

U.S. Public Finance Quarterly Update: Q4 2023

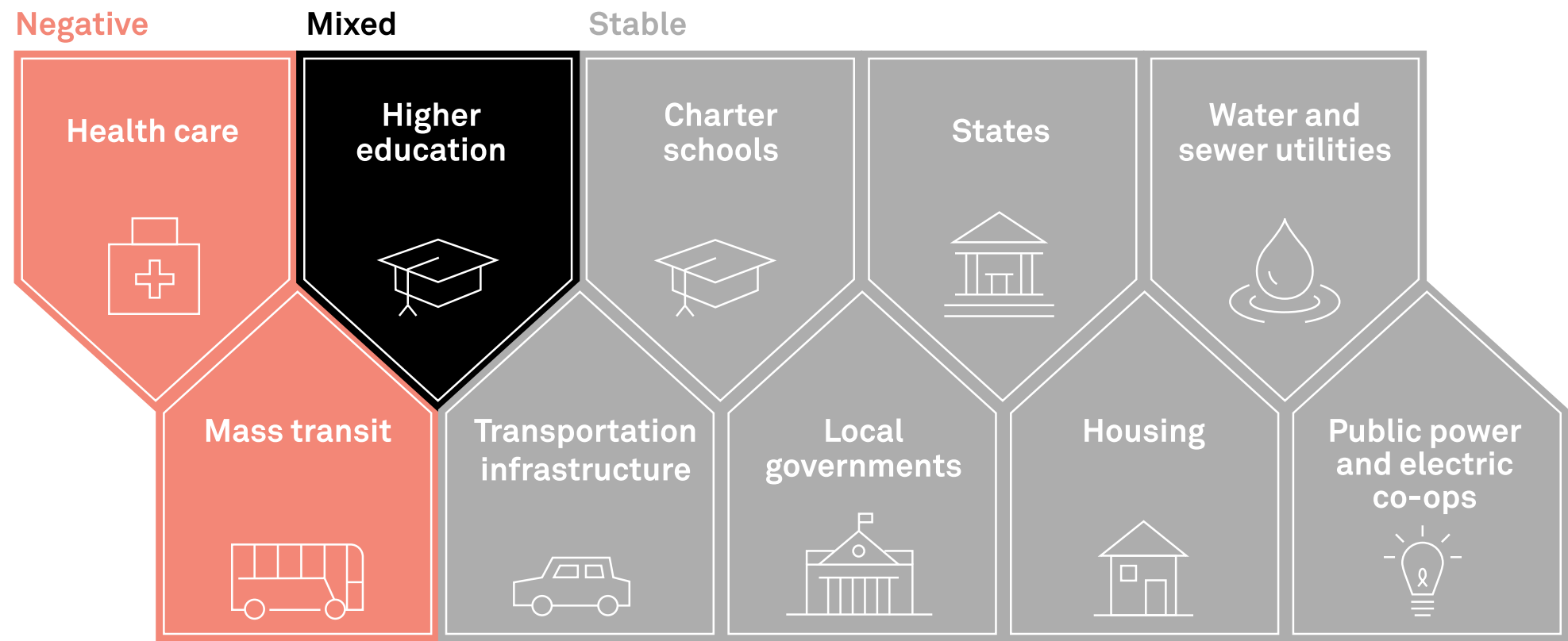
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Oct. 17, 2023



U.S. Public Finance Sector Views



Mixed=some negative, some positive. Source: S&P Global Ratings.

USPF Q4 2023 Update

What we're watching

- Higher interest rates and inflation remain headwinds for most issuers from a debt issuance and operating/capital budget perspective
- Extreme weather events continue, requiring swift response and resource allocation. Cost and availability of property insurance are emerging as a challenge

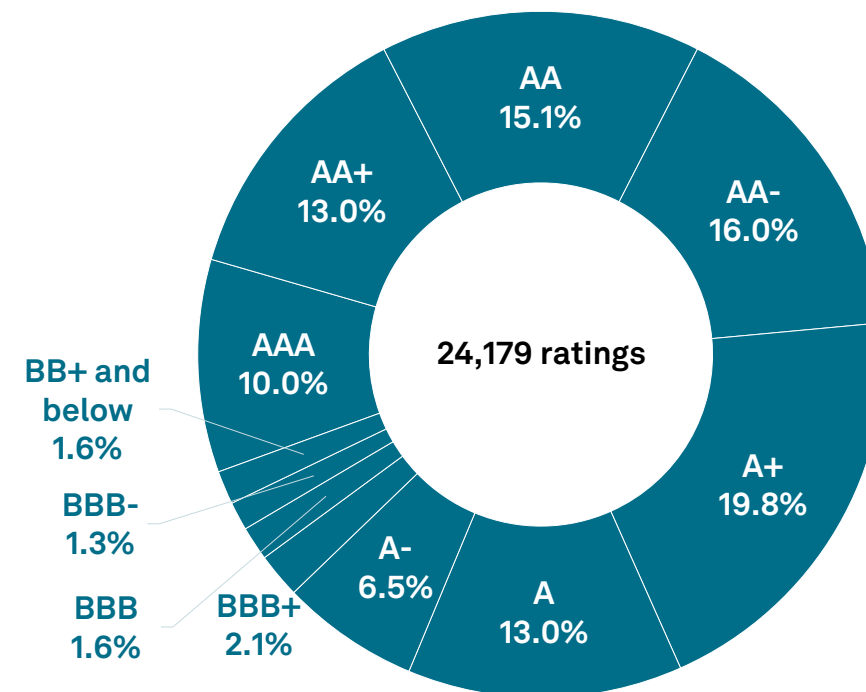
Trends

- Credit conditions have been largely stable, and upgrades have exceeded downgrades this year for most sectors
- The U.S. economy has been resilient, but we expect slower growth ahead. Federal budget deliberations and increased geopolitical tensions could further limit growth
- Federal stimulus and healthy financial reserves continue to provide significant flexibility

