

**Sector-based approach to special tax instruments**  
**August 2024**



## Webinar Series



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# Special tax debt

## Encompasses a variety of debt instruments :

- Pledges of taxes other than real property.
- Assessments or fees levied on economic activity.
- Transaction based charges.
- May be contingent or non-contingent.

## Examples of such pledges include:

- Assessments or fees on a variety of consumer purchases, such as retail sales, hotel stays, food and beverage sales or gasoline sales.
- Income taxes; business taxes; real property transfer taxes.
- Assessments on payrolls, insurance policies or other non property bases.
- Fixed or formulaic allocations of such special taxes from a higher level of government.

# Incorporating special tax in sector-based methodologies

## Recap of methodology updates

- Expanded the instrument guidance frameworks in three sector methodologies to include special tax instruments.
  - US K-12 Public Schools
  - US States & Territories
  - Cities & Counties
- Special tax bonds of these governments are now rated relative to the entity's issuer rating.
- These methodology updates follow a Request for Comment (RFC) that Moody's published on Jan. 16.
- This update reflects our view that the general economic, operational and financial profiles of the governments are a primary driver of credit strength or weakness for many special tax debt instruments.
- Scope of special tax methodology was narrowed.

# Issuer and debt instrument ratings



**Issuer Rating**

Fundamental credit quality

+



**Instrument Considerations**

Evaluation of debt instrument characteristics

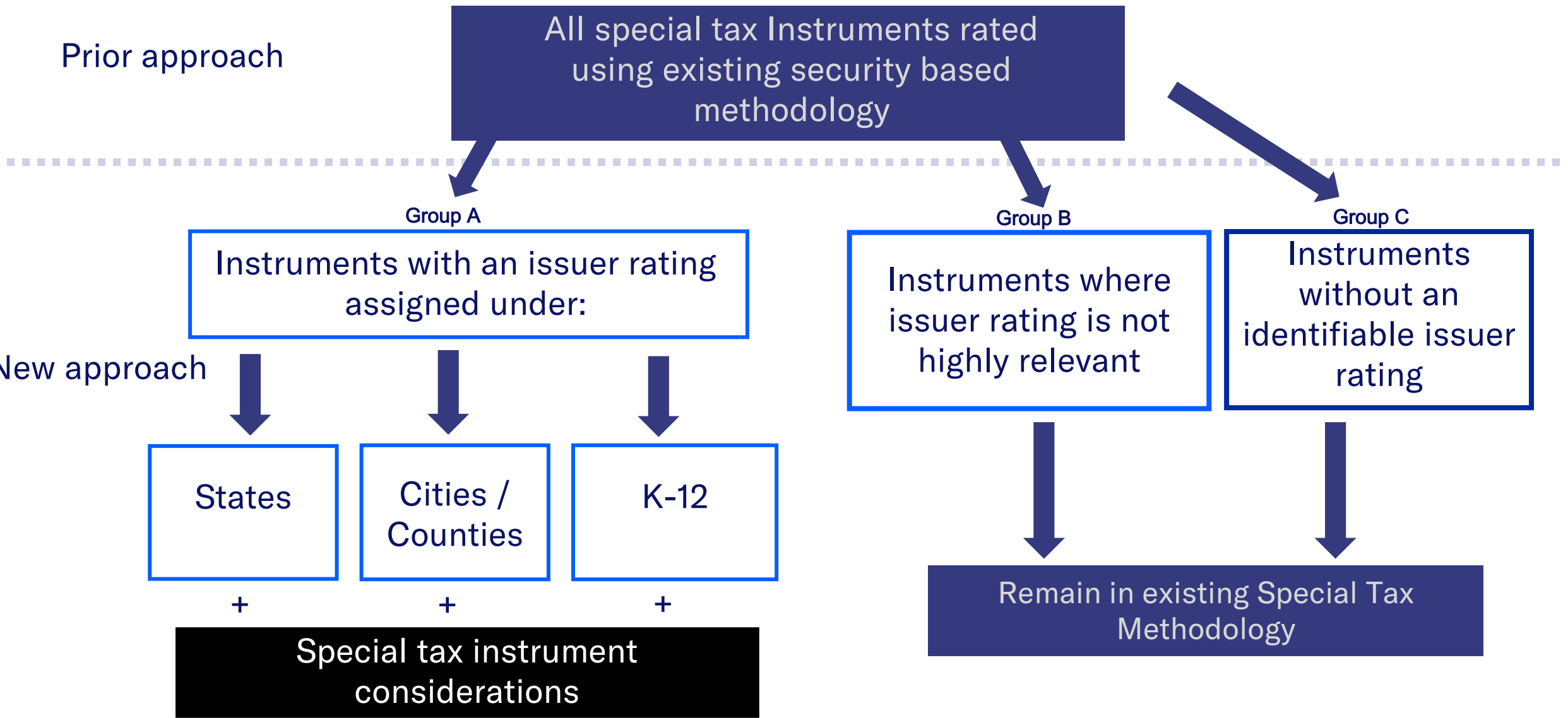
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**Debt Instrument Rating**

