

§ 115C-530. Operational leases of school buildings and school facilities.

9 (a) Local boards of education may enter into operational operating leases of real or
10 personal property for use as school buildings or school facilities. Operational Operating leases
11 for terms of less than three years shall not be subject to the approval of the board of county
12 commissioners. Operational Operating leases for terms of three years or longer, including
13 periods that may be added to the original term through the exercise of options to renew or
14 extend, are permitted if all of the following conditions are met:

(1) The budget resolution includes an appropriation authorizing the current fiscal year's portion of the obligation.

(2) An unencumbered balance remains in the appropriation sufficient to pay in the current fiscal year the sums obligated by the lease for the current fiscal year.

(3) The leases are approved by a resolution adopted by the board of county commissioners. If an operational operating lease is approved by the board of county commissioners, in each year the county commissioners shall appropriate sufficient funds to meet the amounts to be paid during the fiscal year under the lease.

(4) Any construction, repair, or renovation of the property is in compliance with the requirements of G.S. 115C-521(c) relating to energy guidelines.

27 For purposes of this section, an operational operating lease is defined according to generally accepted accounting principles and may be for new or existing buildings.

(b) Local boards of education may enter into contracts for the construction, repair, or renovation of leased property if (i) the budget resolution includes an appropriation authorizing the obligation, (ii) an unencumbered balance remains in the appropriation sufficient to pay in the current fiscal year the sums obligated by the transaction for the current fiscal year, and (iii) the construction, repair, or renovation is in compliance with the requirements of G.S. 115C-521(c) relating to energy guidelines. Construction, repair, or renovation work undertaken or contracted by a private developer is subject to the requirements of Article 8 of Chapter 143 of the General Statutes. Contracts for new construction and renovation that are

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2 subject to the bidding requirements of G.S. 143-129(a) and which do not constitute continuing
3 contracts for capital outlay must be approved by the board of county commissioners.

4 (b1) Net-Zero Energy Schools. – Local boards of education may enter into an operating
5 lease for design and construction of a net-zero energy school. For purposes of this section, a
6 "net-zero energy school" is a school designed to include sufficient renewable energy generation
7 on the school site to equal one hundred five percent (105%) of the school's estimated entire
8 annual electrical consumption. The annual energy consumption shall be determined by meeting
9 all requirements of ASHRAE (American Society of Heating, Refrigeration and Air
10 Conditioning Engineers) Standard 90.1-2007 "Energy Standard for Buildings Except Low-Rise
11 Residential Buildings," Appendix-G "Performance Rating Method." The school shall be served
12 by the utility that provides service in the territory where the school is located in the manner
13 prescribed by G.S. 62-133.11.

14 (b2) In approving an operating lease for a net-zero energy school, the county
15 commissioners may make the following additional provisions as an incentive for the
16 conservation of energy and the use of clean and renewable energy sources:

17 (1) This section applies to operating leases for net-zero energy schools (a
18 "Qualifying Lease") where (i) in the resolution approving such operating
19 lease the county board of commissioners has expressly and irrevocably
20 elected to have the provisions of this section apply and (ii) the payment
21 schedule for the periodic payments due under the operating lease (the
22 "Covered Payments") has been received by the State Treasurer. This section
23 does not apply to any other operating leases or other obligations of a county
24 or a school administrative unit.

25 (2) Whenever the lessor, or its assignee (collectively the "Covered Payee"),
26 under Qualifying Lease has not received a Covered Payment by the fifth day
27 immediately following the due date for such Covered Payment, the Covered
28 Payee shall notify the State Treasurer by telephone, facsimile, or other
29 similar communication, followed by written verification of the payment
30 status. The State Treasurer shall immediately contact the school
31 administrative unit and the county wherein such unit is located and
32 determine whether the school administrative unit will make the payment not
33 later than the fifth day after such notice.

34 (3) If the school administrative unit indicates that it will not make the payment
35 timely, the State Treasurer shall forward the amount in immediately
36 available funds to the Covered Payee necessary to make Covered Payment
37 and shall withhold that amount from any payments due from the State to
38 such school administrative unit or the county in which such unit is located
39 from any source that is not restricted. If the amount payable currently is
40 insufficient to pay the amount necessary, the State Treasurer shall withhold
41 amounts from any future payments, including payments to be made in a
42 succeeding fiscal year, until the total amount of the Covered Payment has
43 been withheld.

44 (4) The State Treasurer shall notify the school finance officer of the school
45 administrative unit and the county finance officer of the county in which
46 such unit is located of amounts withheld and payments made pursuant to this
47 section.

48 (5) The General Assembly covenants that it will not impair the obligations of
49 contracts entered into under the provisions of this section; however, nothing
50 in this subsection is to be construed to require the State to continue the
51 payment of State allocations or distributions to any school administrative
52 unit or the county in which such unit is located, or to limit or prohibit the

repealing, amending, or modifying any law relating to the amount

of State allocation or payments to the school administrative unit or the county in which it is located or the manner or timing of the payments.

Nothing in this section is deemed or construed to create a debt of the State with respect to Covered Payments within the meaning of any State constitutional provision or to create any liability except to the extent provided in this section.

(6) Whenever the State Treasurer is required by this section to make a payment to a Covered Payee on behalf of a school administrative unit or the county in which such unit is located, the State Treasurer or the designee of the State Treasurer shall initiate an audit of the school administrative unit or the county in which such unit is located to determine the reason for failure to make a Covered Payment and to assist the school administrative unit or the county in which such unit is located, if necessary, in developing and implementing measures to assure that future payments will be made when due.

(e)

~~Operational Operating leases and contracts entered into under this section are~~ (c) Approval by Local Board of Education. Any lease entered into pursuant to this section shall not be subject to the requirements of G.S. 143-128.1B. A local board of education, before entering into an operating lease or pursuant to this section, shall adopt a resolution as provided in this subsection. Before adopting the resolution required by this subsection, the local board of education shall publish a notice of its intent to enter into an operating lease or at least 10 days in advance of the date of the meeting at which the action is contemplated and in a newspaper having general circulation within the geographic area served by the local board of education. The notice shall include, at a minimum, the date, time, and place of the meeting, a description in brief and general terms of the subject of the agreement, the name of the other party to the lease, and an indication of the board's intent to take action to authorize the lease at the indicated meeting. The resolution shall provide the following:

(1) That entering into the agreement for one or more specified buildings or facilities is in the unit's best interests under all the circumstances. In making this evaluation, the local board of education may consider the time, cost, and quality of design, engineering, and construction, including the time required to begin and the time required to complete a particular activity; occupancy costs, including lease payments, life-cycle maintenance, repair, and energy costs; and any other factors the board deems relevant.

(2) That the private developer is qualified to provide, either alone or in conjunction with other identified and associated persons, the products and services called for under the proposed operating lease and any related agreements. The local board of education shall make this determination taking into account any factors the local board of education deems relevant, including the knowledge, skill, and reputation of the provider and its associated persons, the goals and plans of providers for utilization of minority business enterprises, and the costs to be incurred by the local board of education.

(d) ~~Operational Operating leases and contracts entered into under this section are~~

subject to approval by the Local Government Commission under Article 8 of Chapter 159 of the General Statutes if they meet the standards set out in G.S. 159-148(a)(1), 159-148(a)(2), and 159-148(a)(3). For purposes of determining whether the standards set out in G.S. 159-148(a)(3) have been met, only the five hundred thousand dollar (\$500,000) threshold shall apply."

SECTION 2. Article 7 of Chapter 62 of the General Statutes is amended by adding

1 24 a new section to read:

2 25 **§ 62-133.11. Net-zero energy schools.**

3 26 (a) Definitions. For purposes of this section, "electric power supplier" means a public

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5 27 utility, an electric membership corporation, or a municipality that sells electric power to retail
6 electric power customers in the State.

7
8 29 (b) Interconnection With Electric Power Supplier. When a local educational authority
9 enters into an operating lease for a net zero energy school as set forth in G.S. 115C-530(b1),
10 the electric power supplier providing electric service in the territory where the school is located
11 shall provide service to the school for a maximum fee of four hundred dollars (\$400.00) per
12 month, escalated annually starting in 2013 at the consumer price index. Services provided by
13 the electric power supplier shall include operation, maintenance, and replacement of
14 interconnection facilities sufficient to carry the electrical load at the interconnection point; and
15 related electric power supplier services including meter reading and accounting. The party
16 entering into the net zero energy lease agreement with the local educational authority shall
17 compensate the electric power supplier for the actual direct costs of initial distribution,
18 transformer, and interconnection facilities on the secondary side of the transformer. These
19 interconnection costs shall not exceed what the electric power supplier would charge any other
20 customer for a similar interconnection.

21
22 42 (c) Purchase and Sale of Electricity. The net zero energy school shall be
23 interconnected with the electric power supplier providing service in the territory where the
24 school is located to provide power to the net zero energy school and to allow the electricity
25 generated by the equipment located at the school to be exported to the electric distribution
26 system. At the end of each annual billing period of the service contract with the electric power
27 supplier, the electricity generated at the net zero energy school shall be netted against the
28 power received from the electric power supplier, and the net zero energy school or its owner
29 shall be invoiced for electricity according to the annual difference between the amount of
30 electricity the electric power supplier delivered to the net zero energy school and the amount of
31 electricity generated at the net zero energy school and delivered to the electric distribution

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35 1 system. To the extent that the generation equipment at the net zero energy school does not
36 generate more electricity than is delivered, the electric power supplier may charge the net zero
37 energy school for the net electric power delivered during the annual billing period at the peak
38 energy rate in effect at the end of that period. If the net zero energy school generates net excess
39 electricity, the electric power supplier shall not be required to pay for the net excess electricity.
40 The electric power supplier shall be required to enter into a contract with the owner of the
41 net zero energy school that meets the requirements set forth in subsection (d) of this section.

42
43 8 (d) Contract Terms. The power purchase contract between the electric power supplier
44 and the owner of the net zero energy school shall include the following terms:

45
46 10 (1) The owner of the net zero energy school shall be paid by the electric power
47 supplier the fixed amount of not less than forty dollars (\$40.00) per gross
48 MWh for (i) electricity generated by a renewable energy resource, as defined
49 in G.S. 62-133.8(a)(8), at the net zero energy school and (ii) energy saved
50 through energy efficiency measures at the net zero energy school.

51
52 15 (2) The term of the contract shall be for a period of not less than 20 years from
53 the date the school initially meets the definition of a net zero energy school
54 pursuant to G.S. 115C-530(b1).

55
56 18 (3) Payments under the contract shall be made no less frequently than annually.

57
58 19 (4) The baseline to be utilized for the calculation of MWh savings due to the
59 installation of energy conserving measures shall be energy use intensity

benchmarks from the most current Commercial Buildings Energy Consumption Survey.

(5) Payments shall (i) be considered the purchase of a Renewable Energy Certificate under G.S. 62-133.8 for each MWh of energy generated or saved and (ii) not be deemed a payment for electricity.

26 (e) Standby Generation Authorized. The net zero energy school or its owner may
27 operate either renewable or nonrenewable on site standby generation up to the prime capacity
28 of the net zero energy school, in conjunction with the installed on site renewable resource
29 generation, and such standby generating equipment shall be included in the electric power
30 supplier's load management, demand response, or interruptible rate program designed to reduce
31 the electric power supplier's peak loads on the same terms and conditions as are made available
32 to other customers of the electric power supplier participating in those programs." The net-zero
energy school will produce tradable instruments in the form of Renewable Energy Certificates as
defined in G.S. 62-133.8 (a "REC"). The Utilities Commission shall assign credit based on the
development tier designation given to the county where the net-zero energy school is located pursuant
to G.S. 143B-437.08 as follows:

(1) Tier one counties: The Utilities Commission shall assign credit of 30 RECs for each megawatt hour of electricity or equivalent as defined under G.S. 62-133.8(a)(6)

(2) Tier two counties: The Utilities Commission shall assign credit of 25 RECs for each megawatt hour of electricity or equivalent as defined under G.S. 62-133.8(a)(6).

(3) Tier three counties: The Utilities Commission shall assign credit of 20 RECs for each megawatt hour of electricity or equivalent as defined under G.S. 62-133.8(a)(6)

RECs generated by a net-zero energy school may be utilized to comply with G.S. 62-133.8(d), (e) or (f); provided the owner of the net-zero school makes an election upon the initial registration of the RECs as to the characterization of such RECs for the purposes of G.S. 62-133.8.

SECTION 3. This act is effective when it becomes law.

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Criteria | Governments | U.S. Public Finance: State Credit Enhancement Programs

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State Credit Enhancement Programs

(Editor's Note: This criteria article was originally published on Nov. 13, 2008. We are republishing this article following our periodic review, completed on Feb. 8, 2013.)

State Enhancement Programs

State credit enhancement programs generally fall into four categories or program structures. Those categories are:

- Intercept/Withholding
- Standing or Annual Appropriation
- State Guarantee
- State Permanent Fund

The type of program and the contractual relationship between the state and the program participant dictates whether a program rating or outlook will change due to a related state rating action. Not all programs fit neatly into the four categories mentioned above. In these cases, whenever there is a state rating change, a program review will also take place to determine if there is a need to adjust the program rating or outlook.

In general, credit enhancement programs are designed to give bondholders additional security for particular general obligation and lease bonds. While the criteria differ depending on the program's structure and the specifics of a state's statutes and constitutional provisions, all programs typically include the following features:

- An independent paying agent, which acts as the state's notification agent in the event of a potential default;
- Sufficient coverage and liquidity of a revenue stream to be used for a debt service deficiency that is independent of the issuer; and
- State oversight of program participants to ensure a well-managed program.

Intercept/Withholding Programs

Intercept or withholding programs operate on the strength and availability of state aid, which can be diverted to a paying agent in the event a local government cannot make its full and timely debt service payment. Standard & Poor's Ratings Services rates intercept or withholding programs that meet certain requirements at a level one notch off of the state's GO rating – on par with the state's appropriation rating – reflecting the appropriation nature of the intercept or withholding mechanism. Accordingly, if the state rating changes so will the program rating. Other programs do not meet these requirements and are rated more than one notch off the state's rating. These program ratings will not change due to a change in the state rating unless and until they converge with the state's rating.

One category of intercept programs rated on par with appropriation debt are programs structured to provide full and timely payment of debt service directly to a paying agent, regardless of the amount of undisbursed state aid due to the entity at the time of intercept. Programs that fall under this category are:

- California Infrastructure Bank School Aid Intercept Program
- Colorado State Aid Intercept Program
- Massachusetts Qualified Bond Act
- Mississippi State Aid Capital Improvement Bond Program
- Missouri Direct Deposit of State Aid Program
- New Jersey Qualified Bonds Program

Although the specific structure of each program varies, these programs are also characterized by strong state oversight in addition to the other characteristics mentioned above.

Other intercept or withholding programs provide for payment of debt service only up to an amount equal to remaining undisbursed state aid. However, some of these programs are rated on par with appropriation debt because they require that participant's available state aid cover debt service by at least 2x maximum annual debt service (MADS), reducing the risk that available state aid will be insufficient to fully cover debt service. In order to achieve an appropriation-equivalent rating, Standard & Poor's requires that the coverage multiple be set equal to at least 2x MADS. Standard & Poor's considers this level of coverage to mitigate the risk of available state aid being insufficient when debt service is due. Programs that qualify for this rating based on coverage requirements include:

- Georgia State Aid Intercept Program (resolution enhanced – see program detail)
- Ohio State Aid Intercept Program
- Indiana State Aid Intercept Program (resolution enhanced – see program detail)
- Kentucky State Aid Intercept Program
- Kentucky State Aid Intercept Program for Commonwealth Universities

Those intercept or withholding programs that do not provide for full and timely payment of debt service or do not have the additional strengths discussed above are not viewed by Standard & Poor's as equivalent to state appropriations. Consequently these programs are rated lower than the state rating and their ratings will not necessarily change due to a change in the state's rating or outlook; however, in the event a state rating is downgraded to a level at, or below, the program rating, the program rating may be lowered to a level at or below the revised state rating. Programs in this category include:

- Georgia State Aid Intercept Program
- Indiana State Aid Intercept Program
- New York State Aid Intercept Program
- Pennsylvania State Aid Intercept Program
- Virginia State Aid Intercept Program

Standing Or Annual Appropriation Programs

Appropriation programs are dependent on a state's ability to use its cash reserves to make up any debt service deficiency for a participating local government's debt service payment. There is a distinction made between standing appropriation programs which are rated on par with the state's GO rating and annual appropriation programs which are subject to appropriation risk and are notched one notch below the state GO rating level. Standing appropriation program ratings are not subject to appropriation risk and reflect both the state's sovereignty and its constitutional

obligation to fund education.

For both standing and annual appropriation programs, the state's credit quality is directly linked to the program's rating. Consequently, the program rating will move in tandem with its related state rating, keeping the relative rating differential between the program and state rating constant. The program's rating outlook will always reflect the state's outlook.

Standing appropriation programs:

- Minnesota State Standing Appropriation Program
- Minnesota County Credit Enhancement Program
- Texas Higher Education Bond Program
- West Virginia Municipal Bond Commission Program

States with Annual Appropriation Programs:

- New Jersey Fund for the Support of the Free Public Schools Program
- South Carolina Education Finance Program

State Guarantee Programs

Currently only four states have constitutionally-created state guarantees of eligible school general obligation bonds. In the event of a debt service shortfall of a participating school district, the state must use its general fund reserves or, in the case of Michigan and Oregon, issue general obligation bonds, if necessary, to make up any debt service deficiency in order that the bondholders receive full and timely payments. In this instance, the state and program ratings are the same. The program rating and outlook will be adjusted as state rating and/or outlook changes occur.

State Guarantee Programs:

- Michigan State School Bond Loan Fund Program
- Oregon School Bond Guarantee Program
- Utah School Bond Guaranty Program
- Washington School Bond Guaranty Program

State Permanent Fund Programs

Ratings on programs structured on the basis of permanent fund support do not have any direct link to the corresponding state's rating. These funds are constitutionally created, and the corpus of the fund is leveraged to provide a guaranty of a participating local government's debt service. The program rating is based on an analysis of the legal structure of the fund, investment policies, liquidity, and operating guidelines. In the event of a rating action on the state, any changes in the credit quality of the program will be determined independently of the state rating.

State Permanent Fund Programs:

- Nevada School District Bond Guarantee Program

- Texas Permanent School Fund Program
- Wyoming School District Bond Guarantee Program

State Programs

Two enhancement programs in California do not fit into the four categories listed above including: the California Construction Loan Insurance Fund and the California Motor Vehicle License Fees Program. The Construction Loan Insurance Program is managed by California's Office of Statewide Health Planning & Development, and ultimately provides for the issuance of state debt to pay debt service if other funds available in the insurance fund are not sufficient to make debt service. The program is rated on par with the state's GO rating and will move in tandem with the state rating. The Motor Vehicle License Fee Program was created by statute, and guarantees an intercept of monthly license fee revenues collected by the state and transferred to cities and counties for various purposes. The security provided by these funds is independent of the credit quality of the state, and any change in the program's rating will be determined separately from the state rating.

Program Descriptions

California Motor Vehicle License Fee Program ('A')

Governing statute: This program was authorized in 1990 under Assembly Bill 1375 and updated in 2004 to hold the program harmless against reductions in MVLF revenues in fiscal 2005 and beyond. This rating does not move in conjunction with the state rating.

Eligibility: The program is open to cities and counties to guarantee payment of GO bonds or lease obligations through their allocation of motor vehicle license fees.

Program provisions: Upon notification to the state from a trustee that a required payment was not made from other sources, the California State Controller is directed to make the payment from the community's share of license fee revenues. Given the historical volatility in statewide license fee revenues and the distribution formula's direct link to populations, only cities or counties with a population of at least 2,500 are eligible to participate in the program. The local unit also must demonstrate that its allocation of license fee revenues in each of the five preceding fiscal years will cover maximum future debt service at least 2.5x. The issuer must covenant not to similarly guarantee payment on other obligations, unless the 2.5x coverage level can be achieved on the new total future maximum debt service.

Final state legislation treats the loss of MVLF tax revenue differently for cities and counties. Cities will receive a partial replacement of lost revenue through state general fund appropriations in an amount that will grow based on what the prior MVLF tax would have produced. Counties will instead receive a portion of their lost MVLF revenues from a new local property tax allocation, and this new revenue source will grow only to the degree that local property taxes grow.