Rest of year expectations

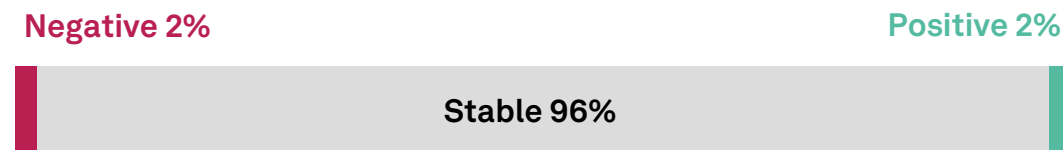
- Our baseline U.S. economic forecast is now for a shallower but more protracted slowdown rather than a recession; however, we don't expect this to disrupt credit stability for most issuers

U.S. Public Finance Ratings Distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

S&P Global Ratings' U.S. Economic Forecast Overview

Key indicators

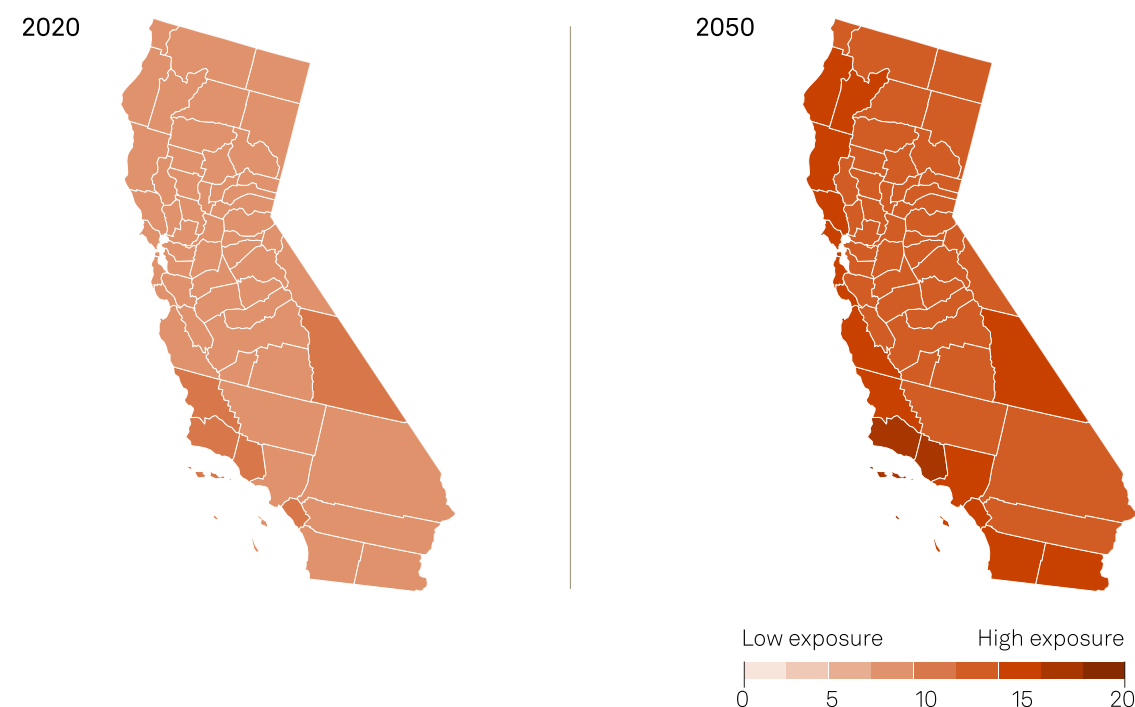
As of September 2023	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Real GDP (annual average % change)	2.3	-2.8	5.9	2.1	2.3	1.3	1.4	1.8
Change from June (percentage point)					0.5	0.0	-0.1	-0.1
Real GDP Q4/Q4 (annual average % change)	2.6	-1.5	5.7	0.9	2.2	1.1	1.6	1.9
Change from June (percentage point)					0.9	-0.4	0.0	0.0
Consumer spending (annual average % change)	2.0	-3.0	8.3	2.7	2.5	1.4	1.5	2.1
Equipment investment (annual average % change)	1.3	-10.5	10.3	4.3	-0.8	1.4	1.7	2.2
Nonresidential structures investment (annual average % change)	2.3	-10.1	-6.4	-6.6	7.6	1.1	0.5	3.2
Residential investment (annual average % change)	-1.0	7.2	10.7	-10.6	-11.1	0.7	3.2	1.8
Core CPI (annual average % change)	2.2	1.7	3.6	6.2	4.7	2.6	2.3	2.3
Core CPI Q4/Q4 (annual average % change)	2.3	1.6	5.0	6.0	3.7	2.4	2.3	2.3
Unemployment rate (%)	3.7	8.1	5.4	3.6	3.6	4.1	4.7	4.8
Housing starts (mil.)	1.3	1.4	1.6	1.6	1.4	1.4	1.4	1.4
Light vehicle sales (mil.)	17.0	14.5	15.0	13.8	15.2	15.2	15.5	15.6
10-year Treasury (%)	2.1	0.9	1.4	3.0	3.9	4.0	3.6	3.6

Note: All percentages are annual averages, unless otherwise noted. Core CPI is consumer price index excluding energy and food components. f--Forecast.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, The Federal Reserve, S&P Global Market Intelligence Economic Simulink, S&P Global Ratings Economics' forecasts.