Placed relative to issuer rating

# Methodology placement for special tax credits



# Remains in special tax methodology

## Regional Transit Authority

- *Pledge:* 1% sales taxes collected throughout the city and county
- *Revenue detail:* Tax is levied by the county, allocated to the transit system, and remitted directly to the trustee
- *Rationale:* Independent transit board is appointed by multiple jurisdictions; operating risk of the transit system is not captured in the county issuer rating

## Regional Convention Center

- *Pledge:* Sales and hotel taxes collected throughout the city and county
- *Revenue detail:* Tax is levied by the city and the county and assigned to the trustee through the conduit issuer
- *Rationale:* The taxes are levied by multiple jurisdictions and therefore one issuer rating from which the instrument rating would be notched cannot be determined

## City Center Mall

- Sales taxes levied only at one specific mall, not city-wide.
- *Revenue detail:* Tax is levied by the state and remitted to the city monthly.
- *Rationale:* The taxes are levied on a geographic area significantly more narrow than the obligor's overall economic base

# Moved to sector methodology

## City Sales Tax Bonds

- *Pledge:* Senior lien on 1% of the city's authorized sales tax levied on most retail activity across the entire city.
- *Revenue detail:* Tax is levied by the city

## County Sales Tax Bond

- *Pledge:* Annual fixed allocation from the state of broad sales tax levied across the state
- *Revenue detail:* Tax is levied by the state and allocated/remitted to the county as authorized by state statute

## County Convention Center Bonds

- *Pledge:* County's local and state-shared hotel taxes
- *Revenue detail:* Local hotel taxes are levied by the county and state-shared hotel taxes are levied by the state and allocated/remitted to the county as authorized by state statute



# General approach for assigning instrument ratings

**SECURITY FEATURES**

Do security features enhance or detract from the revenue pledge?

**ACTIVE OR PASSIVE**

Does the issuer have the ability to adjust or otherwise actively manage the pledge?

**CHARACTERISTICS OF REVENUE BASE**

What is the breadth, stability, and diversity of the pledged revenue base relative to the issuer?

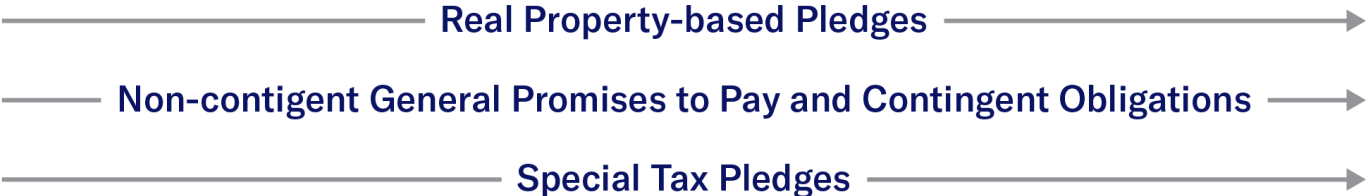
**DEBT SERVICE COVERAGE**

What level of debt service coverage do pledged revenues provide?