The cities' MVLF debt service intercept is held harmless under the legislature's recent bill AB 2115, amending state code Chapter 610, section 6e. This section provides that MVLF property taxes will constitute successor taxes for purposes of the MVLF intercept program.

Counties' MVLF debt service intercept is held harmless under separate legislation, SB 1096, amending Chapter 211, government code Section 25350.55, which requires a county auditor to intercept MVLF-related property tax payments

in favor of debt service under the intercept program, instead of intercepting MVLF revenues.

Additional Standard & Poor's requirements: To qualify for the program rating, the financings must account for the monthly distribution of license fee revenues, and the timing delay associated with the notification requirement. To receive the program rating issues must be structured to provide for monthly lease or sinking fund payments, include a fully funded debt service reserve, and have a paying agent, trustee, or similar representative acting in a fiduciary capacity to promptly notify that state of a locality's failure to make the required payment.

California Health Facility Construction Loan Insurance Program ('A+')

Governing statutes: The program began in 1969 and is managed by the Office of Statewide Health Planning & Development. The rating moves in conjunction with the state rating.

Eligibility requirements: The program is open to health care institutions participating in the California Health Facility Construction Loan Insurance Program.

Program provisions: The bonds are guaranteed by the insurance fund but the ultimate backing for the loans is the full faith and credit of the state. Thus, Standard & Poor's assigns the state's GO rating to participants in the California Health Facility Construction Loan Insurance Program. The Health Facility Construction Loan Insurance fund (HFCLIF) is funded by a one-time fee, not in excess of 3% of the principal and interest payable over the life of the loan. These reserves, along with the HFCLIF, are the only financial resources available to make up payment deficiencies in the portfolio prior to any state involvement. In the event of a default, the state can continue to make regularly scheduled debt service payments or issue debentures having a total face value of and bearing interest at the rate of the respective bonds that they replace.

Five days before an interest payment date, the trustee must notify the office of any deficiencies. The office must make up any shortfall three days before the payment date—first by drawing from the debt service reserve fund, and then, from the Construction Loan Insurance Fund. Since the inception of the program, there has been one default that was cured by payment from the Construction Loan Insurance Fund.

California Infrastructure Bank School Aid Intercept Program ('A+')

Governing statutes: The program began in 2005, and is managed by the state's California Infrastructure Bank. The interception of state aid, if necessary, is authorized under state law AB 1554, as amended by AB 1303. The statutory provisions intercept state general fund money distributed to local school districts under Proposition 98, as well as various forms of state categorical aid. Proposition 98 is a voter initiative, passed in 1988, that amended the state constitution to require, among other provisions, that the percentage of state general fund revenues devoted to K-14 school spending be no less than the prior year, unless overridden by a two-thirds vote of the state legislature. Proposition 98 school aid constitutes a continuing appropriation, even in the event of a late state budget. State statutory law prohibits school districts participating in the program from filing for federal bankruptcy protection. This program rating moves in conjunction with the state.

Eligibility requirements: Only school districts that have received emergency state loans to remain in operation participate in the program. The state uses the intercept program to refinance loans made to the failing districts. Schools receiving emergency loans must consent to state oversight until the loans are repaid.

Program provisions: Each bond issue under the program is separately secured under a separate lease and bond indenture. Each lease requires the respective school district to make lease payments equal to debt service, plus operating costs for its leased asset, usually school buildings and land. When school districts participate in the program, they provide the state controller with a schedule of future lease payments, and the state controller intercepts state school aid in an amount equal to debt service and remits it directly to the bond trustee, before providing the balance of

state aid to the individual school district.

Proposition 98 state aid to school districts is apportioned under a statutory formula that sets a revenue limit per pupil for each district, and backfills state aid to the extent local property tax revenue does not achieve the revenue limit. Revenue limit state aid is distributed in seven equal monthly installments from July through January in the last three to five business days of each month. It is anticipated that each school district's rental payments, under its individual lease, will be due the last day of July, August, September, October, November, and December. The program rating assumes debt service will be structured to be paid February 15 and August 15, consistent with existing debt issued under this program. Under the state statutes, the state controller transfers pledged lease rental payments to the trustee prior to transferring other state aid funds to a participating district. Rental deficiencies from interceptable state aid, if any, are rolled over into the next month. School districts are still required to make pledged lease payments from their general fund if interceptable state aid is not sufficient.

Lease payments, and hence interceptable state aid, may be abated under the respective school district leases to the extent there is damage or destruction to the leased assets. To cover for this risk, participating school district leases will need to have pledged leased assets equal at least to the par value of the bonds and require under their leases casualty insurance, excluding earthquake insurance, equal to the replacement value of leased structures. Due to the absence of earthquake insurance, leased assets will need to pass Standard and Poor's seismic risk screening model. The leases will also need to contain provisions whereby the California Infrastructure Bank is required to actively monitor insurance in force and take action if it appears a casualty insurance policy is about to expire. The leases will also need to require two years' worth of business interruption insurance. Associated indentures are expected to require a debt service reserve equal to the lesser of maximum annual debt service, 10% of the par amount of bond issuance, or 125% of average annual debt service. The leases will also require maintenance and operations expenses for the leased assets to be paid by the participating school districts.

Standard & Poor's requires at least 2x coverage of annual lease payments by state aid in order to maintain the program rating upon the initial rating.

Colorado State Aid Intercept Program ('AA-')

Governing statutes: House Bill 1214 created a state aid withholding program to provide credit enhancement for Colorado school district bonds. Based on the provisions of this law, Section 22-41-110 of Colorado Revised Statutes, school districts must apply to the state to use this program as bond security. This rating moves with that of the state.

Eligibility requirements: Eligible financings include GO bonds issued by a school district on, or after, July 1, 1991, as well as electorate-approved, non-terminable leases and installment contracts. To qualify bonds for the program, a school district must file an issuance resolution, a copy of the bond offering document, and its agreement with an independent paying agent. In 1997, the state clarified that it will cover debt service payments even if it determines that a district is unlikely to repay the advanced funds. Therefore there is no requirement that existing state aid cover future maximum annual debt service as long as it is expected that district will continue to participate in the withholding program and be eligible for future state equalization.

Program provisions: If a paying agent has not received a debt service payment by the business day before the due date, the agent will notify the state treasurer and the school district. After notification, the state treasurer will contact the school district to determine whether payment will be made. If the district cannot make the payment, the state treasurer will forward the amount necessary in immediately available funds to the paying agent to be applied only to debt

service, even if the state determines it is unlikely to be repaid in full by the district's available state aid under Article 53 over the following 12 months.

The state treasurer's policy stipulates that payment will be made by 1 p.m. on the due date to allow for timely payment to bondholders. Upon payment by the state, the state treasurer will notify the department of education, chief financial officer of the school district, and General Assembly. The department of education will initiate an audit to determine the reason for nonpayment and, if necessary, develop control measures that will prevent future nonpayment.

Georgia State Aid Intercept Program ('AA+' or 'A' depending on legal protections)

Governing statutes: Georgia's voluntary state aid intercept program authorized by House Bill 792 in 1991, allows the state to guarantee repayment of a local school district's GO bonds. Eligible financings include any bonded indebtedness that the local school district elects to have covered by the program. The AA+ rating moves with that of the state; the A program will not likely move with the state's rating.

Eligibility requirements: To participate in this program, a school district must, at the time of debt issuance, irrevocably authorize by resolution the State Board of Education to withhold aid payments for debt service purposes when necessary.

Program provisions: Under the program, the paying agent must notify the board if monies held in the sinking fund are insufficient to make timely payment of principal and interest no later than the 15th day of the month before the scheduled debt service payment date. Upon notification, the state transfers to the paying agent the lesser of an amount sufficient to make the debt service payment, or the balance of any funds due the local school district under any state education appropriation authorized for the current fiscal year.

Districts whose eligible principal and interest payments are expected to exceed their average monthly state aid payment are advised by the state against the selection of July 1 and Jan. 1 as the debt service due dates.

Additional Standard & Poor's requirements: To receive a rating under the basic program, Standard & Poor's requires minimum historical state aid coverage of at least 1x on maximum debt service.

Resolution based enhancements: Resolution based enhancements strengthen the structure of the program and make the program more similar to state appropriation debt. Consequently, a school district may qualify for a rating on par with the state's appropriation debt if it includes certain structural elements in its bond resolution. An amendment to the Georgia constitution in 1996 allows school districts to share in the 1% Special Purpose Local Option Sales Tax (SPLOST) revenue used by most of the state's counties. In recognition of the additional security provided by voter-approved SPLOST moneys and the state's increased commitment to fund education, the addition of structural elements to an individual school district's bond resolution can result in a program rating on par with the state appropriation rating. To be eligible to receive this higher program rating, a school district must incorporate one of two debt service coverage conditions in its bond resolution:

For bonds that carry the additional security of the state aid intercept:

- Maintenance of at least 2x state aid coverage of maximum annual debt service; and
- An additional bonds test requiring at least 2x state aid coverage of maximum annual debt service for all outstanding and subsequent bonds issued under the program.

OR

For bonds issued under the state aid intercept program that carry the additional security of the SPLOST:

- Maintenance of at least 1.5x state aid coverage of maximum annual debt service;
- An additional bonds test requiring at least 1.5x state aid coverage of maximum annual debt service for all outstanding and subsequent bonds issued under the program;
- At least 1x SPLOST coverage of annual debt service at the time of issuance, and projected 1x coverage for the life of the bonds; and
- An additional bonds test requiring at least 1x SPLOST coverage of debt service for all outstanding and subsequent bonds issued under the program with the additional SPLOST security.

For all bonds issued under the state aid intercept program, the debt service schedule should conform to the intent of the program's authorizing legislation. The debt service schedule should be established taking into account the availability and timing of state aid payments and be in accordance with the recommendations of the state board of education.

For SPLOST-supported bonds, Standard & Poor's will review the methodology used in calculating available SPLOST revenues. A five-year historical and projected schedule is required for review at the time of sale. An analysis of the schedule will be performed, taking into account actual performance and any new occurrence that could affect future sales tax collections. In general, Standard & Poor's would not expect to see sales tax projections that exceed historical performance without identifiable reasons.

Indiana State Aid Intercept Program ('AA' or 'A' depending on legal protections)

Governing statutes: Based on Section 20.5.4.10 of the Indiana Code, the state treasurer is required to withhold state aid if a school corporation is unable to pay GO debt service requirements. The withholding guarantee also applies to lease rental payments made by a school corporation to meet a school building corporation's debt service. The 'AA' rating moves with the state's rating; the 'A' rating will not likely move with the state.

Eligibility requirements: All school corporations are eligible for the program rating, provided state aid levels are equal to or greater than maximum annual debt service requirements.

Program provisions: If the school corporation is unable to meet its debt service obligation, the state treasurer must make the payment from the corporation's appropriated state aid for that calendar year. Payment is made directly to the paying agent on a school corporation's GO debt, and to the building corporation when lease rental payments are insufficient. If the next state aid payment does not cover the obligation, the balance is deducted from the following allotment. As required by state statute, deducted aid is first taken from the state's property tax relief funds to a school corporation, second from all other state aid funds except tuition support, and third from tuition support to the school corporation. Strong state budget and tax levy oversight decreases the likelihood that revenues will be insufficient for debt service and enhances the quality of the program. The state board of tax commissioners is statutorily required to review GO and lease rental property tax levies annually. If the proposed levies are insufficient, the board will establish a levy to meet the school corporation's obligations.

Resolution based enhancements: Indiana school district bonds and school corporation leases issued under the state aid intercept program will be assigned a higher rating if the following elements are added to the structure of a bond issue:

- State aid coverage of maximum annual debt service on outstanding and proposed program bonds must be at least 2x.

In addition, the school bond resolution must include provisions requiring:

- Transfer of debt service payments to the paying agent at least five business days in advance of the debt service due

dates; and

- An independent paying agent or bond registrar with immediate notification and claimant responsibilities to the state, in the event a debt service deposit is not made or is insufficient.

As is the case with Indiana's basic program rating, the higher rating will carry a provisional ('pr') designation until the project construction certificate is received, since payments are contingent on successful project completion.

Kentucky State Aid Intercept Program ('A+')

Governing statute: State legislation revised in 1994 (KRS 157-611, 157-615-157-620) expanded Kentucky's debt service withholding mechanism to cover all school district general obligation and lease-secured bonds. This rating moves in conjunction with the state's rating.

Eligibility requirements: Prior to the 1994 legislative change, the Kentucky program was limited to school debt issues with at least partial debt service participation by the Kentucky School Facilities Construction Commission. The revised legislation now covers all school district general obligation and lease-secured bonds if the district meets the following criteria: a) it must levy a minimum equivalent tax rate of 25 cents as defined by KRS 157-615; and b) all new revenue generated by any tax increase required to meet the minimum equivalent tax rate must be placed in a restricted account for school building construction bonding and on June 30 of each year the district shall transfer all available local revenues to a restricted account for school building construction.

Program provisions: The program is based on the requirement for the state to withhold appropriated state aid if a school district is unable to meet debt service requirements. In connection with each program bond issue, it is the duty of the commission to send to each board of education at least thirty days before the due date of any payment a notice of the amount to become due and the date thereof and to require acknowledgement thereof; and to receive from the board of education in the event of failure, satisfactory evidence that sufficient funds have been transmitted to the commission or its agent, or will be so transmitted for paying debt service and administrative costs when due, as provided in the lease, to notify and request that the department withhold from the board of education a sufficient portion of any un-disbursed funds then held or set aside or allocated to it, and to request that the department transfer the required amount thereof to the commission for the account of the board of education.

Additional Standard & Poor's requirements: A school district's current annual state aid must cover maximum annual debt service by at least 2x.

Kentucky State Aid Intercept Program for Commonwealth Universities ('A+')

Governing statute: State Legislation revised in 2004 (KRS 160A.550- 164A.630) establishes a debt service withholding mechanism to cover debt obligations of the commonwealth's universities. This rating moves in conjunction with the commonwealth's rating.

Eligibility requirements: The legislation covers all debt issued by the commonwealth's state universities. The commonwealth's Office of Financial Management, (a division of the Finance and Administration Cabinet), reviews all debt issuance by the commonwealth's state universities, and reviews indentures to ensure inclusion of notification guidelines and responsibilities of the Secretary of the Finance and Administration Cabinet.

Program provisions: Under KRS 164A.608, if a university is unable to pay the required principal and interest payments due or fails to transmit to the paying agent bank or trustee the debt service or any payment when due as required by the bond issuance resolution, the paying agent bank or trustee shall notify the secretary of the Finance and Administration Cabinet in writing and request that the cabinet withhold or intercept from the governing board a sufficient portion of any appropriated state funds not yet disbursed to the institution to satisfy the required payment on the bonds. If the secretary determines that the institution is in risk of defaulting on the payment of the bonds, the secretary shall notify the governing board and within five (5) days remit payment to the paying agent bank or trustee

such funds as are required from the appropriation to the institution. Thereafter, the governing board shall, to the extent that it is otherwise legally permitted, take action within sixty days (60 days) to adopt a resolution to generate additional revenues, such as increasing minimum rents, tolls, fees, and other charges, in order to positively adjust remittances to the funds accounts.

Additional program requirement: Provisions contained in the bond indenture must require the university to make sufficient sinking fund payments thirty days prior to debt service due date. If insufficient monies are available 30 days prior to the debt service due date, the trustee must be directed to transfer funds from a debt service reserve (to be funded at maximum annual debt service) to the sinking fund to forestall a default on the bonds. Ten days prior to the debt service due date, the trustee must notify, in writing, both the university and the commonwealth's Secretary of the Finance and Administration Cabinet of such an event and request that amounts be remitted to the trustee pursuant to KRS section 164.608 to cure such deficiency or to restore the amount transferred from the debt service reserve.

If, 10 days prior to the debt service due date, insufficient funds are available to make the debt service payment, or if the debt service reserve has been utilized to forestall a default, then such incidences qualify as an event of default that triggers the intercept, with the exercise of such and remittance of such prior to the debt service due date, representing a cure of the event of default.

In addition to the terms to be included in the bond indenture, Standard & Poor's requires that qualifying universities demonstrate a minimum of 2x coverage of maximum annual debt service on all outstanding debt (regardless of the indenture under which it is issued) from general fund appropriations from the commonwealth for the current fiscal year and the two most recent fiscal years. Furthermore, maintenance of the 'A+' rating will be dependent on maintaining a minimum coverage of 2x.

Massachusetts Qualified Bond Act ('AA-')

Governing statute: Under the Qualified Bond Act (Massachusetts General Law, Chapter 44A), the state treasurer pays debt service directly to the paying agent and withholds the amount of the payment from the borrower's annual state aid appropriation. This rating moves in conjunction with the state's rating.

Eligibility requirements: Approval by the State Emergency Finance Board, which oversees and monitors the program, is required. The program covers all pre-approved local debt issued by cities, towns and regional school districts.

Program provisions: The entity's treasurer certifies to the state treasurer the maturity schedule, interest rate, and dates of payment on the bonds within 10 days of issuance. If necessary, the state treasurer pays debt service and after payment withholds from the distributable aid payments or any other amount payable to the municipality or school district (all state aid is subject to annual appropriation) a sum sufficient to cover debt service. Entities participating in this program are required to appropriate and to include in their tax levies amounts necessary to pay qualified debt service. There is no coverage requirement in the Massachusetts law; however, state aid has historically been substantially higher than the amount of qualified debt service, resulting in multiple times coverage.

Michigan State School Bond Loan Fund Program ('AA')

Governing statutes: Section 16 of Article 9 of Michigan's constitution (adopted in 1963) created the Michigan School Bond Loan Fund Program to provide districts access to funds to avoid a default on qualified debt. This rating moves in conjunction with the state's rating.

Eligibility requirements: For a bond to be eligible for the School Bond Loan Fund Program, it must be a voter-approved qualified bond. The proceeds must be used for capital expenditure purposes, but not for maintenance. To participate in the program, a school district must apply for qualification of each bond issuance. The district must complete the

qualification application forms and substantiate that the planned improvements are needed and the costs are reasonable. In order to borrow from the bond loan fund, the district is required to levy minimum property tax millages for debt service and for general operating expenses as the minimum local property tax effort.

Program provisions: If a school district fails to meet its debt service obligation for qualified debt, the state treasurer is notified and pays the required debt service. The loan from the bond loan fund becomes an obligation of the district, with the loan repayment scheduled as part of the district's annual debt service. Access to the loan fund is also available as a property tax relief mechanism for qualified principal and interest payments. In effect, borrowing from the fund to limit property tax levy requirements extends the debt retirement term. If the balance in the state's loan fund is insufficient to cover obligations, the state is required to make loans from the general fund and issue general obligation bonds if necessary to raise sufficient funds. Since the fund is an obligation of the state, the guarantee program is rated on par with the state's GO debt.

Minnesota State Standing Appropriation Program ('AAA')

Governing statutes: Authorized by Minnesota Statutes, Section 126C.55, the Minnesota program was designed to correct potential school district default situations and is backed by a standing appropriation from Minnesota's general fund. This rating moves in conjunction with that of the state.

Eligibility requirements: All school districts are eligible to benefit from this enhancement. To apply for participation in the School District Credit Enhancement Program, the school district files a school board resolution with the commissioner of education. Upon acceptance into the program, a participation certificate is issued to the applying school district.

Program provisions: A participating district must covenant to notify the commissioner of the department of a potential default as soon as possible, but not less than 15 business days before the debt service due date. A district must also covenant to deposit with a paying agent sufficient funds to make payments on its bonds at least three business days before the debt service due date. The school district must enter into a paying agent agreement that requires the paying agent to inform the commissioner of education if it becomes aware of a default, a potential default or if there are insufficient funds on deposit with the paying agent three business days before the debt service due date. Once a school district elects to enter this program and is accepted by the state, it cannot rescind its application as long as any debt obligation of that issue is outstanding. Upon notification to the commissioner of education, the commissioner of finance will issue a warrant authorizing the commissioner of education to pay the paying agent the amounts necessary on or before the date payment is due. The amounts needed for this purpose are appropriated to the Department of Education from the state general fund.