Extreme Weather Remains On The Radar

- Extreme weather events, including hurricanes, droughts, and flooding remain one of the key emerging risks we're watching for U.S. governments and not-for-profit enterprises
- Through early September 2023, the National Oceanic and Atmospheric Administration reported 23 separate \$1 billion events, leading to more than \$57 billion in costs
- The 2023 reported events exclude Tropical Storms Hilary (Southern California) and Ophelia (Eastern Seaboard)
- By comparison, in 2021 and 2022, there were 20 and 18 \$1 billion events recorded, respectively
- Wildfires are still primarily sparked by lightning, wind, and human activities, but the frequency of these events is increasing and encroaching on communities and populated areas
- Extreme heat can contribute to the prevalence of water shortage conditions as precipitation evaporates more quickly and there is less recharge of underground water sources, which together, can lead to higher wildfire risk due to dry vegetation and lower ground moisture, among other impacts
- When speaking with entities exposed to wildfires, we typically ask about adaptation efforts that may include frequency of vegetation management, ability to acquire fire insurance, and code changes including requirements for more fire-resistant building materials

California's counties exposure to extreme heat 2020 versus 2050 (decadal comparison)



Note: Maps show a change in exposure (represented on a 1 to 100 scale) from S&P Global Sustainable 1's Climate Change Physical Risk dataset. Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Charter schools

What we're watching

- Financial flexibility and liquidity levels remain strong, but economic uncertainty looms
- Learning loss is affecting testing results, but it's not yet clear what this means for charter renewal risk

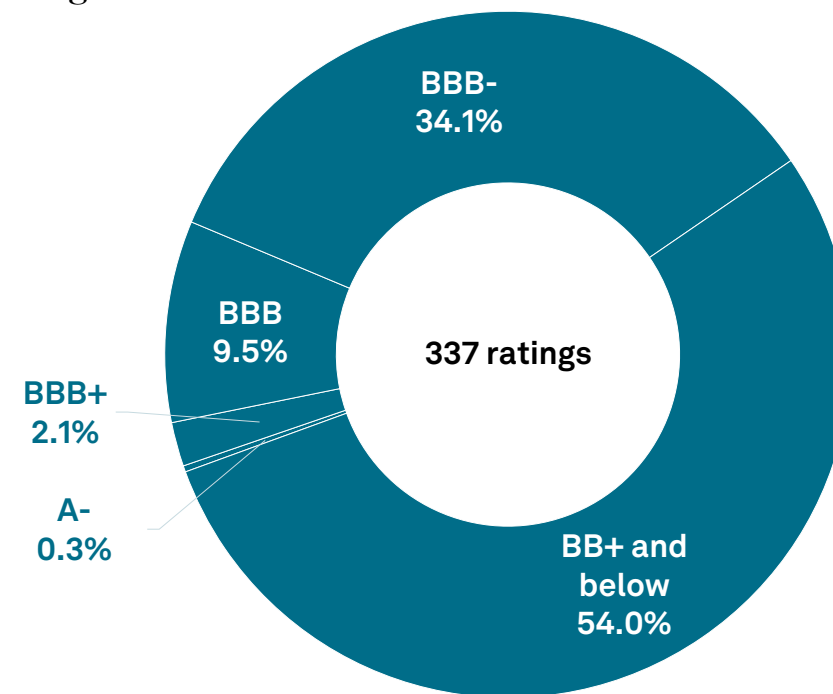
Trends

- Demand continues to grow for charter schools
- Many schools still have federal funds available to spend by September 2024
- Some credit stress exists among lower-rated issuers, as operating pressures mount due to rising costs

Rest of year expectations

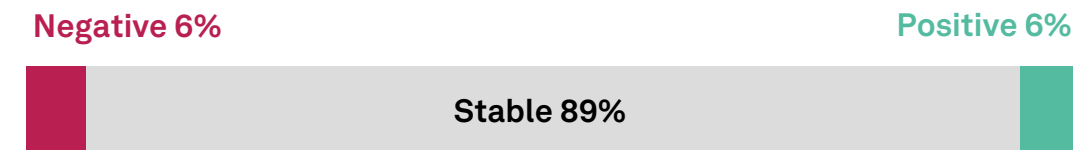
- Absent significant state budget pressure and cuts to K-12 funding, the credit position for charter schools will remain stable
- Longer term, cuts to per-pupil funding could create operating pressure for schools

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Health care

What we're watching

- Level of cash flow improvement over the remainder of 2023 and going into 2024 as this will influence rating stability for many entities
- Strength of balance-sheet flexibility as cash flow remains muted, with some investment market recovery (although volatility persists), and as strategic capital expenditures resume for many organizations

