Comments Related to "Local Government Debt Valuation"

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Discussant

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Comments on Local Government Debt Valuation (LGDV) Primary Themes

1. Large Segments of Municipalities operate with Negative Net Position
2. Financial Condition of Municipalities in Decline
3. Recognized by Muni Market in the form of Higher Spreads
4. Accounting Book vs. Market Valuations are Highly Correlated
5. Negative Equity Position (net position) reflects presence of Equity Insurance (by state and federal governments)

1. LGDV: “Large Segment of Municipalities Operate with Negative Equity Position (Net Unrestricted Position”

Comparison Table showing Parallel Validation applying Negative Position relative to Governmental Activities Expenses and Revenues.

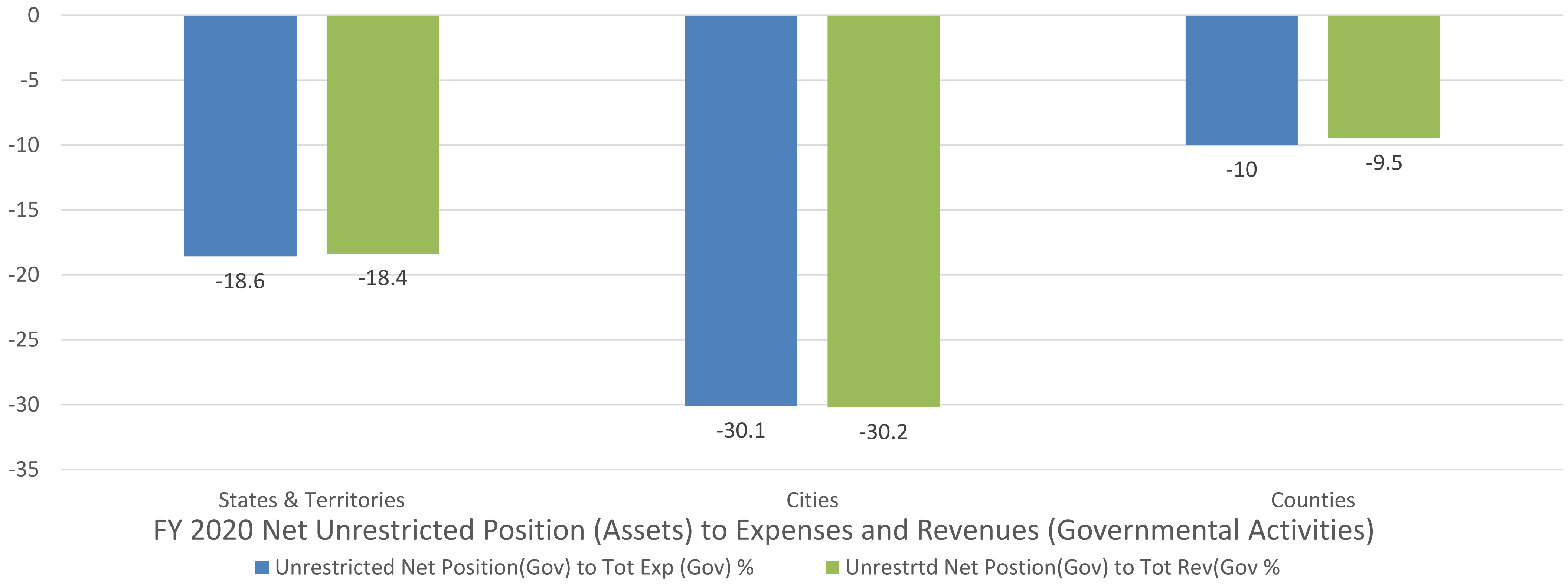
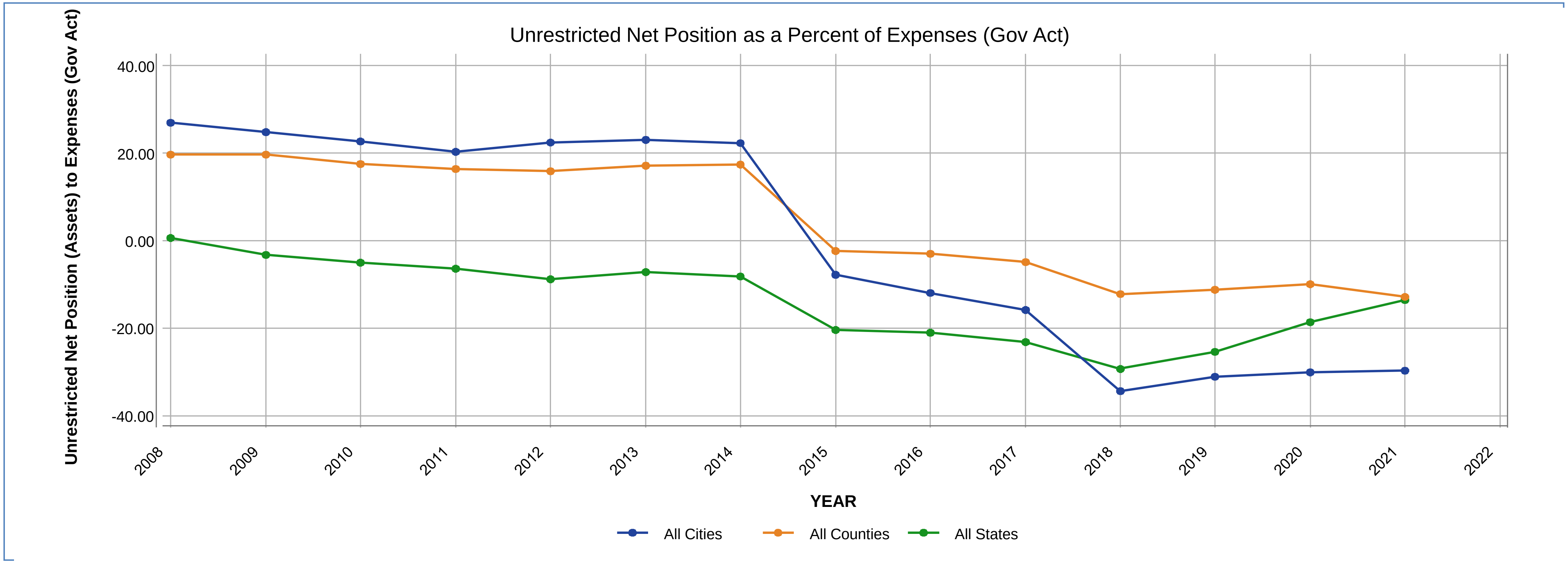