Minnesota County Credit Enhancement Program ('AAA')

Governing statutes: Authorized by Minnesota Statutes, Section 373.45, the Minnesota program was designed to provide a state guarantee of the payment of principal and interest on a county's GO or lease debt obligations issued after June 30, 2000 for the purpose of funding the construction of jails, correctional facilities, law enforcement facilities, social services and human services facilities, or solid waste facilities. This rating moves in tandem with that of the state.

Eligibility requirements: In order to qualify for participation in the County Credit Enhancement Program, the bonds must be issued after June 30th, 2000 and the county must apply to the Public Facilities Authority prior to issuing the bonds. The county must also enter into an agreement with the authority obligating the county to be bound by the provisions of Minnesota Statutes, Section 373.45 Subd. 3.

Program provisions: A participating county must enter into an agreement with the Public Facilities Authority obligating the county to:

- Deposit with the paying agent three days before the date on which the payment is due an amount sufficient to make that payment;
- Notify the authority, if the county will be unable to make all or a portion of the payment; and
- Include a provision in the bond resolution and county's agreement with the paying agent for the debt obligation that requires the paying agent to inform the commissioner of finance if it becomes aware of a potential default in the payment of principal or interest on that issue or if, on the day two business days before the date a payment is due on that issue, there are insufficient funds to make the payment on deposit with the paying agent.

The provisions of this agreement are binding to an issue as long as any debt obligation of the issue remains outstanding.

After receipt of a notice of a potential default in payment of principal or interest in debt obligations covered by this agreement, and after consultation with the county, the paying agent, and after verification of the accuracy of the information provided, the authority shall notify the commissioner of the potential default. The notice must include a final figure as to the amount due that the county will be unable to repay on the date due. Upon receipt of this notice from the authority, the commissioner shall issue a warrant and authorize the authority to pay to the paying agent for the debt obligation the specified amount on or before the date due. The amounts needed for the purposes of this subdivision are annually appropriated to the authority from the general fund.

If Minnesota makes a guarantee payment on a participating county's behalf, the county is obligated to repay the state with interest and would be required to levy a property tax if necessary, to make such repayments.

Mississippi State Aid Capital Improvement Bond Program ('AA-')

Governing statute: The program was created under the state's Accountability and Adequate Education Program Act of 1997, which allows school districts to authorize the state board of education to withhold an amount of the district's Mississippi Adequate Education Program (MAEP) funds and pledge these funds for debt service on capital improvement bonds. The authorization that allowed districts to pledge MAEP funds for debt service expired on June 30, 1998. This rating moves in conjunction with that of the state.

Eligibility requirements: To qualify for the program, districts had to request that the state Department of Education directly deposit their MAEP funds with an independent paying agent and specify this in the bond resolution. Upon state approval of this request, the state irrevocably agreed to perform this function as long as program debt is outstanding.

Program provisions: State funds are deposited directly to a paying agent in advance of the debt service due date and these monies are held in investments that meet Standard & Poor's criteria. Bond issues using this security were sized according to the amount of MAEP allocation each district received (up to \$160 per pupil based on average daily attendance) and bond maturities could not exceed 20 years. MAEP funds had to provide at least 1.0x debt service coverage. The state, by statute will take all actions necessary to ensure that the amount of the district's MAEP funds pledged to repay state aid capital improvement bonds will not be reduced as long as the program bonds are outstanding.

Missouri Direct Deposit of State Aid Program ('AA+')

Governing statutes: In 1995, the Missouri Legislature adopted Senate Bill 301 that established a program to assist Missouri school districts with their financing needs. This rating moves in conjunction with that of the state.

Eligibility requirements: Any school district is eligible to apply to the state to use the program as an additional bond security. Program guidelines specifically exclude any type of obligation other than GO bonds. Conditions for state approval include a state aid coverage requirement plus the district entering into a binding direct deposit agreement with the state to divert monthly state aid to a trustee-held debt service fund. To enter the program, districts must meet coverage requirements of state aid in each of the past three fiscal years covering maximum annual debt service by at least 1.5x and agree to the state making direct deposit of its monthly state aid payments to a state-selected direct deposit trustee. Once debt has been issued using this program, the district cannot pledge state aid as a primary or parity security to any non-program obligation as long as any program debt is outstanding. Participating school districts waive all rights and privileges to institute any action authorized by any act of Congress relating to bankruptcy.

Program provisions: The Missouri program provides for a first-dollar claim on monthly state aid, which will be directly deposited to a master bond trustee. Program oversight and management is the responsibility of the Missouri Health & Educational Facilities Authority (HEFA), as is the ability to establish operating guidelines. HEFA also pays certain issuance costs for participating school districts. Under the program, a school district enters into a direct deposit agreement with the state to fund a debt service payment account for either individual issues or participation in a HEFA-issued pooled financing. Upon application approval, a district can use this security enhancement for new and refunding issues.

The state aid flowing to the direct deposit trustee are the first dollars of the district's monthly state aid payment. The trustee, in turn, remits to each independent district paying agent the required principal and interest at the required times. HEFA, the Department of Elementary and Secondary Education, the Office of Administration, and the treasurer's office coordinate activities to operate the direct deposit mechanism. The direct deposit payments will be made in 10 level monthly increments, with payments starting the month of the bond issue close. If any monthly payment is insufficient to meet the 1/10th monthly increment requirement, the next direct deposit will make up the shortfall and include that month's required payment. Although the annual debt service payments will be made out of the first 10 months of a participating district's state aid, the direct deposit account has access to its entire annual state aid appropriation, if needed.

To eliminate the risks associated with late state budget adoptions or mid-year state aid reductions, debt service payment dates cannot be in the ending or beginning months of the state's fiscal year. All direct deposit funds and HEFA-held moneys will be invested in securities that meet Standard & Poor's investment criteria.

Nevada School District Bond Guarantee Program ('AAA')

Governing statutes: The Nevada permanent school fund was established under Article 11, Section 3 of the Nevada Constitution, to hold the proceeds of federal lands granted to the state by the U.S. Congress for school purposes, estates that escheat to the state, and fines collected under the state's penal laws. The constitution specifies that proceeds of the fund may be pledged only for educational purposes. Interest earnings may be apportioned to the various county districts for educational purposes. Nevada Revised Statutes' chapter 387 enables local school districts to apply for a guarantee of debt service from the state's permanent fund under the Nevada School District Bond Guarantee Program. This rating is independent of that of the state.

Eligibility requirements: The state treasurer will enter into a guarantee agreement with a school district only if the executive director of the department of taxation submits a written report to the state board of finance, indicating that the school district has the ability to timely service of its debt obligations.

Program provisions: Program debt is backed by the constitutional pledge of the permanent fund's assets. There is a statutory requirement that limits the program's guarantee amount to 250% of the lesser of cost or fair market value of the fund's assets. Additionally, the program limits the amount of bonds that may be guaranteed for any individual school district to no more than \$25 million outstanding at any one time. A state board of finance policy limits permanent fund investments to U.S. Treasuries and agencies and specifies a minimum liquidity requirement. The minimum liquidity requirement is defined as the cash flow necessary to support 10% of guaranteed bonded indebtedness and such securities must mature within one year. Finally, legal features structured into the guarantee agreements provide for the early deposit of school district's debt service payment with the state treasurer or a designated paying agent, and immediate notification to the state treasurer if such payment is not made. The guarantee agreement requires that the district transfer debt service amounts to the state treasurer or a designated paying agent, not later than five business days prior to each scheduled payment date. If there is a shortfall, the treasurer pays the deficiency to the paying agent from guarantee funds at least one day prior to the debt service due date. If the guarantee is triggered, the state treasurer will withhold subsequent payments of money that would normally be distributed to the district from local school support taxes and the state distributive account to replenish the permanent fund.

New Jersey Additional State Aid Bonds Program ('AA-')

Governing statute: The New Jersey Additional State Aid Bonds Program is authorized by New Jersey Statutes 18A:64A-22.1. Additional state aid bonds require the state to appropriate funds to pay debt service for school district bonds and for county GO bonds issued on behalf of community college districts. This rating will move in conjunction with that of the state.

Eligibility requirements: In order to participate in the program, the board of chosen freeholders of a county where a college is located must receive a certification from the state treasurer authorizing them to issue bonds or notes in an amount not to exceed 50% of the total cost of the project and not more than \$265 million in principal. The board of chosen freeholders may issue bonds or notes within one year of receiving this certification from the state treasurer.

Program provisions: Within 10 days of issuing bonds secured by this program, the county treasurer or the treasurer of any other legally empowered issuer shall provide the state treasurer with a debt service schedule and the name and address of the paying agent. The state treasurer will appropriate and pay to the county, on or before the payment date, an amount equal to the payment due. The county, or other legally empowered issuer, shall use these funds solely for the timely payment of debt service to the paying agent.

New Jersey Fund for the Support of the Free Public Schools Program ('AA')

Governing statute: The New Jersey Fund for the Support of the Free Public Schools Program is authorized by the Article VIII, Section 4 of the New Jersey Constitution. This rating will move in conjunction with that of the state.

Eligibility requirements: Local school bonds issued by school districts, municipalities, and counties are eligible for this program.

Program provisions: The program pledges a portion of a fund's assets for a school district's debt service should it be unable to meet principal and interest payments. The bonds carry a specific contractual relationship between the bondholder and the state fund. The treasurer acts as agent for the fund and, if needed, applies monies from the support fund to purchase maturing principal and interest due from the bondholder; these payments and purchases continue as long as the issuer remains unable to meet its debt service obligations.

New Jersey Statutes 18A:56-19, as amended, requires two reserve accounts to be maintained in the fund. The old school bond reserve account will be funded in an amount equal to at least 1.5% of aggregate school district debt issued by counties, municipalities, or school districts prior to July 1, 2003. The new school bond reserve account will be

funded in an amount equal to at least 1% of aggregate school district debt issued on or after that date. In the event that the amounts in either the old school bond reserve account or the new school bond reserve account fall below the amount required to make payments on bonds, the amounts in both accounts are made available to make payments for bonds secured under the reserves. On or before September 15th of each year, fund trustees determine the aggregate amount of school purpose bonds outstanding and are responsible for maintaining appropriate reserve levels based on the market value of reserve investments. If at that time, the funds on deposit fall below the required levels, the State Treasurer is required to appropriate and deposit into the school reserve such amounts as may be necessary to meet fund level requirements. To ensure sufficient liquidity, at least one-third of the obligations in the fund must be due within a year. Fund assets are direct or guaranteed U.S. government obligations and are valued annually.

New Jersey Qualified Bond Program ('AA-')

Governing statute: New Jersey Statutes 18A:24-93 authorize the state treasurer to intercept a portion of city, township, and other local municipality qualified state aid to pay debt service on qualified bonds directly to the trustee. This rating moves in conjunction with that of the state.

Eligibility requirements: To qualify for this program, the issuer municipality must receive state approval for the planned capital improvements and the scheduled debt service.

Program provisions: The statute authorizes the state treasurer to intercept a portion of city, township, and other local municipality qualified state aid to pay debt service on qualified bonds directly to the trustee. The state treasurer forwards withheld amounts to the paying agent for payment of debt service on or before each principal and interest payment date. The balance of this state aid is then remitted to the appropriate municipalities.

Additional Standard & Poor's requirements: A municipality's state revenue must be at least equal to 1x maximum annual debt service.

New York State Aid Intercept Program ('A')

Governing statute: Section 99b of the state finance law authorizes the aid withholding and specifies the procedures that would be followed should the state be required to make a debt service payment for a program participant. This rating will not typically move with that of the state.

Eligibility requirements: All school districts are eligible for this program.

Program provisions: Upon notification of a default by a school district, the state comptroller is required to deduct from the next state aid payment due to the school district an amount sufficient to meet any deficiency in debt service. If this aid payment does not cover the obligation, the balance would be deducted from the succeeding allotment. The funds would be forwarded directly to the paying agent, and the comptroller would notify the school district of the payment. A technical default can occur on New York school district GO bonds, as the state finance law contains no provisions to activate the mechanism before actual default. However, the minimum guarantee program reflects the fact that a prompt cure of any such default is assured.

Additional Standard & Poor's requirements: A school district's annual state aid must cover maximum annual debt service by at least 1x.

Ohio State Aid Intercept Program ('AA' or 'AA-' rating depending on required coverage levels)

Governing statute: Pursuant to section 3317.18 of the Ohio Revised Code and section 3301-8-01 of the Ohio Administrative Code, the Ohio Credit Enhancement Program lets a school district enter into an agreement that allows the state to withhold state education funds due to the district under chapter 3317 of the revised code and apply those funds to the district's debt service payments. Section 3301-8-01 of the Ohio Administrative Code was revised in March

2004 to require 2.5x maximum annual debt service coverage levels. Prior to that time, the required coverage under the program was 1.25x. The ratings on bonds secured by the prior version of the enhancement program will be evaluated on a case-by-case basis, and issues that meet the Standard & Poor's requirement of 2x maximum annual debt service coverage will be upgraded to a 'AA' rating. Those that do not meet this coverage level requirement will continue to be rated 'AA-' For bonds issued after the program was amended in March 2004, the 'AA' rating applies. Both ratings move with the state's rating.

Eligibility requirements: To be eligible, a district must meet all program criteria including having the approval of both the state department of education and the office of budget and management to use the security. Districts applying for inclusion in the program must provide financial information to the department of education and the office of budget and management, including assessed value and taxpayer concentration information, audits and budgets, and schedules of proposed and outstanding debt. The program excludes noninvestment-grade rated issuers and requires an extensive review of the credit quality of unrated districts. The district must have an underlying credit rating determination by Standard & Poor's. Upon state approval, the contract between the state and local school district is irrevocable as long as any program debt is outstanding. At the time of state approval for program participation, projected state aid for the current fiscal year must be at least 2.5x the maximum annual debt service on the enhanced debt. In addition, on each debt service date during the current or any subsequent fiscal year, projected state aid remaining for that year must cover the remaining debt service for the year by 1.25x.

Program provisions: The district must certify to the state department of education and the paying agent whether or not it can make its full debt service payment 15 days before each debt service due date. Ten business days before the due date, the district must deposit with the paying agent an amount sufficient to make the debt service payment. If the district has failed to make a sufficient deposit, the paying agent will immediately contact the state department of education. In the event a district is unable to make a sufficient debt service payment and the payment will not be made by a credit enhancement facility, the department of education will pay the paying agent the lesser of the amount of the debt service due or the amount of state aid due to the district for the remainder of the fiscal year. This payment will be made at least one business day prior to the debt service payment date.

Oregon School Bond Guarantee Program ('AA-')

Governing statute: The Oregon legislature passed the school bond guaranty act in 1997 (Oregon Laws 1997, chapter 614). This rating will move in conjunction with that of the state.

Eligibility requirements: Participation in the program is voluntary and open to all common school districts, union high school districts, education service districts, and community college districts in the state.

Program provisions: The amount of debt that can be guaranteed by the state at any one time is limited to 0.5% of true cash value of taxable property in the state. The program is administered by the Oregon State Treasury, which has established administrative rules prescribing application procedures and qualification guidelines. Upon determination of a district's eligibility, the state treasurer issues a certificate of qualification valid for one year from the date of issuance, which may be applied to any or all GO bonds, including GO refunding bonds, issued by the district during that period.

Participating districts are required to submit to the state department of education audited financial statements and budget documents annually, as well as report any material changes or events that might affect their eligibility for participation in the program.

The business administrator of a participating district is required to transfer to its paying agent moneys sufficient to cover each debt service payment at least 15 days prior to the scheduled payment date for guaranteed bonds. If unable to do so, the district must notify the paying agent and the state treasurer. The paying agent must notify the state treasurer if sufficient funds are not transferred to the paying agent at least 10 days prior to the scheduled debt service

payment date. The state treasurer will transfer sufficient funds to the paying agent to make the debt service payment no later than the scheduled payment date if sufficient funds have not been transferred to the paying agent.

A participating school district for which the state has made a guarantee payment is obligated to repay the state, with interest and, in certain instances, an additional penalty. The state may obtain such reimbursement from moneys that otherwise would be used to support the district's educational programs. The state is authorized to intercept any payments from its general fund, the state school fund, income from the common school fund, and any other operating moneys provided by the state to the district. If the state treasurer determines that intercepted funds, interest, and penalty payments will be insufficient to provide timely reimbursement, the state may require the district to meet its repayment obligations with the help of the state attorney general's office. Legal remedies include compelling the district to levy a property tax to pay debt service on its bonds and other obligations when due.

In the event the state is required to make a debt service payment on behalf of a participating district, if sufficient state funds are not on hand or available for such purpose, the state treasurer may obtain a loan from the common school fund or other qualified state funds. The constitutional amendment allows the state to issue property tax-supported GO bonds to provide funding to satisfy its guarantee obligations under the program, including the repayment of borrowed moneys from the common school fund.

Pennsylvania State Aid Intercept Program ('A' or 'A+' depending on legal protections)

Governing statutes: Pennsylvania's state aid intercept program for school districts is based on the withholding provisions of Act 150, which amended section 633 of the Public School code. Standard & Poor's also assigns a program rating to lease bond obligations of Pennsylvania's public school building authority based on the provisions of Sections 785 and 790 of the Pennsylvania Public School Code, and to debt obligations of community colleges under Section 1913-A of the Pennsylvania Public School Code. This 'A' rating will not typically move in conjunction with that of the state; the A+ rating will move with the state's rating.

Eligibility requirements: The program automatically applies to all school districts and community colleges.

Program provisions: Under these provisions, the secretary of education automatically withholds state aid from any school district or community college that fails to meet debt service or fails to pay lease rentals due the State Public School Building Authority, a municipal authority or nonprofit corporation. The withheld amount is the lesser of unpaid principal and interest or lease requirements, or the amount of state aid remaining for the fiscal year. These funds are transferred directly to the bond trustee, or the municipal authority or nonprofit corporation. The secretary of education requires a school district's annual financial report to include debt service payable during the fiscal year.

Additional Standard & Poor's requirements: To receive a program rating, Standard & Poor's requires minimum historical state aid coverage of at least 1.0x on maximum eligible debt service. To satisfy the debt service coverage requirement, the district must consider the timing and amount of debt service payments and state aid receipts. Amending the bond resolution regarding the notification timing in the event of a potential default can help enhance the program rating.

Resolution based enhancements: A school district may receive a higher program rating if it includes certain structural elements in its bond resolution. Amendments to the Pennsylvania public school code enacted in 1998 allow a school district to voluntarily structure its bonds so that a failure to make a required sinking fund deposit prior to the debt service payment date triggers the intercept of the district's receivable state education aid. Prior to the amendment, this intercept was triggered only when a school district failed to pay or provide for the payment of debt service at the date of maturity or mandatory redemption, whether or not the district established a sinking fund.

The ability to leverage state aid receipts under the amended legislation into a higher program rating is contingent on the school district's inclusion of structural provisions in the bond legal documents. These provisions must specify notification and timing requirements such that the state is notified of an impending shortfall, state aid is withheld, and the necessary funds are transferred to the fiscal agent prior to the debt service payment date. As with the basic enhancement program, the district must demonstrate at least 1.0x coverage of maximum annual debt service by remaining state aid appropriations to qualify for the higher program rating. Increased debt service coverage is not required to achieve the higher program rating, because the timing of district receipt of state aid is largely statutorily defined.

South Carolina Education Finance Program ('AA')

Governing statute: The South Carolina program is based on 59-71-155 of the 1976 South Carolina Code. This rating will move in conjunction with that of the state.

Eligibility requirements: The program applies to school district general obligation bonds and does not require a special application to use this program as security - it is effective for all school bonds issued.

Program provisions: Under the program, county treasurers are required to notify the state treasurer 15 days in advance of a district's debt service payment date if insufficient funds are available for full and timely payment. The state treasurer monitors the situation until the third business day prior to the payment date. If amounts are still insufficient at that time, the state treasurer requires the county treasurer to use state distributed school district revenue to make up the deficiency or the state could advance general fund moneys for that purpose. The maximum amount of state general fund moneys available to be applied to a potential default is based on the total appropriation under the Education Finance Act for that year.

South Dakota State Aid Intercept Program ('A')

Governing statutes: The 1988 amendments to Title 13 of South Dakota Codified Laws authorize lease purchase agreements between the facilities authority and school districts. If a school district is unable to meet lease rental requirements to the facilities authority, Chapter 19 of Title 13 of the state's statutes permits the secretary of education to withhold state aid from the school district. This rating will not typically move with that of the state.