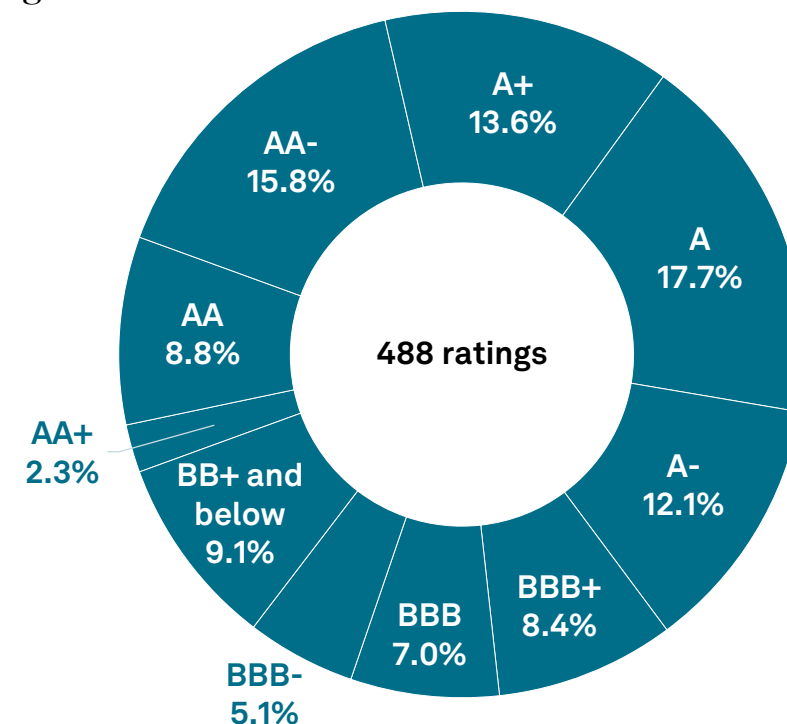
Trends

- Higher salary and benefit costs embedded in cost structure with ongoing staffing challenges, but agency use and rates trending lower
- Reducing length-of-stay remains a focus for managing demand and staff
- Despite generally good demand, revenue and reimbursement rates still lag expense growth

Rest of year expectations

- Operating performance run rate should trend better over the near term, but level of improvement will still lag historical pre-pandemic results
- Negative bias for rating actions and outlooks likely to continue for the remainder of the year
- Covenants could still be a challenge, particularly for lower-rated entities

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Housing

What we are watching

- Higher rates and prices and limited supply contribute to strained housing affordability across the country
- Higher operating expenses, particularly insurance and payroll, may pressure multifamily property performance
- S&P Global Ratings' recession probability remains elevated at 30%-35%

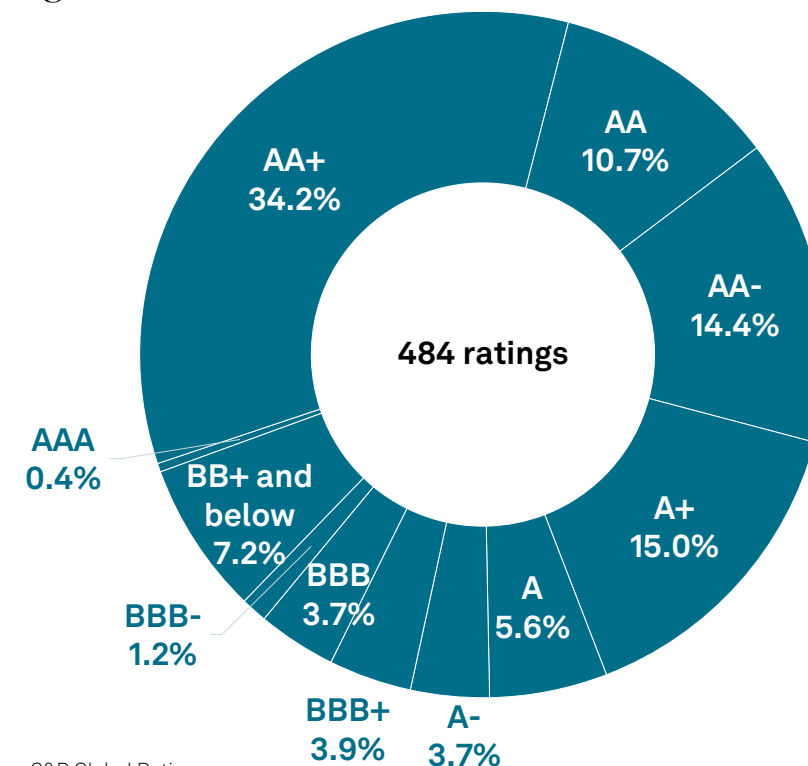
Trends

- Housing finance agencies continue to innovate and evolve their down payment assistance programs to support originations
- Single-family delinquencies at all-time low
- Bonds remain the preferred execution for housing finance agencies