**OTHER FACTORS**

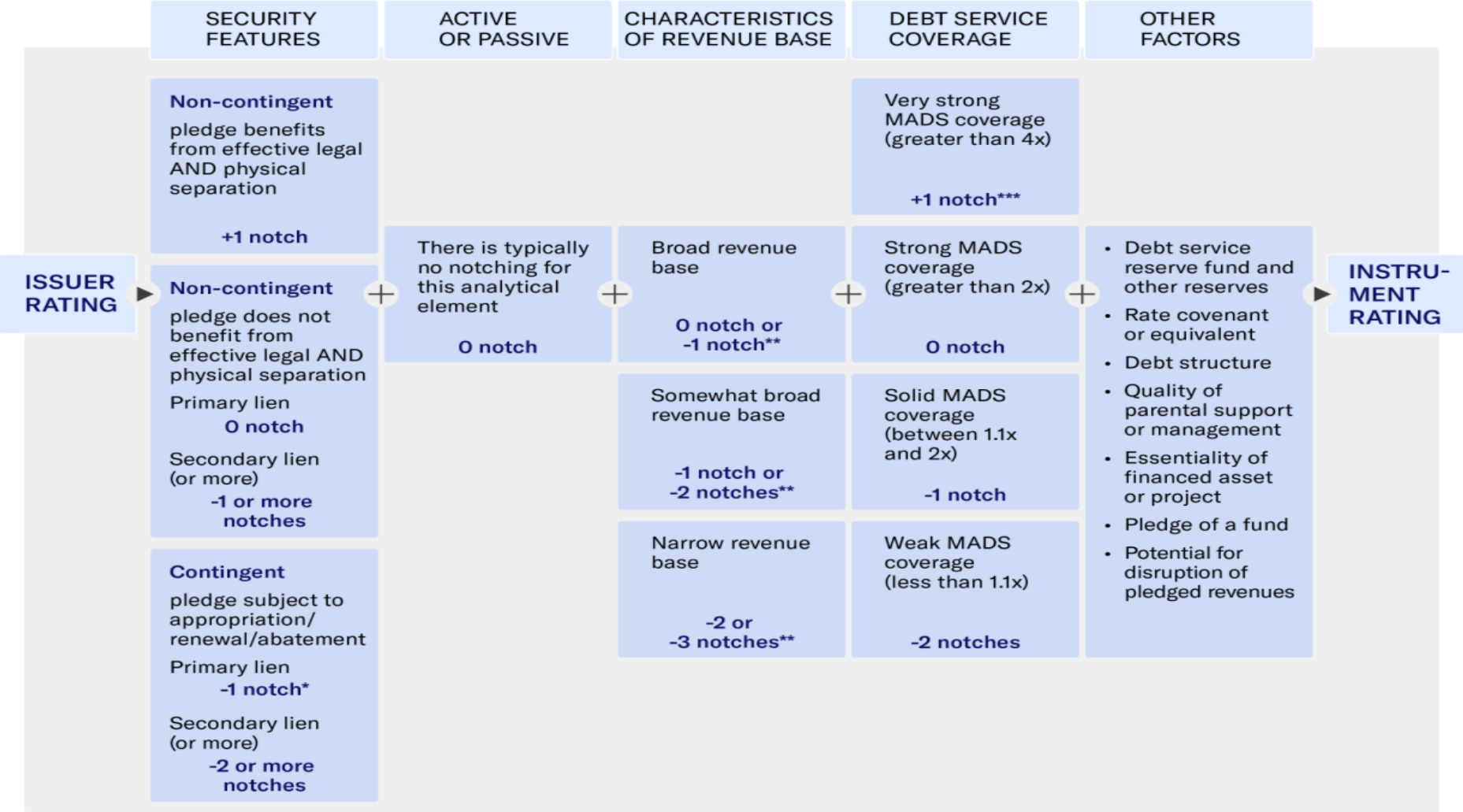
- Essentiality
- Other instrument specific risks or strengths

**ISSUER RATING**



**INSTRUMENT RATING**

# Special tax pledges: Illustrative notching



# Characteristics of the revenue base

## Classifications for most common revenue types

### Broad (0 notch or -1 notch)

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- Sales and use tax
- Income or payroll tax
- Assessments on payrolls, insurance policies or other non-property bases

### Somewhat Broad (-1 or -2 notches)

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- Utility franchise tax or fees
- Utility user tax, fees and surcharges
- Gasoline tax
- Restaurant food or beverage tax
- Motor vehicle registration and similar surcharges or fees
- Liquor tax
- Allocations of somewhat broad taxes from higher levels of government

### Narrow (-2 or -3 notches)

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- Hotel tax or fee
- Cigarette tax
- Gaming tax (other than lottery)
- Extraction and production of natural resource tax
- Real estate transaction tax
- Parking tax
- Motor vehicle rental tax
- Lottery tax
- Court fines and fees
- Allocations of narrow taxes from higher levels of government

# Ratings impact

**Approximately 80% of special tax credits are now rated under the sector methodologies**

- With the release of the updated methodologies, we placed 236 ratings on review for possible change.
  - 226 ratings on review for upgrade
  - 10 ratings on review for downgrade
  - Upgrades will largely be by one notch, with some credits potentially up to 3 notches
  - Downgrades will largely be by one notch, with some credits potentially up to 2 notches
- Ratings placed on review are typically resolved in 90 days
- 148 ratings were affirmed

# Questions and answers

# Thank you

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