Eligibility requirements: Local school districts are eligible for the program. Due to South Dakota's GO debt limitations for school districts; major capital projects are funded by proceeds of bonds issued by the South Dakota Health & Educational Facilities Authority.

The structure of a lease purchase agreement between the facilities authority and a school district must meet statutory requirements. The school district has no option to cancel the agreement and must annually levy a capital outlay millage, which is limited to three mills. The capital outlay millage is the revenue source for lease rental payments. The millage is continuously levied for the life of the lease, eliminating the risk of non-appropriation. The lease is a net lease, entitling the trust agent and the facilities authority to full lease rental payments. Lease rentals are due to the trustee 45 days before debt service payments are due.

Program provisions: Lease rental payments are due to the trustee 45 days before debt service payments are due. If local revenues are insufficient to meet the lease rental requirements, the trustee notifies the facilities authority, as lessor. The authority requests the state Board of Education to direct the defaulting district's state aid to the trustee for payment of unpaid lease rentals. State aid is distributed three times per year (on or about August 15, January 15, and May 15th). Distribution is approximately 1/3, 1/3 and 1/3. The first distribution is an estimate because average daily attendance is not calculated until October so adjustments are made to subsequent payments. Lease payments are due

1/1 and 7/1. Debt service dates are 2/15 and 8/15.

Additional Standard & Poor's requirements: State aid must be at least equal to maximum annual debt service.

Texas Permanent School Fund Program ('AAA')

Governing statutes: The Permanent Fund was created by the state constitution to support public schools, with income generated from state-owned land and mineral interests. A voter-approved amendment to the Texas Constitution allows the Texas Permanent School Fund to guarantee qualified school district bonds. The 1983 amendment, Article VII, Section 5 of the constitution, extends the use of the endowment to ensure bondholders of timely debt service payments. This rating is independent of that of the state.

Eligibility requirements: School districts apply to the Commissioner of Education to qualify bonds for the permanent fund guarantee. The commissioner reviews district economic conditions, academic accreditation record, debt and capital needs and financial performance to determine potential future liabilities against the fund. Standard & Poor's requires evidence of the bond guarantee endorsement before assigning the enhanced Rating.

Program provisions: The amount of debt that can be guaranteed by the permanent fund is limited to the lesser of: a) 250% of the lower of cost or current fair value of the assets in the fund, excluding real estate; or b) 250% of the lower of cost or fair value adjusted by a factor that excludes additions to the fund since 1989. In the event of a default, the school district must notify the commissioner not later than five days before the maturity date of the guaranteed debt. The commissioner will then pay debt service to the paying agent and direct the state to later withhold district state aid to repay the Permanent Fund.

Standard & Poor's rating reflects the fund's strong asset quality and the legal provisions limiting the maximum amount of debt that may be guaranteed by the fund, which is twice the cost or market value of the fund. Additionally, the state's substantial oversight of the qualifying districts enhances the guarantee program.

Texas Higher Education Bond Program ('AA')

Governing statutes: In addition to the programs that benefit elementary and secondary education, an amendment to the state's constitution enhances debt obligations of certain public institutions of higher education. In accordance with Article VII, Section 17 of the Texas Constitution and the 1985 Excellence in Higher Education Act, there is a continuing annual appropriation of \$100 million to support higher education. This rating moves with that of the state.

Eligibility requirements: Since 1985, the 26 state universities that do not benefit from the Permanent University Fund—those outside the University of Texas system and the Texas A&M system, each receive a portion of the annual \$100 million appropriation. To participate in the program, universities must adhere to the Excellence in Higher Education Act of 1985.

Program provisions: The act allocates the annual appropriation among the universities according to a formula based on:

- Student enrollment capacity needs;
- Facilities condition;
- Institutional complexity;
- Existence of medical units; and
- Compliance with the Texas desegregation plan.

A maximum of 50% of each qualified institution's allocation may be pledged for debt service on bonds, while the remaining portion will be used directly for capital improvement projects. According to Vernon's Civil Statutes Article 4357, a university's board of trustees or a university system's board of regents must file a claim in the amount of the

next debt service payment with the state comptroller. Filing of a claim will enable the bond trustees to receive a warrant for payment directly from the state at least 15 days prior to the principal and interest payment date. Bonds issued under Article 7, Section 17 of the state constitution are payable solely from these constitutional appropriations. Each issue must also be in serial form, offered for competitive bidding, and be approved by the state attorney general. Once approved, bonds are incontestable. The legislature may review the level of the appropriation and, with a two-thirds majority of both houses, reduce the amount of the constitutional appropriation for the succeeding five years. However, the legislature may not reduce the appropriation so as to impair the payment of the obligations created by the bonds or notes issued in accordance with Section 17 of the constitution.

Utah School Bond Guaranty Program ('AAA')

Governing statutes: Utah voters approved Proposition 4 in 1996, a state constitutional amendment providing a state general obligation guarantee on qualified local school district debt. The constitutional amendment allows for the implementation of the state's school bond default avoidance program under the Utah School Bond Guaranty Act. This rating moves in conjunction with that of the state.

Eligibility requirements: The state treasurer determines the eligibility of each school district for the program on consultation with the state superintendent of public instruction. Criteria for eligibility include the ability of a school district to meet its debt service obligations without state support.

Program provisions: Once a school district enters the program, the state's full faith and credit and unlimited taxing power are pledged to guarantee timely payment of principal and interest on the district's bonds. Local school district debt guaranteed by the state under the program will not count against the constitutional limit on the state's GO debt.

In order to qualify for a program rating, each school district's issuing bond resolution must provide for adequate and timely notice to the state treasurer, by an independent third party, of impending shortfalls in debt service. Once a state guarantee payment is triggered, the state treasurer will intercept state monies due the school district until the drawn amount is reimbursed to the state. Guarantee payments must be repaid by the school district to the state with interest, and in some cases with additional financial penalties. For additional liquidity, the state treasurer can borrow money from the state's Permanent School Fund to meet a guarantee payment, as well as use other resources.

Virginia State Aid Intercept Program ('A')

Governing statutes: Section 15.1225 of the Code of Virginia authorizes the governor to immediately intercept state aid appropriated for municipalities to pay principal and interest on GO debt in the event of default. This rating will not typically move with that of the state.

Eligibility requirements: The program automatically applies to local governments.

Program provisions: Bondholders must notify the governor of default by a local government. The governor is authorized to withhold debt service payments up to amount of state aid appropriated and payable. The funds would be forwarded directly to the paying agent. A technical default can occur since the notification can occur post default and the state law contains no provisions to force the mechanism before actual default.

Because Virginia's GO bond guarantee program is based on the governor's authority to withhold aid payments to local municipalities, the rating for the program reflects the state's creditworthiness and the legislative appropriations for local municipalities.

Additional Standard & Poor's requirements: To receive the guarantee program's rating based on the withholding provision, a municipality must demonstrate that state aid for each of the last five years was at least 1.25x future maximum annual GO debt service. Each bond issue also must have a paying agent, trustee, or similar fiduciary representative to promptly inform the state of a default.

Washington School Bond Guaranty Program ('AA')

Governing statutes: In November 1999, Washington voters passed by a vote of 60% to 40% a constitutional amendment that allows the state to provide a backup general obligation pledge to local school district voter approved GO bonds. The program is authorized in chapter 39.98 of the Revised Code of Washington.

The program provides pledges the full faith and credit of the state of Washington to the payment of voter-approved school district GO bonds. Upon request and receipt of a certificate evidencing the state guaranty from the Washington State Treasurer's Office, Standard & Poor's rates Washington state local school bond issues on par with the state rating and the rating will move in conjunction with that of the state.

Eligibility requirements: A school board electing to use the guarantee program must pass a resolution authorizing the district to apply to the state treasurer's office. This resolution can be included as part of the district's bond election resolution or can be a separate resolution. Following a successful bond election the district must submit an eligibility request to the state treasurer's office. The state treasurer's office reviews the request and determines eligibility.

Program provisions: If during the term of the bonds, the county treasurer is unable to apply funds sufficient to make debt service payments on district bonds guaranteed under the program, the county treasurer notifies the state treasurer who would immediately transfer sufficient funds to make the required debt service payment. The state treasurer's office would recover from the district any funds paid on the district's behalf as well as any interest, recovery costs or penalties.

West Virginia Municipal Bond Commission Program ('AA-')

Governing statutes: The program is authorized by Chapter 13, Article 3 of the West Virginia Code. West Virginia's Municipal Bond Commission is the successor to the state's Sinking Fund Commission. This rating will move in conjunction with that of the state.

Eligibility requirements: The program covers all local GO debt.

Program provisions: The bond commission serves as the bond trust agent, administering the GO debt sinking funds for the state's school districts and municipalities and oversees debt service. All funds collected to meet debt service on a municipality's general obligation bonds are turned over to the commission for payment of debt service.

In addition to this statutory provision, the commission's administrative guidelines include notifying the local government unit 35 days before a debt service payment if funds on hand are insufficient for debt service. If sufficient funds are not on hand 15 days before the debt service payment, the entity is contacted again. Since 1921, the state legislature has made an annual blanket appropriation in the budget authorizing the governor to meet any deficiency in the state sinking fund because of a school district or governmental unit's failure to meet its debt service obligations. The rating for West Virginia's program reflects the state's strong debt service oversight and the legislature's replenishment provision for the bond commission's sinking fund.

Wyoming School District Bond Guarantee Program ('AAA')

Governing statutes: Local school district bonds are eligible to be guaranteed by the Wyoming School District Bond Guarantee Program under Chapter 13 of the state's Farm Loan Board rules and regulations and Wyoming state statutes 9-4-701(j). This rating will move in conjunction with that of the state.

Eligibility requirements: School districts applying for qualification under the program must first provide the Office of State Lands and Investments a letter from a nationally recognized rating agency indicating that the bonds would be of at least investment-grade quality. Applications for bond issues over \$5 million must be accompanied by the precise underlying rating before the guarantee can be granted.

Program provisions: No more than \$300 million in school bonds may be guaranteed by the pledged guarantee fund, a very strong 3:1 leverage ratio. Bonds guaranteed under this program are backed by \$100 million from the state's Common School Account. The \$100 million guarantee fund is a fungible subset of the Common School Account. The Common School Account is a state trust fund derived from mineral royalties on lands dedicated for school income and is, in turn, a non-fungible subset of the state Permanent Land Fund. While only \$100 million is pledged from the Common School Account, and amounts over \$100 million in the Common School Account could be dedicated in the future to other school programs, current implementation rules charge investment losses first against the non-obligated part of the Common School Account. This provides an even greater guarantee cushion, as the pledged fund would garner the last non-obligated \$100 million in the fund in the event of investment losses.

The Common School Account can be used only for school purposes and currently contributes investment income for yearly distributions to schools. The state treasurer's investment policy sets guidelines intended to maximize yield within the constraints of maintaining book value. Outside money managers can be hired to manage a portion of investments. Outside managers' transactions are reported monthly and performance is judged quarterly. Each outside manager is expected to maintain an average portfolio credit quality of at least 'AA'. Up to 5% of a portfolio may be invested in unrated securities, provided that these securities are judged by the Board to be at least of investment-grade quality. No more than 5% of the portfolio may be invested in obligations of any single issuer other than the U.S. government. Investment allocations may change over time, but have historically been conservative. In addition, the guarantee program rules require that an amount at least equal to 10% of guaranteed bond principal be invested in U.S. government securities of three years' maturity or less to ensure liquidity. Debt service payments are not accelerated in the case of an underlying school district's default, preserving the liquidity of the guarantee fund.

Program rules provide adequate time for guarantee funds to cover debt service payments when due, if needed. An independent paying agent is required to notify the State Treasurer not less than five days before a debt service payment date if it becomes aware of a potential default on a guaranteed debt obligation. Program rules also require a school district to notify the state treasurer on its own 15 days before a due date, if it projects that it will not be able to pay debt service. If there is a debt service shortfall, the treasurer must pay the paying agent an amount to cover the shortfall at least one day before the debt service due date. The state requires a defaulting school district to repay the Common School Account for any draw, including lost interest on the fund.

Standard & Poor's Rated State Credit Enhancement Programs

State	Debt Type Covered	Rating	Outlook	Enhancement
California	Eligible city and county bonds	A	Stable	Motor Vehicle license fee and leases
California	Eligible health care bonds	A+	Stable	Construction Loan Insurance Fund
California	School districts that have received emergency state loans	A+	Stable	State aid withholding law

Standard & Poor's Rated State Credit Enhancement Programs (cont.)

Colorado	Local school bonds	AA-	Stable	State aid withholding law
Georgia*	Eligible local school bonds	A	Stable	State aid withholding law
Georgia*	Eligible local school bonds	AA+	Stable	State aid withholding law with additional coverage of 1.5x state aid and 1x SPLOST or 2x state aid
Indiana*	Local school bonds, leases	A	Stable	State Withholding Law
Indiana*	Local school bonds, leases	AA	Stable	State Withholding Law with enhanced coverage provisions
Kentucky	Local school bonds, leases	A+	Stable	State aid withholding law
Kentucky	Commonwealth Universities	A+	Stable	State aid withholding law
Massachusetts	All pre-approved local	AA-	Stable	State direct deposit of state aid to paying agent
Michigan	Qualified local school bonds	AA	Neg	Constitutional School Bond Loan Fund; state general fund support
Minnesota	Eligible local school bonds	AAA	Stable	State standing appropriation law
Minnesota	Eligible counties	AAA		State standing appropriation law
Mississippi	Eligible local school bonds	AA-	Stable	State direct deposit of annual adequate education program funds to paying agent
Missouri	Eligible local school bonds	AA+	Stable	State direct deposit of state aid to paying agent
Nevada	Eligible local school bonds	AAA	Stable	Permanent School Fund
New Jersey	Local school bonds	AA	Stable	Constitutional Fund for the Support of Free Public Schools
New Jersey	Additional state aid bonds	AA-	Stable	State appropriations for school districts and community colleges
New Jersey	All pre-approved local qualified municipal debt	AA-	Stable	State direct deposit of state aid to paying agent
New York	Local school bonds	A	Stable	State aid withholding law
Ohio*	Eligible local school bonds	AA	Stable	State aid withholding law with 2x MADS coverage
Ohio*	Eligible local school bonds	AA-	Stable	State aid withholding law
Oregon	Qualified local school bonds	AA-	Stable	State guarantee
Pennsylvania*	Local school bonds	A	Stable	State aid withholding law
Pennsylvania*	Local school bonds	A+	Stable	State aid withholding law with enhanced resolution provisions
South Carolina	Local school bonds	AA	Stable	State aid withholding and general fund make-up provision
South Dakota	Local school bonds	A	Stable	State aid withholding law
Texas	Approved local school bonds	AAA	Stable	Constitutional Permanent School Fund
Texas	Higher education bonds	AA	Stable	Direct and continuing state appropriations
Utah	Qualified local school bonds	AAA	Stable	State guarantee
Virginia	All local G.O. debt	A	Stable	State aid withholding law
Washington	Qualified local school bonds	AA	Stable	State guarantee
West Virginia	All local G.O. debt	AA-	Stable	Continuing state appropriations to cover deficiencies
Wyoming	Eligible local school bonds	AAA	Stable	Common School Account, Permanent Land Fund

*See program detail.

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State Credit Enhancement Programs: Current List

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State Credit Enhancement Programs: Current List

State credit enhancement programs are designed to give bondholders additional security for particular general obligation and lease bonds. The type of program and the contractual relationship between the state and the program participant dictates whether a program rating or outlook will change when the state's rating or outlook changes.

Here are the current state credit enhancement program ratings.

State Credit Enhancement Programs

Ratings as of Sept. 20, 2012

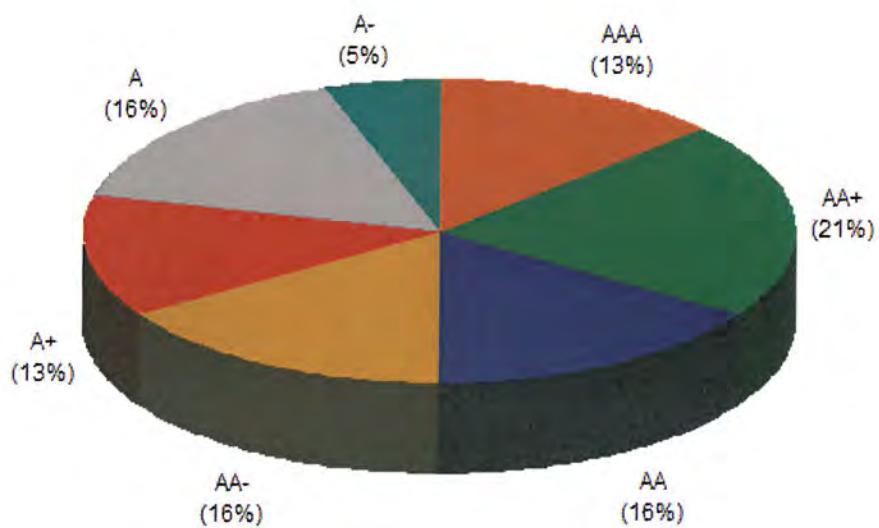
Ratings				
State	Program	State	Program	Move in tandem?
California	Health Facility Construction Loan Insurance Program	A-/Positive	A-/Positive	Yes
	Infrastructure Bank		A-/Positive	Yes
Colorado	State Aid Intercept	AA/Stable (ICR)	AA-/Stable	Yes
Georgia	State Aid Intercept	AAA/Stable	A/Stable	No
	State Aid Intercept w/ enhancements		AA+/Stable	Yes
Idaho	School Bond "Guaranty" Program	AA+/Stable	AA+/Stable	Yes
	Credit Enhancement Program For School District Bonds		AAA/Stable	No
Indiana	State Aid Intercept	AAA/Stable	A/Stable	No
	State Aid Intercept w/ enhancements		AA+/Stable	Yes
Kentucky	State Aid Intercept	AA-/Stable	A+/Stable	Yes
	State Aid Intercept for universities		A+/Stable	Yes
Massachusetts	Qualified Bond Act	AA+/Stable	AA/Stable	Yes
Michigan	Bond Loan Fund	AA-/Stable	AA-/Stable	Yes
Minnesota	State Standing Appropriation	AA+/Stable	AA+/Stable	Yes
	County Credit Enhancement		AA+/Stable	Yes
	City Credit Enhancement		AA+/Stable	Yes
Mississippi	State Aid Capital Improvement	AA/Stable	AA-/Stable	Yes
	Mississippi Development Bank Community and Junior College State Aid Intercept Program		AA-/Stable	Yes
Missouri	Direct Deposit of State Aid	AAA/Stable	AA+/Stable	Yes
Nevada	School District Guarantee	AA/Stable	AAA/Stable	No
New Jersey	State Aid Bonds	AA-/Negative	A+/Negative	Yes
	Support of Free Public Schools		AA-/Negative	Yes
	Qualified Bond Program		A+/Negative	Yes
New York	State Aid Intercept	AA/Positive	A/Stable	No
Ohio	State Aid Intercept	AA+/Stable	AA/Stable	Yes
	State Aid Intercept		AA-/Stable	Yes
Oregon	School Bond Guarantee Program	AA+/Stable	AA+/Stable	Yes
Pennsylvania	State Aid Intercept	AA/Negative	A/Stable	No
	State Aid Intercept w/ enhancements		A+/Stable	No
South Carolina	Education Finance Program	AA+/Stable	AA/Stable	Yes

State Credit Enhancement Programs (cont.)

South Dakota	State Aid Intercept	AA+/Stable	A/Stable	No
Texas	Permanent School Fund	AA+/Stable	AAA/Stable	No
	Higher Education Bond Program		AA/Stable	Yes
Utah	School Bond Guaranty Program	AAA/Stable	AAA/Stable	Yes
Virginia	State Aid Intercept Program	AAA/Stable	A/Stable	No
Washington	School Bond Program Guarantee	AA/Stable	AA/Stable	Yes
West Virginia	Municipal Bond Commission	AA/Stable	AA/Stable	Yes
Wyoming	School District Bond Guarantee	AAA/Stable	AAA/Stable	No

State Credit Enhancement Program Ratings Distribution

As of Sept. 20, 2012



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RATING METHODOLOGY

State Aid Intercept Programs and Financings: Pre and Post Default

Part I: Pre-Default Intercept Programs

Part II: Post-Default Intercept Programs (New)

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Preface: Addition of Part II

Part II of this methodology, which begins on page 13, is a new addition to the State Aid Intercept Programs and Financings Rating Methodology, and describes our approach to rating debt supported by post-default intercept programs. Part II of this methodology also formally adopts in all material respects the methodology proposed in our October 2012 Request for Comment on post default intercept programs and financings following our review of market feedback. Part I of this methodology is an updated republication of the February 2008 methodology which outlines our approach to rating pre-default intercept programs.