Rest of year expectations

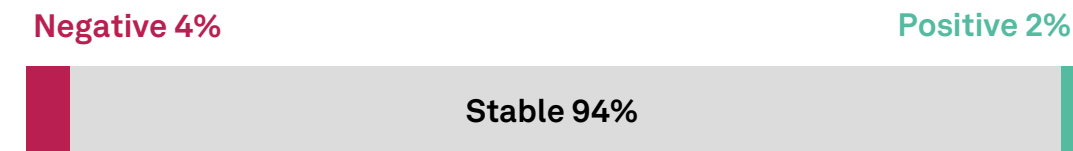
- Higher-for longer interest rates
- Generally stable rating performance across the sector

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Higher education

What we're watching

- Operating costs continue to rise, pressuring cash flows and capital spending
- Amid rising tuition and fees, the value proposition debate intensifies, affecting enrollment

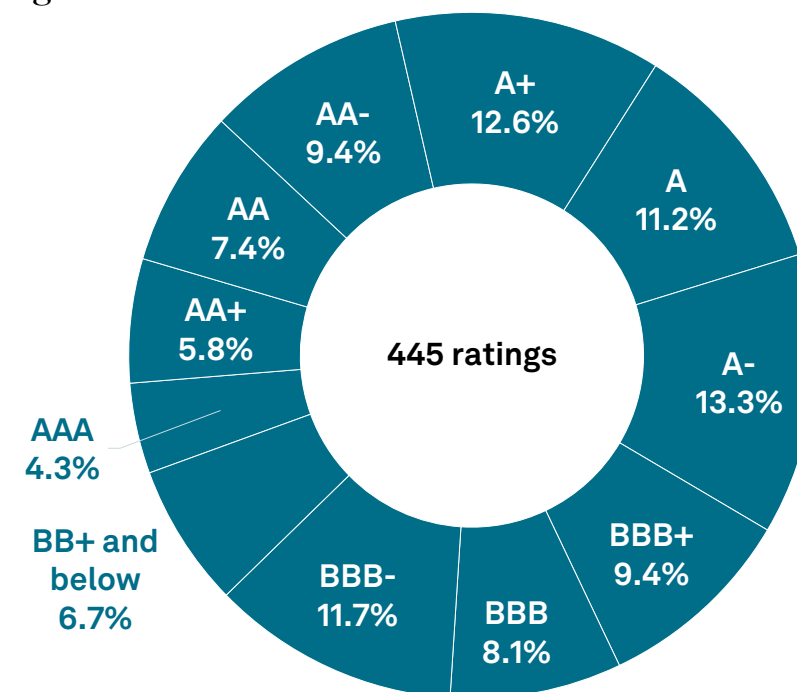
Trends

- Preliminary fiscal 2023 operating results were generally weaker than prior years' margins, and we expect similar operations in fiscal 2024
- Credit quality continues to diverge, with pressure prominent at the lower end of the ratings spectrum
- Consolidations, combinations, and closures continue at an elevated rate

Rest of year expectations

- Fiscal 2023 endowment returns were mostly positive, and generally, balance sheets remain stronger than pre-pandemic levels
- Downgrades continue for many schools already with a negative outlook, while negative outlooks increase at the lower end of the ratings spectrum, suggesting greater potential for downward trajectory in the next year or two

Ratings distribution



Source: S&P Global Ratings. 445 excludes auxiliary and related ratings and includes only issuer credit ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Local government

What we're watching

- Macroeconomic pressure that affects revenue growth, especially at the state level where shortfalls can trickle down to local governments
- Inflationary pressures or weakening consumer confidence that leads to a pull-back in consumer spending and slow sales tax collections

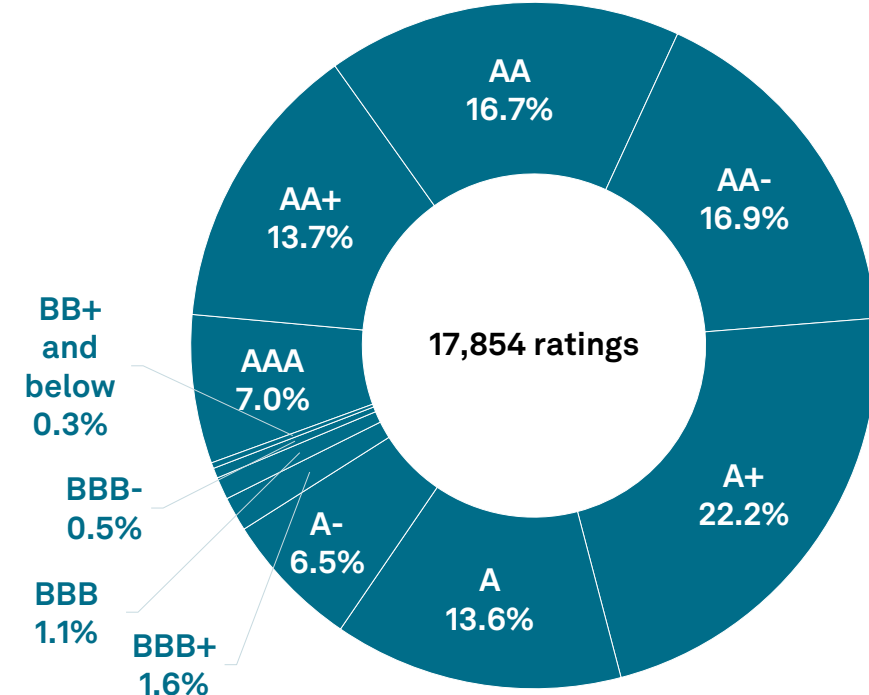
Trends

- Financial stability created by healthy reserves and enhanced by economic growth and pandemic-related federal stimulus
- Labor shortages that create difficulty in hiring workers and require more innovative solutions to staff key positions