Summary

This two-part methodology explains Moody's approach to assigning enhanced ratings on debt that is supported by pre-default (Part I) and post-default (Part II) intercept programs. The goal of this methodology is to articulate how key qualitative and quantitative rating factors drive specific rating outcomes. The report provides a detailed guide to the main analytic factors that drive these types of ratings, although it does not include an exhaustive discussion of every sub-factor that may be relevant when evaluating an individual financing's unique credit characteristics. Highlights of this report include:

- » Presentation of factors for a top-down approach to rating pre-default intercept, notched off the general obligation rating of the state
- » Description of a scorecard for factors to be considered in rating pre-default intercept programs
- » Revision of the post-default intercept methodology to a rating approach that builds on the underlying credit of the borrower (bottom-up) from a rating approach that strictly notches down from the state rating (top-down)
- » Introduction of a scorecard for post-default intercept ratings that standardizes the analysis and relative weighting of quantitative and qualitative factors

Moody's currently rates pre- and post-default state aid intercept programs in 20 states. Intercept programs are designed to divert intergovernmental revenues that are payable to a municipal bond issuer – cities, school districts, community colleges, or other governmental facilities – but which are expected to be intercepted for the benefit of bondholders. In pre-default programs, which are covered in Part I of this methodology, early notification and strong mechanics provide that state aid will be intercepted in time to avoid a missed debt service payment. Post-default programs, covered in Part II, are designed (i) to intercept funds for debt service payments only after a debt service default or (ii) are unclear about when funds would be available to make debt service payments.

In this report, we present scorecards which use qualitative and quantitative factors to estimate i) the number of notches a pre-default enhanced rating will be below the state's rating, and ii) the number of notches a post-default enhanced rating will be above the issuer's underlying rating. This methodology provides an overview of each of the factors in the scorecard, its importance to the rating, and how we review the factor. In both methodologies, we will consider a debt service coverage ratio as a factor in the scorecard (pre-default) or as a below-the-line consideration (post-default) to provide a minimum threshold for annual revenue availability. Although following different approaches, the two methodologies provide a full analytic framework for all Moody's rated intercept enhancement programs.

Methodology Implementation and Rating Implications

Ratings may move down or be withdrawn as a result of this methodology update. Post-default enhanced ratings will be capped at two-notches below the state's general obligation rating. This methodology will rely on a public underlying rating to assign or maintain an enhanced rating. It is possible that for some issuers without public underlying ratings, particularly in Arkansas and Pennsylvania, we may determine that we do not have sufficient current information to assign a public underlying rating. Therefore, we will likely withdraw those enhanced ratings since they would no longer be consistent with the new methodology. In the state of Arkansas, there are approximately 260 issuers that do not have public underlying ratings and in Pennsylvania there are about 50. In the other states, there are very few issuers that do not have public underlying ratings. Going forward, Moody's assessment of a post-default enhanced rating will include assignment of an underlying rating and review of the scorecard presented here, incorporating the relative weighting of quantitative and qualitative factors important outlined above.

Part I: Pre-Default Intercept Programs

Overview

Pre-default intercept programs take advantage of the substantial revenues and sophisticated governance of states, tying the issuer's rating to the state's credit and supporting a top-down rating approach. Accordingly, this methodology and scorecard determine the number of notches a pre-default intercept rating will be below the state's G.O. rating.

Assignment of a rating to a pre-default intercept financing is a two-phase process. The first phase involves the assessment and rating of the **intercept program** as a whole by setting guidelines for notching it below the state's G.O. rating. The program rating establishes a ceiling for ratings that individual financings under the program can achieve. Each of the factors is categorized as being either strong, average or weak. The two primary factors for assessing intercept programs are:

Factor 1: State Commitment and Program History

Factor 2: Program Mechanics

Once the program rating has been assigned, the second phase considers two additional factors to determine the rating of an **individual financing** issued under a program. Factors assessed are:

Factor 3: Sufficiency of Interceptable Revenues

Factor 4: Transaction Structure

If a financing has average or higher scores on these two dimensions, it will generally receive the program-level rating. If, however, the financing's scores are below-average, it will be rated one or more notches lower than the program rating. For intercept financings that are structured as leases, the rating of the financing will reflect not only the structure of the intercept, but the risk of nonappropriation and/or abatement of the lease payments.

Types of Pre-Default Intercept Programs

Certain intercept program structures are stronger than others, warranting more or less distance from the state G.O. rating. For example, unlimited advance intercepts, by virtue of their access to the state treasury, are stronger than current year intercepts that are dependent on state budgeting and for which limited funds are available. It is possible to achieve a rating for an unlimited advance intercept equal to that of the state G.O. rating. However, consistent with Moody's ratings of state obligations subject to annual appropriations, there is generally at least a one rating notch distinction between the state G.O. rating and the rating assigned to the intercept program. Particularly weak intercept programs may be rated as many as three notches below the state G.O. rating. Due to the connection to the state's credit, when a state G.O. rating is upgraded or downgraded, the intercept programs and financings within the state will also generally be upgraded or downgraded.

Pre-default intercept programs generally fall into one of four categories:

- » Unlimited Advance
- » Directly Funded

- » Limited Advance

- » Current Year

Unlimited Advance

The source of funds for an unlimited advance intercept is the state treasury or some other source of state funds. In this strongest of intercept types, the state, upon notification from a trustee, will make up debt service deficiencies for a local government or instrumentality from the state treasury or other source, without limitation. Further, the state will continue to advance funds for debt service even if prior advances have not been fully repaid.

In practice, unlimited advance programs are generally rated one notch lower than the applicable state G.O. rating. Theoretically, with very strong program mechanics, interceptable revenues, state commitment and program history, an unlimited advance program could be assigned the same rating as the state G.O. rating.

Directly Funded

Directly funded intercepts are also very strong in that they require no notification of debt service deficiency to trigger payments from the state. At the inception of a directly funded intercept financing, the state agrees to forward state aid, otherwise payable to a local unit of government or instrumentality, directly to a trustee or paying agent for the benefit of bondholders based on the debt service schedule. Directly funded intercepts are generally rated one notch lower than the state G.O. rating.

Limited Advance

A limited advance intercept makes a large pool of state funds available from which debt service payments can be made, if necessary. This pool of funds exceeds the amount of state aid that would be directly attributable to an individual local unit of government in the current fiscal year, but is smaller than the entire state treasury that would be available under an unlimited advance program. Generally, the state will reimburse itself for any payments made from the pool by capturing state aid due to the local unit of government on whose behalf funds had been advanced. These limited advance intercepts are generally rated one notch lower than the state G.O. rating.

Current Year

Current year intercepts are the most common type of intercept programs. They are not generally as strong as unlimited, directly funded, or limited advance intercepts, because interceptable aid is limited to the state appropriations for a local unit of government for a particular fiscal year. In most cases, any state aid appropriated for a particular fiscal year can be accelerated, as needed, to pay for debt service. However, in some cases, state aid can only be intercepted as scheduled to be paid to the local unit of government. Depending on the strength of program characteristics, these current year intercepts are typically rated one to three notches below the state G.O. rating.

FIGURE 2
Types of Pre-Default Intercept Programs

Type of Program	Available Funds for Debt Service	Notification Required to State Related to Fund Insufficiency	Notches Lower than State G.O. Rating
Unlimited Advance	Any legally available funds from the state	Yes	0 to 1
Directly Funded	Aid appropriated to local unit	No	1 to 2
Limited Advance	Pool of funds larger than aid allocated to local unit, but smaller than total state treasury budget	Yes	1 to 2
Current Year	Aid appropriated to local unit for a specific fiscal year	Yes	1 to 3

Unique (Non-Programmatic) Intercept Financings

While most intercept programs fit into one of these four categories, there are approximately one dozen rated financing structures throughout the country that employ an intercept mechanism as only one of many credit elements. In these cases, the Moody's rating will consider the strengths of the intercept as one credit factor, but will also incorporate other material rating elements into the analysis, some of which may be more heavily weighted than the intercept mechanism. For example, the Maine Health and Higher Education Facilities Authority Reserve Fund Bonds have an intercept provision that allows the state to intercept funds in its custody for any of the borrowers in the pool to make debt service payments. Moody's rates these bonds on par with the state G.O. rating. This rating incorporates the (i) underlying rating of the borrowers and the diversity of the pool, (ii) moral obligation of the state of Maine, and (iii) oversight and monitoring function of the authority itself, as well as the intercept mechanism.

Rating Factors for Pre-default Intercept Program-Level Ratings

Moody's assigns a program-level rating to each state aid intercept program, as an input into the ratings assigned to individual transactions. The program-level rating is the highest rating an individual transaction can achieve, and some transactions may be rated lower if they have below-average transaction-specific factors. The primary factors in rating an intercept program are (1) State Commitment and Program History and (2) Program Mechanics. Each of these factors has multiple subfactors that are individually scored, and then the scores are combined to arrive at a rating for the program.

FACTOR 1: STATE COMMITMENT AND PROGRAM HISTORY

A state's commitment to and experience with a state aid intercept program are important factors in evaluating the strength of a particular intercept program. Commitment is measured by assessing the amount of state oversight, the state's commitment not to impair the security for the bonds issued under the program, and, given the long-term nature of these financings, the expectation of continued state support.

While very few intercepts, other than directly funded programs that are continually forwarding state aid to a trustee or paying agent, have been tested with an actual deficiency by an underlying obligor, those that have provide valuable insight into how programs will perform when and if needed again.

Available Funds. Moody's will first identify the funds that are available to be intercepted. The strongest intercepts will have funds of at least five times annual debt service attributable to any individual obligor available while the amount of money available for intercept under most programs

will be restricted to state aid appropriated for a particular local government for the remainder of the respective state's fiscal year. Those programs that allow no acceleration of appropriated state aid or lack clear documentation about which funds are available are considered to be weak.

State Oversight. Strong state oversight of an intercept program and the debt and finances of a local unit of government signal a vested interest in making sure that debt service is paid in full and on time. Oversight is considered strong when a state reviews state aid adequacy to cover debt supported by an intercept program prior to approval of a particular financing. A state may have explicit coverage ratio requirements and/or restrict debt service payments to particular months of the state's budget cycle. Another sign of strong oversight is when the state oversees the budgeting and finances of local units of government. Such oversight is likely to ensure that state officials have advance notice of any expected debt service deficiency on behalf of a local unit of government. A state or state department may have the authority and/or practice of intervening and/or requiring multi-year plans for financial remediation.

If the state does not involve itself in the prior review of intercept program financing, oversight is considered to be weak. Weak oversight is also attributed to those programs managed by a small and/or inexperienced governmental or private party or entity.

Nonimpairment. Some states commit not to repeal, revoke, rescind or modify statutory authority for an intercept program or financing. This type of pledge is considered to be very strong as the state has made a commitment not to change its enhancement program in such a way as to harm bondholders. Conversely, some states have explicitly stated that they do have the right to repeal, revoke, rescind or modify statutory authority for an intercept program or, in fact, to reduce state aid that might be interceptable. This latter approach is considered weak as any such action could adversely affect the program. Most programs are silent on this point which we view as "average".

Expectation of Continued State Support. Since state aid intercept programs are generally structured as long-term obligations, it is important to evaluate whether the state expects to continue to support the program. Our assessment of this factor is based on the breadth of the existing program and the essentiality of the projects it supports. Statewide programs for essential public facilities are considered to be the strongest while a narrowly focused program to benefit less essential public facilities is considered to be weak.

Program History. Assessing the history of programs that have been activated can provide valuable insight into the probability of program success in the future. Intercept programs that have been activated where notifications were timely and bondholders were paid on time and in full are considered strong. If an intercept program has not been utilized and there is some doubt as to whether security holders would be paid in full and on time or if the program was utilized and there were instances of late payment, our assessment of the program history would be weak. Aside from directly funded intercepts whereby state aid is forwarded to a fiduciary without prior notification, we are not aware of any Moody's rated pre-default intercepts that have actually been called upon to make a debt service payment.

If there is an absence of documented program mechanics or if a particular state has a history that resulted in a late bondholder payment, Moody's may opt not to assign an intercept program rating.

Factor 1: State Commitment and Program History

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Available Funds	Unlimited, or limited to an amount at least equivalent to 5 times maximum annual debt service for a particular borrower.	Restricted to state aid appropriated for a particular borrower for the remainder of the state's fiscal year. Any balance of state funds appropriated, but not paid can be accelerated. Or, in the case of a limited advance intercept, a pool of funds equivalent to less than 5 times maximum annual debt service for a particular borrower.	Restricted to state aid appropriated for a particular borrower within a fiscal year, but with no opportunity to accelerate state aid payment dates; no clear documentation of what funds would be available.
State Oversight	Strong state oversight in areas of budgeting, debt issuance and/or remediation; review of state aid adequacy to cover debt supported by an intercept program.	No review by state officials prior to use of the intercept program; state is notified when debt supported by intercept has been issued.	No review by state officials prior to use of intercept program; state is not notified when debt supported by intercept has been issued; parties to the transaction may be small and/or inexperienced.
Nonimpairment	Statutory commitment by state with bondholders not to repeal, revoke, rescind, modify or amend the statutory authority for the intercept so as to limit or impair the security holders' rights and remedies.	Statute is silent on commitment to bondholders not to repeal, revoke, rescind, modify or amend the statutory authority for the intercept so as to limit or impair the security holders' rights and remedies.	Explicit statement by state that it retains the right to repeal, revoke, rescind, modify or amend the statutory authority for the intercept or to reduce state aid.
Expectation of Continued State Support	Statewide program for essential public facilities.	Statewide program for moderately essential public facilities or narrowly focused program to benefit an essential public facility.	Narrowly focused program to benefit less essential public facilities.
Program History	Program has been utilized; notifications were timely and bondholders were paid on time and in full.	Program has not been utilized but documentation suggests that, if utilized, there would be sufficient time and money to pay bondholders in full and on time.	Program has not been utilized and there is some doubt as to whether bondholders would be paid in full and on time. Program has been utilized and there were instances of late payment.

FACTOR 2: PROGRAM MECHANICS

The mechanics of an intercept program are important as they dictate responsibility for various actions at certain times. Clearly documented, institutionalized procedures and responsibilities with a high probability of available funds to make timely debt service payments will result in a strong assessment of program mechanics. Set forth below is an explanation of the various elements considered when evaluating the mechanics of an intercept program and a characterization of those approaches that are considered strong compared to those that are considered weaker.

State's Documentation of Intercept Mechanics. Moody's will review documentation submitted to us that supports an intercept program. Mechanics dictated by statute and/or administrative rulemaking are considered the strongest, while mechanics documented in attorney general opinions, memoranda of understanding, and/or administrative procedures are less strong. The lack of significant documentation of mechanics or documentation that is unclear (or, in some cases, contradictory) is considered to be weak.

Required Notification to State Related to Insufficiency of Funds. Moody's analysts will ascertain what notification, if any, is required to activate the intercept. Of course, the strongest situation, as in the case of directly funded intercepts, is one where no notification is required to initiate the intercept process. However, with unlimited advance, limited advance, and current year intercepts, the state generally requires notification of debt service deficiency before intercepting funds for the

payment of debt service. In those cases where notification is required, notice of at least one week prior to a scheduled debt service payment date is considered strong, whereas notice of less than three days before a scheduled debt service payment date is considered to be weak.¹

Timing of Intercept Payment by State. The timing of payments by the state relative to a scheduled debt service payment date is also considered when evaluating an intercept program's mechanics. Strong programs will require the state to forward funds for debt service payments three days or more prior to a scheduled debt service payment date. Guidelines that allow a state to make payments the same day as a scheduled debt service payment date are considered to be weak.² Similarly, in the absence of explicit instructions to forward state aid for the timely payment of debt service, evidence of intent to do so will be considered to be weak.

State Budget Timing. The timing of state budget adoption is important to the evaluation of intercept programs as most programs only allow the intercept of state funds after they have, in fact, been appropriated by the state. The exception to this would be an unlimited advance intercept under which the state's commitment is to pay bondholders from the state treasury or other source with no further approval required. Strong scores for state budget timing will reflect a state that always passes its budgets on time, or, if not, (i) has a history of adopting continuing resolutions or interim budgets so that funds will be available for intercept, or (ii) has the statutory authority to appropriate interceptable aid in the absence of an adopted budget.

Weak scores will be assigned for this element when the state has a history of late budget adoption with no provision for continuing resolutions and the intercept of state funds is dependent upon the adoption of same.

State's Mandate to Act. Moody's will evaluate the strength of the state's mandate to cure a debt service deficiency prior to a local government's scheduled debt service payment date. Any approvals required after receipt of a debt service deficiency notification will weaken the score for this element as will lack of clarity or the absence of guidance with regard to required approvals.

Factor 2: Program Mechanics

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
State's Documentation of Intercept Mechanics	Intercept mechanics documented in statute(s) and/or administrative rulemakings.	Intercept mechanics documented in attorney general opinions, memoranda of understanding, and/or administrative procedures.	Lack of significant documentation of mechanics. Documentation that exists may be unclear or, in fact, may be conflicting or contradictory. In the absence of written documentation, state officials may offer verbal explanation of intercept mechanics.
Required Notification to State Related to Insufficiency of Funds	Direct advance intercepts whereby the schedule for payment of state aid for purposes of paying debt service is established upon closing of the bond issue and no other notification is required. For those programs requiring notice, notice should be at least one week prior to scheduled debt service payment date	Direct advance intercepts where vouchers must be presented prior to payment of state aid. For those programs requiring notification, such notification should be at least three days prior to scheduled debt service payment date.	Notification is less than 3 days prior to scheduled debt service payment date.

¹ Whenever the term "debt service" is used in this document, it should be understood that we also mean "lease" or "rental" payments, if applicable.

² Whenever the term "debt service" is used in this document, it should be understood that we also mean "lease" or "rental" payments, if applicable.

Factor 2: Program Mechanics

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Timing of Intercept Payment by State	State is required to forward state aid for debt service payments at least 3 days prior to scheduled debt service payment date.	State is required to forward state aid for debt service payments 1-2 days prior to scheduled debt service payment date.	State is required to forward state aid for debt service on the scheduled debt service payment date. Evidence of intent to forward state aid for timely payment of debt service in the absence of specific instructions to do so.
State Budget Timing	State always passes its budget on time, or, if not, (i) it has a history of adopting continuing resolutions or interim budgets so that funds will be available for intercept or (ii) it has statutory authority for appropriating interceptable aid in the absence of an adopted budget.	State has usually adopted its budget in time to make state aid available for timely debt service payments; may not have employed a continuing resolution or interim budget, but has the authority to do so or has statutory authority for appropriating interceptable aid in the absence of an adopted budget.	State has (i) a history of late budget adoption, (ii) no provision for continuing resolutions or interim budgets and/or (iii) no statutory authority for continuing state aid intercepts in the absence of an adopted budget; late state budget may result in a temporary lack of funds available to be intercepted.
State's Mandate to Act	State will immediately advance funds.	Series of approvals required, each with its own time parameters set forth in statute or an administrative order.	Lack of clarity; no specific guidance on required approvals.

Rating Factors for Individual Intercept Financings

Once an intercept program has been rated, Moody's can then assign ratings to individual financings within the program. This involves the consideration of two additional primary factors, **Sufficiency of Interceptable Revenues** and **Transaction Structure** that can vary from transaction to transaction within a program. Financings that achieve strong or average scores on a majority of subfactors will usually achieve ratings that are equivalent to the program-level rating, whereas financings with weaker scores will be rated one or more notches lower than the program-level rating.

FACTOR 3: SUFFICIENCY OF INTERCEPTABLE REVENUES

Since the success of an intercept program is dependent upon state aid payments made to the issuer, it is important to determine the sufficiency of these funds. Sufficiency is measured by a number of elements. Moody's will assess the amount of funds available for intercept relative to the amount of debt service to be paid. We will assess the reliability of state aid payments through the years and note whether the payment of debt service from state funds is a priority, payable before other obligations of the municipal obligor. We will also apply a stress test to this analysis by evaluating sufficiency in the event that the state delays the payment of any state aid due in the last month of its fiscal year. In short, when assigning an intercept rating, we want to ensure that sufficient state funds will be available, if needed, to make timely payments of debt service on behalf of local units of government in spite of potential fluctuations in state aid.

The types of state aid that can be intercepted to pay debt service vary according to each state and its intercept program(s). Some states limit interceptable aid to construction or debt service aid, while others permit state aid for operations to be intercepted as well³. There are a handful of programs that allow specific fees collected by the state such as vehicle license fees to be intercepted. In one case, state Medicaid payments are interceptable to make lease payments related to a city's health facilities, if sufficient lease payments are not appropriated by the city. When assessing the sufficiency of funds available to make debt service or lease payments, Moody's considers only the

³ In the event that a local unit's state operating aid payments are intercepted to pay debt service, there would likely be a negative effect on the unit's own fiscal condition. This deterioration would not be reflected in the intercept rating, but in the local unit's own underlying rating.

specific sources of funds that can be intercepted under each program to make debt service payments on behalf of the local unit of government.

Debt Service Coverage. One way of evaluating the sufficiency of interceptable state aid is to calculate a debt service coverage ratio. Moody's will calculate the debt service coverage ratio by dividing available interceptable state aid by periodic debt service payments (see the text box below for a detailed example of how debt service coverage will be calculated). Debt service coverage of greater than 1.5 times is considered strong while debt service coverage of between 1.0 and 1.25 times is considered relatively weak.

Debt service coverage throughout this document means, for each Debt Service Payment Date, a ratio of (i) interceptable state aid to (ii) debt service due on that date. Debt service payment date is defined as a given month and day when debt service comes due. Interceptable state aid refers to any interceptable payments included in the most recently adopted state budget available to make scheduled payments of debt service (by acceleration or otherwise), less the excess, if any of (a) debt service due on a debt service payment date earlier in the fiscal year less (b) interceptable state aid expected to be remitted between that debt service payment date and the current debt service payment date. Debt service refers to the largest aggregate amount due on a given debt service payment date over the life of the bonds, for all parity debt.

If coverage is below 1.0 times, Moody's may not be able to assign an intercept rating for the financing that heavily weighs the respective state G.O. rating even if the intercept program reflects the state G.O. rating and the other subfactors related to the financing receive "strong" scores. Instead, we would approach the rating on the basis of the underlying obligor's credit, possibly strengthened by the availability of the intercept mechanism.

Timing of Debt Service Payment Dates Relative to State's Fiscal Year. The timing of debt service payment dates relative to the state's fiscal year is important because sometimes state budgets are adopted late and, in most situations, state aid cannot be intercepted until it has been appropriated by the state legislature. A strong structure will have no debt service scheduled during the first three months of the state's fiscal year to ensure against issues arising from any late budget adoption. Debt service payments scheduled during the first 60 days of the state's fiscal year are considered weaker than those with a longer lead time if the availability of interceptable funds is dependent upon the adoption of the state budget.

Reliance on Final State Aid Payment. From time to time, states will delay the payment of state aid late in their fiscal years to provide themselves budgetary relief. As a result, Moody's will apply a stress test to the debt service coverage test by calculating it without the inclusion of state aid scheduled to be paid in the final month of the state's fiscal year. Again, debt service coverage of greater than 1.5 times is considered strong while debt service coverage of less than 1.25 times is considered relatively weak.

Stability of State Aid Payments. Given that intercept programs generally support long-term financings, Moody's will evaluate the likelihood that state aid payments will at least be maintained at the current level moving forward based on the historical stability of this budget item in the state's budget. A record of increasing state aid for a particular local unit of government despite periods of fiscal stress at the state level and fluctuations in components of formulaic aid, such as

population, is considered to be strong. Conversely, a record of declining or fluctuating state aid is considered to be weak.

First Use of State Aid Payments. In the strongest intercept programs, state funds available to pay debt service must be used for that purpose before they can be used for any other purpose. This first use of state aid payments is incorporated in a directly funded intercept program where the first available state aid payments are sent directly to a paying agent or trustee for the benefit of bondholders. Other types of programs are considered stronger when state aid can be accelerated, if needed, to pay debt service. Those programs that allow for the intercept of state funds only as those state funds become available to be paid to the local unit of government are considered the weakest in this category.

Factor 3: Sufficiency of Interceptable Revenues

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Debt Service Coverage	Greater than 1.5 times	Between 1.25 times and 1.5 times	1.0 to 1.25 times
Reliance on Final State Aid Payment	Stress test of debt service coverage provides 1.5 times or better coverage of each debt service payment even without state aid scheduled to be paid in the last month of the state's fiscal year.	Stress test of debt service coverage provides between 1.25 and 1.5 times coverage of each debt service payment even without state aid scheduled to be paid in the last month of the state's fiscal year.	Stress test of debt service coverage provides less than 1.25 times coverage of each debt service payment without consideration of state aid scheduled to be paid in the last month of the state's fiscal year.
Stability of State Aid Payments	Record of increasing state aid even in periods of fiscal stress, fluctuations in population or other components of formulaic aid. (Note: all unlimited intercept programs should be scored as "strong.")	Record of flat state aid even in periods of fiscal stress, fluctuation in population or other components of formulaic aid.	Record of declining/fluctuating state aid in periods of fiscal stress or fluctuation in population or other components of formulaic aid.
First Use of State Aid Payments	All unlimited advance intercepts. Directly funded intercepts whereby 100% of the amount of state aid required for debt service is sent directly to the paying agent prior to the payment of any state aid to the local unit of government. Other programs for which it is documented that the debt service is paid from intercepted state funds prior to its use for other purposes.	Not applicable.	State funds sufficient to make debt service payments for the entire fiscal year are not set aside before some or all of these interceptable funds have been used for other purposes.

FACTOR 4: TRANSACTION STRUCTURE

Certain structural elements, such as the use of a fiduciary and a debt service reserve fund, add strength to an intercept program. Moody's will ascertain whether these features are in place and will determine how important they are to the specific intercept program.

Presence and Role of Fiduciary/Conduit. The strongest intercept programs involve the services of a fiduciary or an experienced conduit issuer. In those cases, a trustee, paying agent or strong, experienced conduit issuer will be responsible for tracking sufficiency of funds to be used for debt service payments and for notifications to the state if funds on deposit to make debt service payments are insufficient. If state aid is not sent directly to the fiduciary, as in the case of directly funded intercepts, there should be explicit instructions to the fiduciary set forth in statute or in legal documents to which the fiduciary is a party, to notify the state on a timely basis that the interception of state aid is required to make debt service payments. Without such a fiduciary/conduit issuer, bondholders are often dependent upon the local unit of government

benefiting from the intercept to notify the state of a need to intercept state funds for payment of debt service. In other cases, bondholders themselves will have to notify the state that a debt service payment has been missed in order to have funds intercepted. A weak rating for this subfactor could result in a financing rating that is notched below the program rating.

Reserve Fund. Some intercept programs offer a debt service reserve fund to protect against missed or late debt service payments. These reserves, which allow time for the state to make up any deficiencies, are not considered necessary if notification requirements, mechanics and the availability of funds are sufficient. Reserve funds are not typically utilized to support intercept financings supporting municipalities or school districts.

Factor 4: Transaction Structure

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Presence and Role of Fiduciary/Conduit	State aid is sent directly to a trustee, paying agent or conduit issuer with a professional staff and no notification is required.	Relatively new or small conduit issuer. Trustee, paying agent or conduit issuer is explicitly required, by statute or contract, to notify the state on a timely basis, of a need for interception of state aid.	State aid is sent to the local unit. Trustee, paying agent or conduit issuer is not explicitly required to notify the state on a timely basis, of a need to intercept state aid.
Reserve Fund	A reserve fund is established to guard against late intercept payments. All unlimited and directly funded intercepts should be scored as "strong."	Lack of a reserve fund for limited and current year intercepts when notification requirements, mechanics and the availability of funds should ensure timely debt service payments.	Lack of a reserve fund when notification requirements, mechanics and the availability of funds may not ensure timely debt service payments.

Rating Outcomes

Factors 1 and 2 will be assessed first to determine the program-level rating. Analysts will use the scorecard in Appendix A to review each subfactor and determine the relative strength of a program. Each applicable subfactor will be ranked "strong," "average" or "weak." The scores will then be combined roughly on an equal basis to rank the program as "extremely strong," "strong," "average," "below average," or "weak."

A program that is ranked "strong" for every subfactor and benefits from an unlimited advance intercept will be considered "extremely strong" and will likely be assigned a rating equivalent to the state G.O. rating. Programs with a preponderance of "strong" scores and those with mostly "average" scores, will be ranked "strong" or "average" and will likely be assigned a rating equivalent to one notch below that of the state G.O. rating. Programs with a mix of "average" and "weak" scores will receive an overall ranking of "below average" and will be rated two notches below that of the state G.O. rating. Programs with predominantly "weak" scores will be ranked as "weak" and may be rated as many as three notches below that of the state G.O. rating.

Factors 3 and 4 will then be assessed to determine the financing-level rating. Just as with factors 1 and 2, analysts will use the scorecard in Appendix A to review each subfactor and determine the relative strength of the financing. Each applicable subfactor will be ranked "strong," "average" or "weak." Financings that achieve strong or average scores on a majority of subfactors will usually achieve ratings that are equivalent to the program-level rating, whereas financings with weaker scores will be rated one or more notches lower than the program-level rating.

Moody's approach to the rating assignment will include some judgment on the part of the analyst and the rating committee, and unusual circumstances may lead to outcomes that vary from what is

expected based on this methodology. Depending on the circumstances, individual factors may not necessarily bear the same weight in the rating as other factors. In addition, some financings supported by the intercept of state aid, are structured as leases and are subject to the risk that the local unit of government will fail to appropriate sufficient funds for debt service or that lease payments will be abated. If state aid is not available to make timely payments of debt service in the event of nonappropriation or abatement of the lease payments, then the state aid intercept rating will be one notch lower than it would be without these risks.

Part II: Post-Default Intercept Programs

Summary of Methodology Revision

Part II of this rating methodology describes our revised approach to rating debt that benefits from intercept programs that i) are designed to intercept state aid to benefit bondholders after a scheduled debt service payment date has been missed, or ii) are unclear about the timing of such intercepts and payments, thereby increasing the likelihood that the payments will occur post-default. This report revises Moody's post-default intercept methodology to a bottom-up rating approach. Post-default intercept programs have been previously rated with a top-down approach, ranging from two to three notches below the state's general obligation rating. As a result of this change to notching up from the issuer's underlying credit quality, some enhanced ratings will likely be lowered. In addition, under our methodology, the enhanced rating will also be capped at two-notches below the state's general obligation rating.

Our approach to rating post-default programs and financings includes two broad factors and five sub-factors:

Factor 1: Revenue Sufficiency

- » Available funds
- » Timing of state aid payments
- » State aid trend

Factor 2: Timing and Mechanics

- » Strength of notification requirement
- » Timing between notification and intercept

Given the bottom-up rating approach, our methodology will use public underlying ratings to assign enhanced ratings. An underlying rating is assigned to the obligor on the basis of its intrinsic financial strength without the benefit of the intercept mechanism. The enhanced rating will be notched up from the underlying rating to reflect the additional support of state aid revenues to repay a missed debt service payment. In cases where we do not obtain sufficient information to assign a public underlying rating, we may withdraw enhanced ratings.

Given the bottom-up approach of this methodology, ratings will be maintained at the financing level and we will no longer maintain a programmatic rating for each of the five programs. We will continue to maintain the issuer pages for each program on www.moodys.com as a central location for all program level research publications.

This methodology provides an overview of each of the factors in the scorecard, its importance to the rating, and how we review the factor. In addition to the scorecard, we will consider a debt service coverage ratio to provide a threshold for minimum annual revenue availability.

Overview of Post-Default Intercept Programs

Post-default intercept programs typically support school district general obligation bonds, but may also cover other local government entities, as well as other forms of debt including leases and unrated bank loans. Moody's currently maintains over 720 enhanced ratings on approximately \$11 billion of debt enhanced by five post-default intercept programs in Arkansas, Indiana, New York, Pennsylvania, and Virginia.

The legal framework for post-default intercept programs is established through statutory law. All of the programs' legislation share similar language committing the state to withhold state aid appropriated for the participating issuer when notified that a debt service default has occurred. Pursuant to this legislation, a trustee, bondholder, or even the participating issuer, can notify the state that a debt service payment had been missed, and based on this notification, the state is required to withhold revenues otherwise due to the issuer and redirect them to the trustee or bondholders. Although the states similarly define the function of post-default programs, the specific implementation varies greatly in legislation from state to state. For example, Virginia law clearly defines the timing and mechanics of an intercept in the event of a default while other state statutes are not as exacting. Pennsylvania law, like most of the programs, lacks a clearly defined notification requirement, yet gains additional strength from specific details on the timing between notification and intercept. In other cases, such as in Arkansas, Indiana, and New York, legislation pertaining to timing and mechanics is vague and does not expressly define the process for repayment.

Each of the five rated programs offers a continuous commitment to intercept – in other words, the state will continue to withhold funds from aid distributions until the default is cured, even crossing into future fiscal years as additional aid becomes appropriated and available. With these rated programs, Moody's assumes that full recovery will be made to bondholders, but the timing of that recovery will be influenced by annual revenue sufficiency and the strength of the program's mechanics.

The five rated programs automatically include all applicable entities as defined in its state statute. Since there is little to no state governance of the programs, there are no controls over the size, structure, or terms of the debt as it relates to interceptable revenues. Some programs, like the ones in New York and in Pennsylvania, only include school district debt, while others like the Virginia program include cities, counties and school districts. Governance is enhanced in some states, such as in Indiana, which has regular monitoring and fiscal intervention of all local governments, but this strong governance feature will be incorporated in the issuer's underlying rating as it is not specific to the intercept program.

The high average rating assigned to post-default intercept programs is consistent with historical and expected rating performance and the lack of defaults in the sector. We are not aware of any cases where a rated financing in these five programs has triggered a post-default intercept due to a missed debt service payment.

Rating Approach for Post-Default Intercept Programs

This methodology revises the analysis of post-default intercept programs to a bottom-up approach from a top-down approach. The bottom-up approach notches up between one to three notches from the underlying rating of the issuer, rather than notching down from the credit quality of the state

providing the enhancement. Given that the credit enhancement provided by the state is not accessed until after a debt service default has occurred, notching up from the underlying rating results in the default and recovery risk being more accurately reflected in the enhanced rating, with the default probability more closely linked to the issuer's underlying credit quality. The enhanced rating will reflect the expectation that, once a debt service default has occurred, the state intercept of aid due to the issuer will result in higher recovery levels and faster recovery times than bondholders would enjoy from the underlying issuer alone.

In addition, in this methodology, the enhanced rating will be capped at a level two rating notches below the state's general obligation (or equivalent) rating. In other words, the enhanced rating will be the lower of the rating derived from the bottom-up assessment, or the rating two notches below the state. By way of example, if a state's general obligation rating is Aa1, and the issuer's underlying rating is A1 with potential for a two-notch uplift on the enhanced rating (to Aa2), the enhanced rating will be set at the lower Aa3, which is two rating notches below the state's general obligation (or equivalent) rating. The two notch cap is one notch below a notional well-structured state appropriation commitment, as the intercept program has access to a much more limited revenue stream.

Introduction of Scorecard

The scorecard provides a reference tool that can be used to evaluate the credit profiles of debt backed by a state aid intercept. It is intended to help issuers, investors, and other interested market participants understand how key qualitative and quantitative risk characteristics are likely to affect rating outcomes. There are many factors that go into producing a credit rating and they cannot all be captured by the scorecard. The rating methodology does not provide an exhaustive treatment of every rating factor that we consider, but should enable the reader to understand the qualitative and quantitative considerations that are most important.

The scorecard was developed to aid in determining the enhanced rating. It is not meant to be a substitute for rating committee judgments regarding individual credit assessments, nor is the scorecard meant to be a method for automatically assigning or changing these assessments. Scorecard results have limitations in that they are generally backward-looking, using historical data, while ratings are forward-looking opinions of credit strength. Moreover, the limited number of variables included in the scorecard cannot fully capture all idiosyncratic risks nor the breadth and depth of the analysis considered by rating committees. Nevertheless, the performance metrics captured in the scorecard is important and, in general, higher ratings can be expected among issuers with the highest scorecard results.

Because this methodology will apply to all post default programs – not just those that exist today – it is necessarily general in some respects and is not intended to be an exhaustive discussion of all factors that rating committees consider for every rating. The scorecard represents a compromise between greater complexity, which would result in scorecard-estimated ratings that map more closely to actual ratings, and simplicity, which enhances a transparent presentation of the factors that are most important for ratings in this sector most of the time.

Moody's scorecard will be used by analysts to assess the credit strength of financings enhanced by post-default intercept programs. The scorecard provides a notching guideline that will be used to notch an enhanced rating up from the issuer's underlying rating. The key rating factors considered in this methodology and in the scorecard are described in the "Key Rating Factors" section, below.

When applying this methodology, analysts will first review a post-default intercept program for a minimum level of governing documentation and state involvement. As discussed further in

"Additional Factors Important to the Rating" below, analysts will evaluate the strength of the documentation that authorizes and governs the program, as well as the level of commitment the state has in implementing or enforcing the program. Only intercept programs that have specific authorization established in constitutional or statutory documents, and explicit support by the state will be considered under this methodology. As a result, the lowest score in the scorecard discussed below is a one-notch uplift, reflecting the expectation that even a weak but well-documented and state-supported program will provide at least a one-notch enhancement for the underlying issuer.

Rating Factors for Post-default Intercept Programs

Moody's revised analysis of post-default intercept programs includes an assessment of the likely recovery level and recovery timing provided to bondholders after a debt service default has occurred. A review of two key factors, revenue sufficiency and timing and mechanics of the intercept, will result in an enhanced rating up to three notches higher than the issuer's public underlying rating. Revenue sufficiency and timing and mechanics will each comprise 50% of the total scorecard. The enhanced rating will be capped at two notches below the state's general obligation rating.

For most of Moody's-rated post-default intercept programs, the questions of recovery level and timing are intertwined. The majority of these programs do not have a specific notification requirement from the issuer, trustee or bondholder to an authorized party in the state; therefore there is no certainty around when the intercept process would begin. As a result, recovery timing, from the date of a debt service default until the date the program has intercepted all available revenues, is typically uncertain. In reviewing revenue sufficiency, Moody's could also draw some broad conclusions about how long recovery will take, once the state is notified of a default.

All of the rating sub-factors will be considered at both the programmatic level and the financing level. Some of the sub-factors are more typically determined at the programmatic level (ex. Available Funds) and will have very consistent results across all issuers participating in the intercept program. However, should a specific issuer have a unique state aid distribution schedule or bond documents that provide more specific intercept mechanics, the scorecard output will reflect these financing-level features.

FACTOR 1: REVENUE SUFFICIENCY

Revenue sufficiency will measure the likelihood that bondholders will receive 100% ultimate recovery of defaulted debt service through the intercept program. Moody's will evaluate the amount and availability of interceptable revenues to determine the level to which defaulted debt service will be recovered. Revenue sufficiency also provides insight into recovery timing, as an inability to immediately intercept sufficient revenues upon notification of a default would result in a delay in full recovery. The timing of recovery will be considered more directly in the second factor.

Revenue sufficiency will comprise 50% of the scorecard output and be evaluated through three sub-factors: (a) available funds, (b) timing of state aid payments and (c) state aid trend.

Available Funds. Moody's will first identify which revenues will be available for state intercept upon notification of a default, and when they will become interceptable. Available funds could be limited to current year appropriations from the state, or include budgeted future year appropriations as well if the state is on a biennial budget. In addition, in stronger programs the state immediately intercepts from any appropriated aid that has yet to be distributed to the underlying issuer. In other words, these programs will accelerate aid that is scheduled to be paid later in the fiscal year, and intercept it on behalf of bondholders. Those programs that only

intercept from current year aid at the time of regularly-scheduled distributions generally are considered weaker because this provision limits revenue availability and could lengthen the timing of full recovery. The program's definition of available funds makes up 20% of the scorecard output.