Rest of year expectations

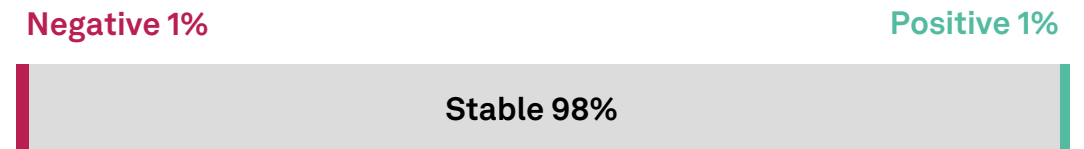
- Continued credit stability stemming from a benign economic environment; support from federal stimulus dollars, which many local governments have yet to spend
- Limited impact to local governments from federal government budget negotiations, although an extended shutdown could have wider-reaching implications for the macro economy

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Public power and electric cooperative utilities

What we're watching

- The financial and operational effects of legislative and regulatory energy transition initiatives
- Prospects for elevated costs of debt, construction materials, and labor diminishing ratemaking flexibility

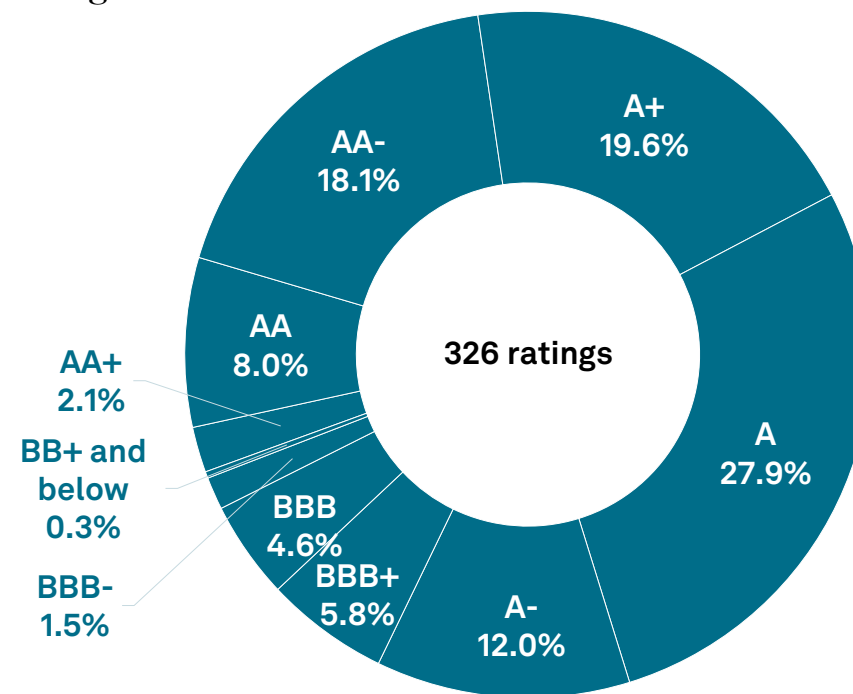
Trends

- Financial margins generally continue to mitigate exposures to elevated delinquent accounts attributable to inflationary pressures
- Costs of mitigating exposures to increasingly frequent extreme weather and wildfire events might adversely affect operational and financial performance

Rest of year expectations

- While we see broad stability in the sector, the current outlook distribution and rating activity indicate that inflationary pressures and capital spending needs are eroding some utilities' ratemaking flexibility and financial metrics
- Nevertheless, cost recovery mechanisms and autonomous ratemaking authority should generally continue to support sound financial performance

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Transportation

What we're watching

- Travel and related-consumer spending is showing no signs of slowing and continues to boost activity levels across asset classes – particularly U.S. airports
- Spend-down of remaining pandemic federal operating assistance by transit operators is accelerating decision-making on plugging the funding hole left by lagging ridership and fare revenue