Timing of State Aid Payments. The timing of state aid payments to the underlying issuer can influence the amount of funds that are available for the intercept program at any one time. If the underlying issuer's state aid payments are primarily received in the first half of the fiscal year, there may not be sufficient remaining funds to cover a default in the latter half. An irregular payment schedule could make recovery from a program that does not accelerate aid particularly unpredictable, given that bondholders must wait for the next sizeable aid distribution. For example, payment on an intercept request received early in the fiscal year will not be available near the default date if the underlying issuer's aid is primarily distributed in the final month of the fiscal year and cannot be accelerated. The sub-factor also considers the potential impact of a late state budget on the payment schedule. Programs that have strong timing patterns may be scored lower if there is a history of payment interruption due to state budget constraints. This sub-factor makes up 15% of the methodology scorecard.

State Aid Trend. Given that intercept programs generally support long-term financings, Moody's will evaluate the likelihood that future state aid payments will be maintained at sufficient levels to cover a potential default. These trends can be influenced both by state-level budget decisions as well as demographic or financial shifts at the underlying issuer. Programs in states that have cut or maintained flat funding for primary and secondary education, or have a history of mid-year aid deferrals, will be considered weak or average. Depending on the specific state funding formula, distributions to a particular school district could also be influenced by enrollment trends, socio-economic shifts, and/or state intervention to resolve financial issues. This factor will be reviewed at both the state and local levels, and comprises 15% of the scorecard.

FACTOR 2: TIMING AND MECHANICS

The second factor, timing and mechanics, considers recovery timing. The mechanics of an intercept program are important because they dictate responsibility for various actions at certain times. This factor will comprise 50% of the scorecard output and is divided into two sub-factors, (a) strength of notification requirement, and (b) timing between notification and intercept.

Strength of Notification Requirement. This sub-factor considers whether a specific party to the transaction is required to promptly notify the state that a debt service default has occurred. This notification would trigger the beginning of the state's intercept process, and is an important first step in ensuring timely recovery. As mentioned above, the majority of Moody's-rated post-default intercept programs do not have a specific party obligated to notify the state of a default, therefore recovery timing is uncertain and untested in most cases.

This sub-factor considers whether notification requirements are (i) in state statute or other state documentation, or (ii) in bond documents. Although most programs do not have specific notification language included in program level documentation, specific financings could obligate a party to notify the state of a default in the bond documents. For example, the issuers rated under the Virginia intercept program have included in their bond documents a requirement that the trustee notify the state on the day of a default, which results in strong scoring under this sub-factor. This factor is a critical component of recovery timing and the overall intercept strength, therefore this sub-factor comprises 30% of the scorecard.

Timing Between Notification and Intercept. Moody's also reviews state statutes to evaluate the extent to which program mechanics are detailed and the likely timing between notification and intercept. Programs that do not have specific mechanics, including responsible parties and timing requirements, identified in state statute or their bond documents will receive a weak (one notch) score for this sub-factor. Thoroughly documented mechanics will cover all the actions required by the state once notification of default has occurred, typically including: notification to various state departments of the pending intercept, acquisition of necessary approvals, and direction to the appropriate state office to intercept the state aid distribution and remit it to the trustee or bondholders. Moody's views legislation that specifically delineates the process, the responsible parties, and the timing as a strength, and the program would receive a strong score for this sub-factor. This factor comprises 20% of the notching output.

Debt Service Coverage

Moody's will calculate a debt service coverage ratio (DSCR) for each issuer participating in a post-default intercept program, and expect a minimum 1.5x ratio to attain the level of uplift provided by the scorecard. The DSCR will be calculated as (1) the issuer's current year state aid revenues, as appropriated in the state budget, divided by (2) current year debt service on all the issuer's debt that is enhanced by a pre-default intercept program as well as the post-default intercept program. Given the uncertainty around the notification of a default to the state (in most Moody's-rated programs), the DSCR is not a precise measure of how much revenue will be available to bondholders to recover a debt service default. The DSCR will serve as a screen to identify specific financings that will likely require an above-average recovery time due to low revenue availability. Issuers with a DSCR below 1.5x may receive an enhanced rating one or two notches below the outcome proposed in the rating scorecard. If an issuer has a relatively low DSCR, but has interceptable revenues in excess of current year state aid revenues, then the original scorecard outcome may be maintained.

Rating Outcomes and Ratings Below Investment Grade

The final scorecard outcome will represent a notching convention that will position the enhanced rating up to three notches above the underlying rating, capped at two notches below the state's general obligation rating. By starting the analysis with an assessment of the underlying credit, we will factor in the probability of default, given that these enhancements only become available after a debt service default has occurred. The enhanced rating will be capped at two notches below the state's general obligation rating to incorporate the credit quality of the entity providing the available revenues and implementing the intercept mechanics. The final notching for the enhanced rating will be rounded up from the scorecard outcome. For example, a financing with a final score of 1.50 would receive an enhanced rating two notches higher than its underlying rating.

Given the bottom-up approach in this proposed methodology, the enhanced ratings will move up or down in lock-step with the issuer's investment grade underlying rating, until they reach the point of being compressed as they near the state's general obligation bond rating.

If an issuer's public underlying rating falls to B1, which reflects a risk of default and projected 99% to 100% recovery, then the notching will be preserved until the enhanced rating reached B1, reflecting the expectation of full recovery from the state after the underlying default.

In cases where the underlying rating is in the speculative grade category, a rating committee will determine whether there should be any compression in the notching between the underlying rating and the enhanced rating. If the underlying rating continued to fall below B1, the enhanced rating will

remain at B1 based on the expectation that the state intercept program will guarantee nearly full recovery.

Bankruptcy Unlikely to Interrupt Intercept

Although municipal bankruptcies remain rare, recent cases have questioned the position of intercepted revenues in a bankruptcy case. This is a limited risk across the five rated post-default programs, as local governments do not have access to bankruptcy protection in Indiana, New York, and Virginia. In Arkansas and Pennsylvania, Moody's expects that a bankruptcy of an intercept participant would not interrupt or delay the intercept of revenues on behalf of bondholders. This expectation is primarily based on the strength of state statute to direct intercepted revenues, and the fact that interceptable revenues – which have not yet been disbursed – are owned by the state, not the local government participant. Further, each of the state statutes explicitly direct the controlling state official to redirect appropriations intended for the locality and use those funds to pay trustees on behalf of bondholders who have missed a payment until the missed payment is paid in full. In our view, since ownership of those funds remains with the state, we expect that interceptable revenues could not be included in the local government's bankruptcy estate. This is further supported by the City of Vallejo, CA bankruptcy case, in which the city and the bankruptcy court recognized that a state intercept had been triggered and did not apply the automatic stay to these revenues, allowing bondholders to be fully paid.

Although this was not fully litigated in court, the case settlement strongly suggests that these revenues would not be part of the bankruptcy estate.

Additional Factors Important to the Ratings

In addition to the scorecard, other qualitative factors will be considered by the analysts when rating financings enhanced by post-default intercept programs. These factors do not have a specific impact on the rating notching, but may influence a program's scoring when it falls between two categories. These include, but are not limited to:

- » the strength of documentation supporting program mechanics,
- » whether the program and mechanics have ever been tested and, if so, an assessment of how well the program performed, and
- » the level of state involvement and oversight in the program.

The strength and clarity of the language in the intercept's governing documents provides the foundation that enhances bondholders' level and timing of full recovery upon a default. As mentioned above, Moody's will review the clarity of the language at the beginning of the rating process to determine if there is sufficient authorization and state support to apply this methodology. Analysts will also factor the form of the documentation as a qualitative consideration in the final notching score. Governing documents can be in the form of constitutional provisions, statute, and procedural memos. In most of the programs rated by Moody's the intercept is authorized and defined through statute, which are considered strong but could be revised by the state legislature. Constitutional provisions are more difficult to revise because they generally require a full referendum; therefore these are considered a stronger governing document. In some states, the Treasury or Department of Education have produced additional documents, such as procedural memos and administrative notices, to further define the various programs' mechanics and timing of payments. Moody's views the clarity provided by these administrative documents as a strength, but notes that these are weaker than constitutional or statutory provisions.

The historic experience of the intercept program is also an informative qualitative input, but does not guarantee similar future outcomes therefore is not a factor in the scorecard. Although the post-default intercept programs have existed in statute for many years, there are a limited number of examples in which a state has remedied a default through withholding or intercept of state aid. In Pennsylvania and Indiana, the programs have each been tested on two separate occasions. In New York and Arkansas the post-default intercept programs have never been tested. Virginia's program has also not been used, however, the Virginia treasury has successfully tested the notice and payment process in a mock scenario. A demonstrated, successful test of the intercept program increases the likelihood, but does not guarantee, that future intercept requests will be fulfilled in a timely manner.

State commitment and oversight is also important to post-default intercept programs. The strength of state commitment to the program can be demonstrated through the governing documentation, historic experience, direct communications, as well as the state's approach to supporting other local governments outside the program. As mentioned above, programs rated under this methodology will have at least some level of state acknowledgement and support of the intercept. The level of ongoing oversight will influence the likelihood that a state will be prepared to respond quickly to an intercept request. Although none of the currently-rated intercept programs receive ongoing oversight by the state, oversight could come in the form of state approval to issue debt or state monitoring of financial health. Some states provide this type of oversight outside the scope of their intercept program, which will be factored into the issuer's underlying rating.

Methodology Implementation and Rating Implications

The enhanced rating will be capped at two-notches below the state's general obligation rating. This methodology will rely on a public underlying rating to assign or maintain an enhanced rating. It is possible that for some issuers without public underlying ratings, particularly in Arkansas and Pennsylvania, we may determine that we do not have sufficient current information to assign a public underlying rating. Therefore, we will likely withdraw those enhanced rating since they would no longer be consistent with the new methodology. In the state of Arkansas, there are approximately 260 issuers that do not have public underlying ratings and in Pennsylvania there are about 50. In the other states, there are very few issuers that do not have public underlying ratings. Going forward, Moody's assessment of a post-default enhanced rating will include assignment of an underlying rating and review of the scorecard presented here, incorporating the relative weighting of quantitative and qualitative factors important outlined above.

Additional Factors

This methodology, in addition to the scorecard, considers other qualitative factors when rating financings enhanced by post-default intercept programs. The aforementioned additional factors (refer to section "Additional Factors") could cause Moody's rating committee to deviate from the scorecard derived rating. Examples of notable deviations may be related to credit events like, but not limited to, whether the program and mechanics have ever been tested and if so, how well the program performed, the level of state oversight and involvement in the program, the strength of documentation supporting program mechanics, and the complexity of the flow of intercepted funds from the state to the trustee or bondholders. Moody's approach to the rating assignment will include some judgment on the part of the rating committee, and unusual circumstances may lead to outcomes that vary from what is expected based on this methodology. Depending on the circumstances, individual factors may not necessarily bear the same weight in the rating as other factors.

Appendix A: Pre-Default Intercept Scorecard

Program Level

Factor 1: State Commitment and Program History

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Available Funds	Unlimited, or limited to an amount at least equivalent to five times maximum annual debt service for a particular borrower.	Restricted to state aid appropriated for a particular borrower for the remainder of the state's fiscal year. Any balance of state funds appropriated, but not paid can be accelerated. Or, in the case of a limited advance intercept, a pool of funds equivalent to less than five times maximum annual debt service for a particular borrower.	Restricted to state aid appropriated for a particular borrower within a fiscal year, but with no opportunity to accelerate state aid payment dates; no clear documentation of what funds would be available.
State oversight of the program	Strong state oversight in areas of budgeting, debt issuance and/or remediation; review of state aid adequacy to cover debt supported by an intercept program.	No review by state officials prior to use of the intercept program; state is notified when debt supported by intercept has been issued.	No review by state officials prior to use of intercept program; state is not notified when debt supported by intercept has been issued; parties to the transaction may be small and/or inexperienced.
Nonimpairment	Statutory commitment by state with bondholders not to repeal, revoke, rescind, modify or amend the statutory authority for the intercept so as to limit or impair the security holders' rights and remedies.	Statute is silent on commitment to bondholders not to repeal, revoke, rescind, modify or amend the statutory authority for the intercept so as to limit or impair the security holders' rights and remedies.	Explicit statement by state that it retains the right to repeal, revoke, rescind, modify or amend the statutory authority for the intercept or to reduce state aid.
Expectation of Continued State Support	Statewide program for essential public facilities.	Statewide program for moderately essential public facilities or narrowly focused program to benefit an essential public facility.	Narrowly focused program to benefit less essential public facilities.
Program History	Program has been utilized; notifications were timely and bondholders were paid on time and in full.	Program has not been utilized but documentation suggests that, if utilized, there would be sufficient time and money to pay bondholders in full and on time.	Program has not been utilized and there is some doubt as to whether security holders would be paid in full and on time or program was utilized and there were instances of late payment.

Factor 2: Program Mechanics

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
State's Documentation of Intercept Mechanics	Intercept mechanics documented in statute(s) and/or administrative rulemakings.	Intercept mechanics documented in attorney general opinions, memoranda of understanding, and/or administrative procedures.	Lack of significant documentation of mechanics. Documentation that exists may be unclear or, in fact, may be conflicting or contradictory. In the absence of written documentation, state officials may offer verbal explanation of intercept mechanics.
Required Notification to State Related to Insufficiency of Funds	Direct advance intercepts whereby the schedule for payment of state aid for purposes of paying debt service is established upon closing of the bond issue and no other notification is required. For those programs requiring notice, notice should be at least one week prior to scheduled debt service payment date.	Direct advance intercepts where vouchers must be presented prior to payment of state aid. For those programs requiring notification, such notification should be at least three days prior to scheduled debt service payment date.	Notification is less than 3 days prior to scheduled debt service payment date.
Timing of Intercept Payment by State	State is required to forward state aid for debt service payments at least three days prior to scheduled debt service payment date.	State is required to forward state aid for debt service payments at least two days prior to scheduled debt service payment date.	State is required to forward state aid for debt service on the scheduled debt service payment date. Evidence of intent to forward state aid for timely payment of debt service in the absence of specific instructions to do so.
State Budget Timing	State always passes its budget on time, or, if not, (i) it has a history of adopting continuing resolutions or interim budgets so that funds will be available for intercept or (ii) it has statutory authority for appropriating interceptable aid in the absence of an adopted budget.	State has usually adopted its budget in time to make state aid available for timely debt service payments; may not have employed a continuing resolution or interim budget, but has the authority to do so or has statutory authority for appropriating interceptable aid in the absence of an adopted budget.	State has (i) a history of late budget adoption, (ii) no provision for continuing resolutions or interim budgets and/or (iii) no statutory authority for continuing state aid intercepts in the absence of an adopted budget; late state budget may result in a temporary lack of funds available to be intercepted.
State's Mandate to Act	State will immediately advance funds.	Series of approvals required, each with its own time parameters set forth in statute or an administrative order.	Lack of clarity; no specific guidance on required approvals.

Financing Level

Factor 3: Sufficiency of Interceptable Revenues

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Debt Service Coverage ^[1]	Greater than 1.5 times	Generally between 1.25 times and 1.5 times	1.0 to 1.25 times
Reliance on Final State Aid Payment	Stress test of debt service coverage provides 1.5 times coverage of each debt service payment even without state aid scheduled to be paid in the last month of the state's fiscal year.	Stress test of debt service coverage provides at least 1.25 times coverage of each debt service payment even without state aid scheduled to be paid in the last month of the state's fiscal year.	Stress test of debt service coverage provides less than 1.25 times coverage of each debt service payment without consideration of state aid scheduled to be paid in the last month of the state's fiscal year.
Stability of State Aid Payments	Record of increasing state aid even in periods of fiscal stress, fluctuations in population or other components of formulaic aid. All unlimited intercept programs should be scored as "strong".	Record of flat state aid even in periods of fiscal stress, fluctuation in population or other components of formulaic aid.	Record of declining/fluctuating state aid in periods of fiscal stress or fluctuation in population or other components of formulaic aid.
First Use of State Aid Payments	All unlimited advance intercepts. Direct advance intercepts whereby 100% of the amount of state aid required for debt service is sent directly to the paying agent prior to the payment of any state aid to the local unit of government. Other programs for which it is documented that the debt service is paid from intercepted state funds prior to its use for other purposes.	Not applicable.	State funds sufficient to make debt service payments for the entire fiscal year are not set aside before some or all of these interceptable funds have been used for other purposes.

[1] Debt service coverage throughout this document means, for each Debt Service Payment Date, a ratio of (i) interceptable state aid to (ii) debt service due on that date. Debt service payment date is defined as a given month and day when debt service comes due. Interceptable state aid refers to any interceptable payments included in the most recently adopted state budget available to make scheduled payments of debt service (by acceleration or otherwise), less the excess, if any of (a) debt service due on a debt service payment date earlier in the fiscal year less (b) interceptable state aid expected to be remitted between that debt service payment date and the current debt service payment date. Debt service refers to the largest aggregate amount due on a given debt service payment date over the life of the bonds, for all parity debt.

Factor 4: Transaction Structure

Subfactor	Strong/Yes	Average/Not Applicable	Weak/No
Presence and Role of Fiduciary/Conduit	State aid is sent directly to a trustee, paying agent or conduit issuer with a professional staff and no notification is required.	Relatively new or small conduit issuer. Trustee, paying agent or conduit issuer is explicitly required, by statute or contract, to notify the state on a timely basis, of a need for interception of state aid.	State aid is sent to the local unit. Trustee, paying agent or conduit issuer is not explicitly required to notify the state on a timely basis, of a need to intercept state aid.
Reserve Fund	A reserve fund is established to guard against late intercept payments. All unlimited and directly funded intercepts should be scored as "strong."	Lack of a reserve fund for limited and current year intercepts when notification requirements, mechanics and the availability of funds should ensure timely debt service payments.	Lack of a reserve fund when notification requirements, mechanics and the availability of funds may not ensure timely debt service payments.

Appendix B – Summary of Pre-default Program Ratings

State	Program	Program Type	State G.O. Rating as of 1/1/2013	Program Rating As of 1/1/2013	Notches Lower than State G.O. Rating
CO	CO School District Enhancement Program (Section 22-41-110)	Unlimited Advance	None ^{[1]*}	Aa2 Stable	Not applicable
CO	CO Higher Education Enhancement Program	Unlimited Advance	None ^{[1]*}	Aa2 Stable	Not applicable
GA	GA School District Intercept Program (Section 20-2-170)	Current Year	Aaa Stable	Aa1 Stable	1
KY	KY Public University Intercept Program (Act 164A.608)	Unlimited Advance	Aa2 Negative ^{[2]*}	Aa3 Negative	1
KY	KY School District Enhancement Program [157.627 (5) and KRS 160.160(5)]	Unlimited Advance	Aa2 Negative ^{[2]*}	Aa3 Negative	1
MA	MA Qualified Bond Program (MGL Chapter 44A)	Directly Funded	Aa1 Stable	Aa2 Stable	1
MD	MD Infrastructure Financing Intercept Program	Current Year	Aaa Negative	Aa1 Negative	1
MN	MN Credit Enhancement Program	Unlimited Advance	Aa1 Negative	Aa2 Negative	1
MN	MN School District Credit Enhancement Program	Directly Funded	Aa1 Negative	Aa2 Negative	1
MO	MO Direct Deposit Agreement Intercept Program	Directly Funded	Aaa Stable	Aa1 Stable	1
NJ	NJ School Qualified Bond Program (Title 18A)	Directly Funded	Aa3 Stable	A1 Stable	1
NJ	NJ Municipal Qualified Bond Program (Title 40A)	Directly Funded	Aa3 Stable	A1 Stable	1
ND	ND Department of Public Instruction School District Credit Enhancement Program	Current Year	Aa1 Stable ^{[2]*}	Aa3 Stable	2
NM	NM School District Enhancement Program (NMSA 1978 Section 22-18-13); Pre 3/30/07	Limited Advance	Aaa Negative	Aa1 Negative	1
NM	NM School District Enhancement Program Post 3/30/07	Limited Advance	Aaa Negative	Aa1 Negative	1
NY	DASNY OMRDD Intercept Program	Current Year	Aa2 Stable	Aa3 Stable	1
NY	DASNY Master BOCES Program (Public Authorities Law 1689.10)	Current Year	Aa2 Stable	Aa3 Stable	1
NY	DASNY Court Facilities Program (Dormitory Authority Act, Article 8)	Current Year	Aa2 Stable	Aa3 Stable	1
NY	DASNY Municipal Health Facilities Program (Chapter 392 of Laws of 1973, Section 8)	Current Year	Aa2 Stable	Aa3 Stable	1
NY	DASNY School District Revenue Bond Financing Program (Public Authorities Law 1680.38)	Current Year	Aa2 Stable	Aa3 Stable	1
OH	OH School District Credit Enhancement Program (Revised Code 3317.18)	Current Year	Aa1 Stable	Aa2 Stable	1
OH	OH Technical and Community College Program	Other	Aa1 Stable	Aa2 Stable	1
OR	OR Pension Obligation State Intercept Program (ORS 238.692 to ORS 238.698)	Directly Funded	Aa1 Stable	Aa2 Stable	1
PA	PA State Public School Building Authority Lease Intercept Program	Directly Funded	Aa2 Stable	Aa3 Negative	1
PA	PA School District Fiscal Agent Agreement Intercept Program (Section 633)	Current Year	Aa2 Stable	Aa3 Negative	1
RI	RI Health and Education Building Corp. Intercept Program	Current Year	Aa2 Negative	A1 Negative	2
RI	RI HEBC 6-Month Intercept Program	Current Year	Aa2 Negative	Aa3 Negative	1
SC	SC School District Credit Enhancement Program (SC Code of Laws Section 59-71-155)	Limited Advance	Aaa Stable	Aa1 Stable	1
TN	TN State School Board Authority Higher Ed. Intercept Program	Limited Advance	Aaa Stable	Aa1 Stable	1
TN	TN State School Bond Authority Intercept Program	Other	Aaa Stable	Aa1 Stable	1

[1] The state has no G.O. rating. Certificates of participation are rated Aa3 with a stable outlook

[2] The state has no G.O. rating. This rating represents an issuer rating.

Appendix C: Post-Default Intercept Scorecard

Post-Default Intercept Scorecard

	1 Notch Up	2 Notches Up	3 Notches Up	Weight
Revenue Sufficiency				
Available Funds	Current year aid is interceptable and it cannot be accelerated.	Current year aid is interceptable and it can be accelerated.	Current and future year aid are interceptable and both can be accelerated.	0.2
Timing of State Aid Payments	State aid is distributed in a pattern that could weaken revenue availability OR risk of material delays due to late state budget.	State aid is distributed in a pattern that has a neutral impact on revenue availability OR no risk of material delays due to late state budget.	State aid is distributed in a pattern that could increase revenue availability AND no risk of delays due to late state budget.	0.15
State Aid Trend	Expectation of large or persistent declines in state aid and/or occasional state aid deferrals.	Expectation of flat state aid and/or very infrequent state aid deferrals isolated to no history of deferring aid to school periods of state fiscal stress.	Expectation of increasing state aid and districts.	0.15
Timing & Mechanics				
Strength of Notification Requirement	No trustee is in place and no specified party is required to notify the state. Actual notification is uncertain.	A trustee is in place, but not specifically charged with notifying the state promptly upon default.	A specified party or trustee is charged with notifying the state promptly upon default.	0.3
Timing between notification and intercept	No clear mechanics regarding process or timing. Timing is uncertain.	Process is clearly laid out but timing is not specified, or will take more than two weeks after notification.	Process and timing are clearly laid out and will support an intercept of revenues within 2 weeks of notification.	0.2
			Total Score	
			Debt Service Coverage < 1.5x (-1 to -2 notches)*	
				Total Uplift

* Debt Service Coverage will be determined at the financing level

Appendix D: Summary of Post-Default Intercept Programs

State	Program	State G.O. Rating as of 1/1/2013	Program Rating prior to release of methodology	Notches Lower than State G.O. Rating
AR	AR School District Enhancement Program	Aa1 Stable	Aa3 Stable	2
IN	IN School District Enhancement Program	Aaa Stable	Aa2 No Outlook	2
NY	NY State Section 99-B Intercept Program	Aa2 Stable	A1 Stable	2
PA	PA Act 150 School District Intercept Program	Aa2 Stable	A1 Stable	2
VA	VA Localities Intercept Program	Aaa Negative	Aa3 Negative	2

Arkansas School District Enhancement Program

- » Current programmatic rating: Aa3 with a stable outlook
- » 266 outstanding enhanced ratings

The State of Arkansas has recently passed legislation implementing new intercept program requirements for bonds issued by school districts after July 1, 2013. The new requirements include, but are not limited to: early notification requirements of an insufficiency of funds; pre-default intercept of state aid remitted to a trustee for debt service; and specific timing of payments by the state relative to a scheduled debt service payment date. The new legislation does not address bonds issued before July 1, 2013, therefore enhanced ratings on outstanding debt will continue to be under the current, post-default program.

In 1997, the Arkansas state legislature enacted statute *A.C.A. § 6-20-1204* which reads, "As additional security for the payment of any bond of a school district, the State Board of Education shall cure any delinquencies in payment by withholding state aid due to the district." This statute forms the basis for the state's post-default intercept program, which encompasses all school district bond issuances without additional application or approval.

State statute further details the process by which payments would be made in the event of a default. "Whenever the designated paying agent for receipt of the district's payments does not receive a payment when due pursuant to the authorizing documents, the paying agent will be entitled to payment from the withheld state aid in any amount sufficient to cure the payment deficiency upon notifying the Commissioner of Education and the superintendent of the school district by telephone, facsimile, or other similar communication followed by written verification" *A.C.A. § 6-20-1204(c)(2)(A)(i)*. If a school district is delinquent on more than one obligation, the commissioner will transfer payments to the paying agent in the order in which notifications of default were received.

School districts in Arkansas receive state aid in eleven equal monthly installments with the exception of July. While state statute does indicate that the Commissioner would continue to withhold monthly state aid until the deficiency is cured, the State Board of Education also notes that it is unclear how much unencumbered state aid, if any, is available for intercept.

The program has never been tested and the statutory language regarding program mechanics is vague. Thus, it is difficult to determine how quickly and efficiently defaults would be cured. Prior to the enactment of the post-default statute, the state carried out a post-default payment for the Lake View

School District in the summer of 1994, which demonstrates the state's willingness to execute an interception.

Indiana School District Enhancement Program

- » Current programmatic rating: Aa2 with no outlook
- » Eight underlying ratings have outstanding enhanced ratings

The Indiana Post Default Enhancement Program is offered to all school districts in the state. It authorizes the state treasurer to intercept state aid in order to make bond or lease rental payments in an event of default by a school district or school corporation. Typically, Indiana school districts issue debt through a conduit corporations (such as a building corporation) that are payable from and secured by a first mortgage lien on the proposed project or school facility and rental payments which are payable from the levy of ad valorem property taxes on all taxable property within the school corporation's boundaries.

Under the program, if the district fails to pay any debt service obligations on time and in full, the state treasurer is notified by the claimant, which is defined as the underwriter or bondholder. The program's authorizing legislation does not mandate when that notification must occur, however, a weak provision of its mechanics that means the notification may only happen after a missed payment. Favorably, the statute directs the treasurer to withhold state aid payments from current and future year's allotments until the deficit has been cured. The statute also allows school districts to utilize available aid to pay past and current debt service obligations. Indiana's program has existed since 1965, but has been tested on only two separate occasions. The two known cases involved fraudulent actions by the same financial advisor and neither credit was rated by Moody's.

School districts typically receive monthly distributions of state aid between January and December; based on the state's July 1 start to its fiscal year, the risk of delays due to a late state budget are minimal. Indiana has not passed a budget late since 1887. Additionally, local governments including school districts benefit from strong governance with regular monitoring and fiscal intervention by the state. All Indiana local government budgets are reviewed by the state's department of local government finance to determine if levies and appropriations are sufficient to cover debt service obligations. If insufficient, the department has the authority to increase them to adequate levels. While we view this as a credit strength, this strong governance feature is incorporated into an issuer's underlying rating and does not factor into the intercept program rating. Overall, the legal structure of Indiana's intercept program does not provide clear timing and mechanics and does not expressly define the process for payment. However the state is strongly committed to the program, given the mechanics which provide the treasurer with the authority to intercept current and future aid to cure any debt service obligation.

New York State Section 99-B Intercept Program

- » Current programmatic rating: A1 with a stable outlook
- » 195 outstanding enhanced ratings

New York's school debt enhancement program, contained in Section 99-B of the State Finance law, authorizes the state to withhold state aid in order to make bond payments in the event of default by a school district. Following default, and subsequent notification by a bondholder of a missed payment, the Comptroller is directed to investigate and verify the principal and interest amounts in arrears. The

State Comptroller will then deduct sufficient funds to pay these amounts from succeeding allotments of state aid.

Although enacted in 1959, the law has never been tested, and some of the program's precise mechanics, including which sources of school building aid would be made available and timing of notification, are not clearly specified in the authorizing legislation. The program does not ensure avoidance of a pending default or guarantee immediate repayment.

The risks associated with the failure of New York's state legislature to pass an annual budget on time and reductions in aid to school district's are generally mitigated by a state mandate to appropriate state aid to school districts in advance of final budget approval. The risks associated with this and the uncertainty regarding how quickly and efficiently defaults would be cured will drive individual reviews of the enhanced rating for all school districts. There are currently 195 school district's with enhanced ratings with a total \$1.9 billion in enhanced rated debt outstanding.

Pennsylvania Act 150 School District Intercept Program

- » Current programmatic rating: A1 with a stable outlook
- » 243 outstanding enhanced ratings

The Pennsylvania Act 150 School District Enhancement program is authorized under Sections 633 and 785(A) of the Public School Code of 1949. The intercept has been tested twice; both times, voluntary notification came early, enabling the mechanism to operate successfully prior to default. In an instance of default, the Secretary of Education would continue to withhold state aid until the deficiency is cured. Payments can be withheld into the subsequent fiscal year if necessary. Payments can be accelerated within the current fiscal year and all forms of state aid are interceptable.

State aid payments to Pennsylvania school districts are distributed evenly throughout out the fiscal year with approximately 35% of payments distributed in the last quarter of the fiscal year. The fiscal 2012 budget was the first state budget passed on time in 8 consecutive fiscal years with the fiscal 2010 budget being dramatically late. However, there are certain programmatic mechanics that aid in ensuring appropriations despite delays in state budgets.

While the program does not have a notification requirement there are specific mechanics in place to aid in timely recovery once notification has been received. A Memorandum of Agreement (MOA) signed by the Secretary, the Labor, Education and Community Services Comptroller ("Comptroller") and the State Treasurer established procedures all parties are to follow as set forth by the act. Notification of a deficiency or possible deficiency can be made to the secretary by: a school district; bond trustee; depository; bondholders; other entity. The Secretary has 2 business days to ascertain the amount of state appropriation due to the defaulting school district and deliver to the Comptroller a notice stating the amount of state aid due to the district that should be intercepted. The Comptroller then has 2 business days from the receipt of the notice from the Secretary to approve payments and prepare and deliver a pay voucher to the State Treasurer. If the Comptroller disapproves any or all of the payments he or she shall immediately notify the Secretary and provide specific objections to approval. The State Treasurer has 2 business days from the receipt of the pay voucher from the Comptroller to approve the intercept payment. If the State Treasurer approves the payment, he or she then has 2 business days to make a wire transfer of the payment to the Depository.

Virginia Localities Intercept Program

- » Current programmatic rating: Aa3 with a negative outlook
- » 11 outstanding enhanced ratings

The Virginia Localities Intercept Program is authorized under Section 15.2-2659 in the Code of Virginia. The program covers the general obligation debt of all local governments in Virginia but currently the enhanced programmatic rating is applied upon request only to issuers that meet two conditions; (1) they must document that they use a paying agent who will be responsible for timely notification to the commonwealth in the event of a payment default; and (2) their annual state aid must cover maximum annual debt service by approximately two times. The program is currently rated Aa3 with a negative outlook.

In the event of a default, the commonwealth may be notified by a bond holder, paying agent, or bond trustee. Once notification has been received, there are specific procedures for officials to follow which are designed to ensure payment is made on the same business day if notification was received by 10 a.m. or by the next business day if notification was received after 10 a.m.

Upon notification of a default, the state treasurer investigates the matter and upon confirmation directs the comptroller to withhold all further funds appropriated and payable by the commonwealth to the locality until the default is cured. If the amount of state aid that is currently appropriated and payable to the locality is sufficient, the commonwealth makes the full payment that has been defaulted upon to the bondholders. If the default amount exceeds the current amount of state aid appropriated and payable, future additional funds are only available to be intercepted and advanced once additional state aid is considered appropriated and payable.

The intercept has never been used for a debt payment default but the notice and payment process has been tested by the treasury to ensure that its processes work properly. Virginia operates on a biannual budget with state aid distributed evenly throughout the year. All localities in Virginia receive some form of payment from the state that can be intercepted.

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Rating Guidelines for State Credit Enhancement Programs

Sector-Specific Rating Criteria

This report updates the report of the same title published on June 19, 2012.

Scope

Many states have programs designed to enhance the credit quality of local borrowers with the goal of broadening market access and lowering the cost of capital. Such programs include state aid intercepts, state guarantees, state direct-pay obligations and permanent fund commitments. The enhancement programs most commonly support long-term borrowing by school districts, but have been developed for other types of local borrowers as well.

This criteria report covers programs that provide enhancement linked to a state's general credit quality. The enhancement provided by permanent funds, for which ratings are unrelated to the state's general credit quality, is not assessed using these criteria, but, rather, is covered in issuer-specific rating commentary.

There are no material changes to the previous version of this criteria.

Key Rating Drivers

Program Rating Replaces That of Borrower: U.S. state government credit enhancement programs provide for timely payment of debt service from state sources if the borrower cannot make payments on its own. As such, the credit quality of the program replaces the underlying credit quality of the borrower.

Revenue Adequacy and Stability Key: In determining the credit quality of the program, Fitch Ratings considers the historical and prospective adequacy of state funds available to pay bond debt service to be critical. With intercept programs, the focus is on debt service coverage (DSC) by state funding flows to a local borrower. For bonds backed by a state's GO guaranty, the power of the state's full faith and credit pledge as expressed in its GO rating reflects adequacy. For other direct-pay programs, state resources available for debt service are evaluated.

Timely Payment By State Funds Required: Fitch focuses on the ability of the enhancement program to provide for full and timely payment of debt service. Fitch's state credit enhancement program criteria are not applied in cases where payment would most likely be delayed until after bond payment dates.

State Credit Quality Key: The state's general credit condition — expressed through the state GO rating — is a key rating consideration for the enhancement program, since the same factors considered in rating GO bonds affect the state's ability to support the payment of local debt.

Related Criteria

Tax-Supported Rating Criteria (August 2012)

U.S. State Government Tax-Supported Rating Criteria (August 2012)

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Analytical Considerations

State credit enhancement programs use different methods to avoid a bond default if the borrower cannot pay debt service. In cases of state guaranties, states pledge their full faith, credit and taxing power as a backup. For other direct state payment programs, states commit to provide direct payment from their general fund or another revenue source. In intercept programs, in the event the borrower fails to make a scheduled payment to the paying agent, the state agrees to intercept for bondholders state funds previously appropriated but not yet disbursed to the borrower. Intercept programs are most commonly used to enhance debt issued by school districts, which in most cases receive a significant amount of state aid.

The following factors are considered in assigning ratings for all state credit enhancement programs.

Timeliness

For a program to provide enhancement, procedures should be set forth under state law, regulations and/or administrative guidelines so state payments can be directed to bondholders by debt service payment dates. Notification requirements by paying agents should allow the state sufficient time after a borrower deficiency has been reported to transfer necessary funds to bondholders on or before bond payment dates. No enhancement is provided in cases where payment would most likely be delayed until after bond payment dates.

Revenue Adequacy and Stability

Fitch considers the historical and prospective adequacy of state funds available to pay bond debt service. With intercept programs, annual state funding flows to an issuer must meet minimum DSC levels from historical revenues for the issuer's bonds to earn the enhancement program rating. For school districts, which have historically benefited from substantial and stable-to-growing state funding, Fitch generally looks for DSC of 1.25x–1.50x. For borrowers who provide less essential government services and are therefore more exposed to the potential for significant state funding reductions, DSC ranging from 1.75x–2.0x or higher would be expected.

For local bonds backed by a state's GO guaranty, the power of the state's full faith and credit pledge, as expressed in its GO rating, reflects the adequacy of revenue. For other direct payment programs, the general fund or other specific state resources that are dedicated to debt service are evaluated for adequacy, and the state's creditworthiness remains a key credit factor. In cases where Fitch does not maintain a GO rating for the relevant state, Fitch will conduct an internal review to arrive at the credit quality of the state's GO.

State GO Guaranties

Under GO guaranty programs, states pledge their full faith and credit to the payment of certain local government bonds if the issuer fails to meet its obligation. Therefore, the state's GO bond rating also applies to the enhanced debt of the issuer, as long as timeliness and legal considerations have been satisfied.

Direct Payment Commitments

Some states commit themselves to paying borrower debt service from all or part of their general funds or another specific funding source in the event the local borrower's payment is insufficient. Fitch evaluates the breadth and strength of the state funding commitment in

determining the enhancement program rating. Because these commitments are less expansive than GO full faith and credit pledges, the credit enhancement program rating is at least one notch lower than the state's GO rating, even if the pledge is from the state's entire general fund and can be lower if the commitment is of a more narrowly defined funding source. In these cases, Fitch evaluates the quality of the revenue stream pursuant to state tax-supported rating criteria.

Intercepts

Intercept programs require states to divert to bondholders appropriated, but not yet disbursed, state funds otherwise due to a local borrower when needed to cover that borrower's payment deficiencies. Considered in the intercept program rating process are features of the intercept mechanism, historical and projected DSC levels by interceptable state funding and debt payment timing. Intercept programs that provide an enforceable mechanism and adequate coverage to ensure timely debt service payments to bondholders if the issuer is unable to make its payment will typically be rated one notch lower than the state's GO rating, on par with the rating on most state appropriation debt.

Program Mechanisms

Fitch reviews intercept program mechanics, as expressed in state statute, interagency agreements or through constitutional provisions, to understand how appropriated state funding not yet disbursed to the local borrower would be channeled to bondholders on a timely basis if needed to pay debt service. As noted above, the mechanism should include notice of a deficiency to the state, favorably by a paying agent but in no case solely reliant on the borrower, by a date that gives the state time to provide the necessary funds for debt service.

For an intercept rating to be applied to variable-rate debt, it must be established that the intercept mechanism works with the provisions and remedies of any third-party bank credit enhancement or liquidity-support agreements. Fitch also reviews details of each state's finance and budgeting structures to determine whether and how the intercept would function in the event the state is late in adopting its budget.

Coverage

Historical and projected state funding revenues must comfortably exceed debt service costs for all local bonds that benefit from the intercept to receive Fitch's enhanced intercept program rating for a given program. The level of MADS coverage by historical revenues necessary for a transaction to be assigned a program rating one notch below the state GO is 1.25x–1.50x for school districts that historically have seen generally growing annual support due to the states' responsibility for funding education.

Nonschool district borrowers may require significantly higher coverage levels to receive the program rating, or Fitch may not be able to assign a program rating to a nonschool district, regardless of the coverage level, due to greater potential volatility in the state funding for less essential services.

In addition to annual calculations, Fitch also reviews the timing of state funding receipts during the year when considering whether sufficient coverage by interceptable funds will be available on each debt service payment date. For pooled financings, concern where annual or interceptable period coverage levels are not met by a portion of borrowers can be mitigated by the involvement of and issuance through a state bonding authority that Fitch expects would

exercise a strong commitment to avoiding a default, although this may be reflected through additional notching below the state's GO rating.

Process for Assigning Enhanced Ratings

Analysts in Fitch's state ratings group are responsible for assigning the programmatic ratings for state credit enhancement programs using these criteria. The application of these program ratings to specific bonds is typically the primary responsibility of analysts in the local tax-supported group. The analyst for the local government issuer, in consultation with the state ratings group, will review the parameters of the specific borrowing to ensure that the issue qualifies for the programmatic rating. In cases where a local borrower's acceptance into a state program is a necessary precondition for the enhancement, Fitch will confirm such acceptance.

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