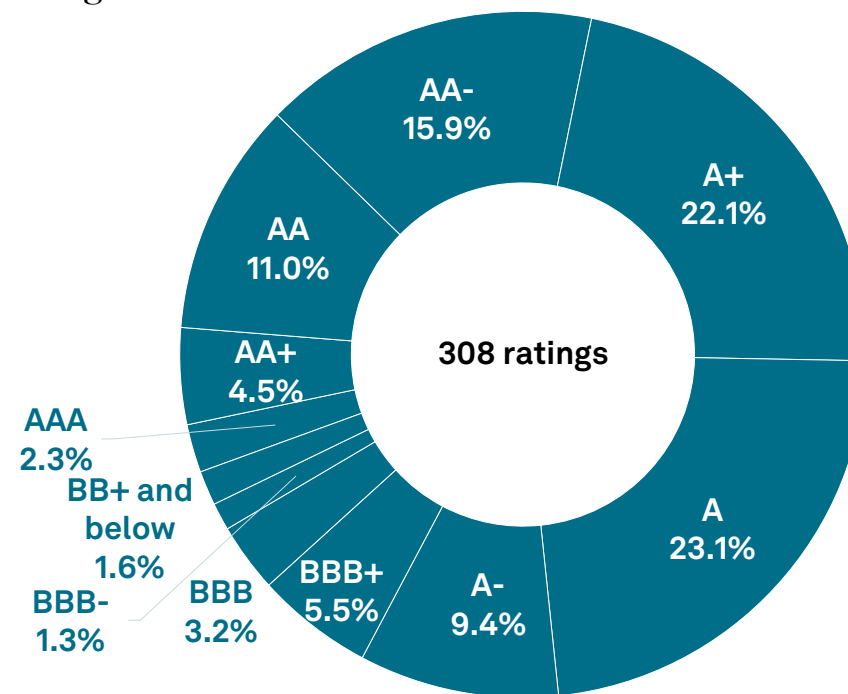
Trends

- Return of large capital programs and federal spending from Bipartisan Infrastructure Law continues to flow to local operators as construction cost inflation slows
- Improved airport and toll road credit quality in 2023 as demand levels, rate increases, and new business terms with tenants enhance forward-looking metrics. Rising tax revenue enhances credit quality of many transit providers

Rest of year expectations

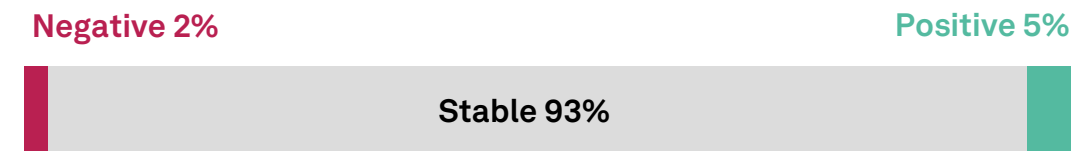
- Rebound in airport sector financial performance coverage metrics with business-as-usual rate-setting and spend-down of federal operating assistance
- Supply chain activity continues normalizing and shipping seasonality returns

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

States

What we're watching

- With revenues slowing and inflationary pressures holding, we're watching for current and out-year budgetary challenges
- Federal criticism of Medicaid redetermination actions in some states could force a change in eligibility rolls

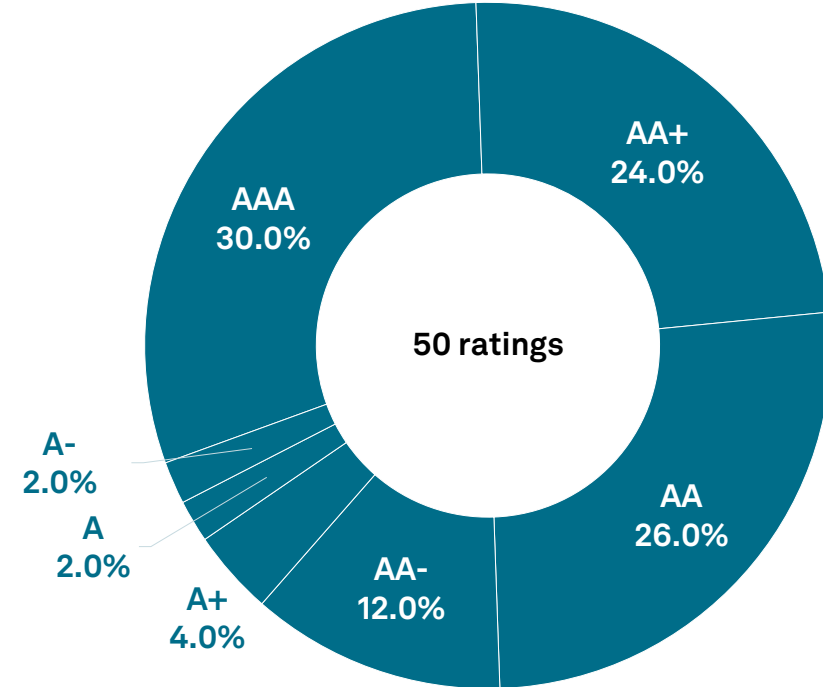
Trends

- Reserves holding steady at all-time highs or even increasing in fiscal 2024
- Jobs are still hard to fill, and retention actions like benefit enhancements and across-the-board wage increases could have long-term budgetary impacts

Rest of year expectations

- The national economy will feel the effects of labor shortage and work stoppages and growth will slow, affecting state revenue collections
- Continued credit stability with some strengthening possible, as ratings on seven states have a positive outlook

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution

Negative 0%

Positive 14%

Stable 86%

Source: S&P Global Ratings.

USPF Q4 2023 Sector Summary

Utilities

What we're watching

- Influence of rate structure and customer service programs on rate-setting flexibility
- Climate volatility and the effect on operations, financial uncertainty, and future leverage

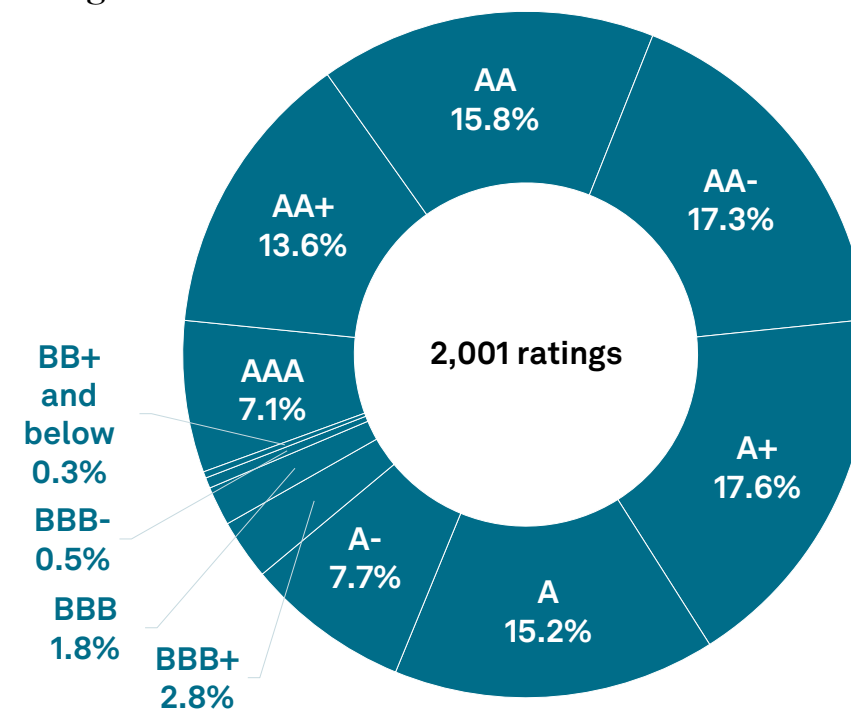
Trends

- Labor pressures continue to affect expenditures, operations, and even compliance
- Capital project budgets are significantly above initial projections due to rising interest rates and construction costs, which may pressure financial performance, especially for issuers with mandated capital spending

Rest of year expectations

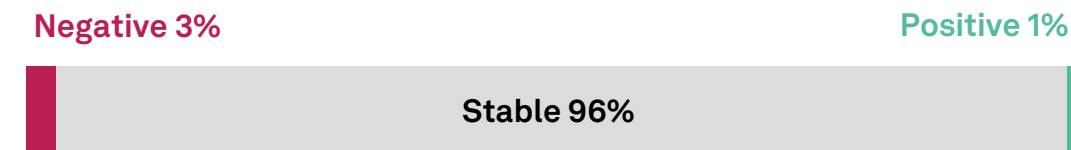
- Smaller utilities continue to face greater challenges and downside risk given weaker economies of scale, lower nominal cash, and weaker management policies
- Inflationary costs continue to outpace average rate hikes, increasing the potential for narrowing debt service coverage in 2023 and 2024

Ratings distribution



Source: S&P Global Ratings.

Outlook distribution



Source: S&P Global Ratings.

Related Research

- [Sustainability Insights: Managing Renewables Risk Is Increasingly Integral To U.S. Power Utilities Credit Quality](#), Oct. 9, 2023
- [How Resilient Are U.S. Public Finance Ratings To A Federal Government Shutdown?](#), Sept. 29, 2023
- [U.S. Transportation Infrastructure Transit Update: End Of The Line Nears For Federal Assistance As Low Ridership Pressures Operators](#), Sept. 28, 2023
- [U.S. Highway User Tax Bond Report Card: Strong Coverage Drives Rating Resiliency](#), Sept. 28, 2023
- [U.S. Municipal Water And Sewer Utility Medians Held Strong In 2022 Amid Rising Costs](#), Sept. 27, 2023
- [U.S. States Jump Start Electric Vehicle Charging Infrastructure](#), Sept. 21, 2023
- [U.S. Housing Finance Agencies 2022 Medians: Strong Metrics, Balance Sheets Reinforce Credit Quality](#), Sept. 19, 2023
- [Turning Houses Into Homes: U.S. HFAs Evolve Down Payment Assistance Programs Amid Changing Housing Market Dynamics](#), Sept. 14, 2023
- [U.S. Mortgage Revenue Bond Program Medians: Strong Credit Quality Keeps The House In Order](#), Sept. 12, 2023
- [U.S. State Pension And OPEBs: Funding Progress Is Likely To Pick Up In 2023 After Slipping In 2022](#), Sept. 7, 2023
- [What To Expect From S&P Global Ratings' U.S. Public Finance Rating Process](#), Aug. 29, 2023
- [Hawaii Wildfires: Strong Reserves Position Governments And Related Credits Well In Short Term Despite Pressures And Uncertainty](#), Aug. 23, 2023
- [U.S. Transportation Infrastructure Toll Sector Report Card: Resilient Demand And Higher Tolls Underpin Credit Strength](#), Aug. 17, 2023
- [What U.S. CDFI Ratios' Resilience Through Changing Economic Landscapes Means For Long-Term Credit Quality](#), Aug. 10, 2023
- [U.S. Not-For-Profit Acute Health Care 2022 Medians](#), Aug. 7, 2023
- [Economic Momentum Expected To Wane For Mineral-Producing U.S. States As Tailwinds Abate](#), Aug. 3, 2023
- [Sustainability Insights: California's Evolving Insurance Market Has Mixed Impacts: Spotlight On U.S. Public Finance, Spotlight Off U.S. RMBS](#), Aug. 2, 2023
- [U.S. Not-For-Profit College And University Fiscal 2022 Medians And Ratios](#), July 25, 2023
- [U.S. Public Finance Long-Term Municipal Pools: Key Information And Characteristics](#), July 20, 2023

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