Chart Data Source: Merritt Research Services, an Investortools Company derived from Audited Comprehensive Financial Reports of July 15, 2022. Dataset used for Local Government Debt Valuation Study uses Total Operating Revenues rather than Total Expenses (Gov Activities).

2. LGDV: “Financial Condition of Municipalities is Declining”

Comparative Chart shows negative trend for Cities as well as Counties and States. Steep declines occurred as GASB pension and OPEB rule changes took effect for FY 2015 and FY 2018.



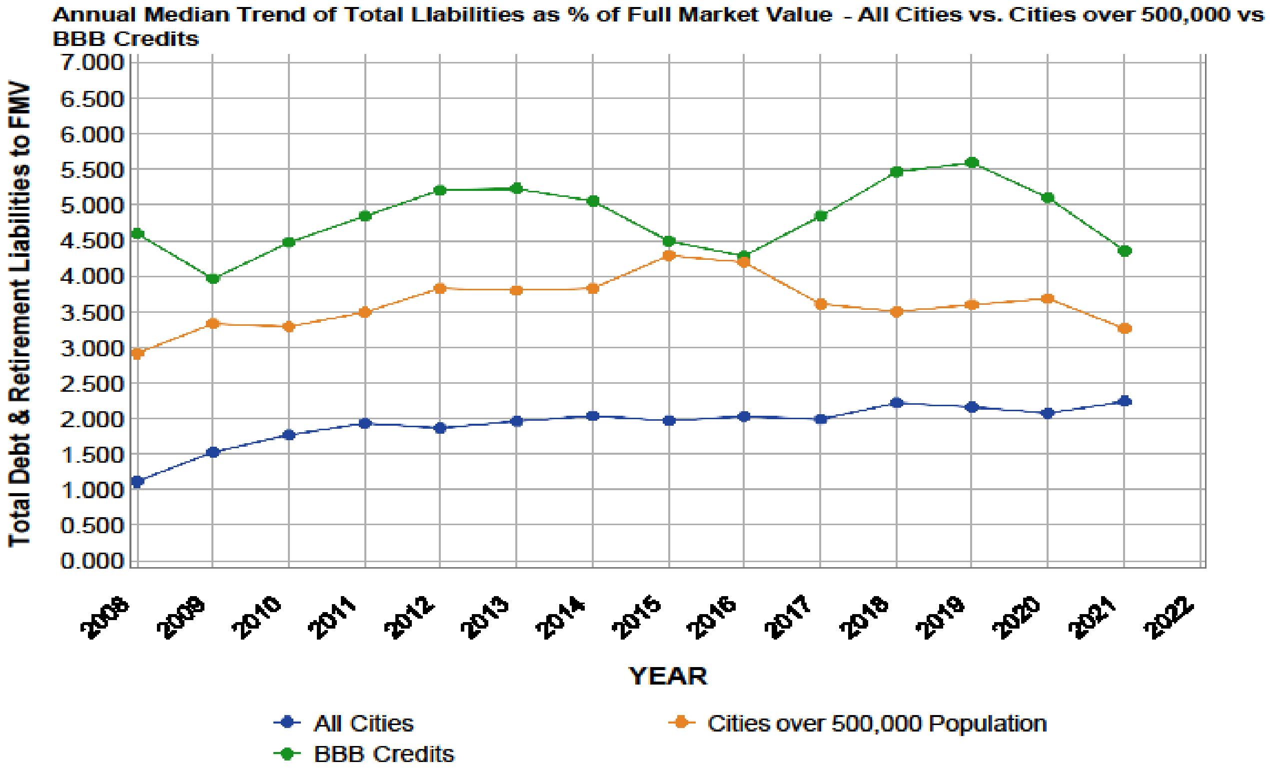
Source: Merritt Research Services, an Investortools Company. Data derived from Audited Comprehensive Financial Reports. Audits for FY 2021 are still being received; Median is Indicative of Trend.

3. LGDV: “Most of the Decline is Associated with Legacy Obligations”

Higher Leverage is More Evident with Large Cities and Lower Rated Cities.

Legacy Obligations:

- Total Direct Debt
- Unfunded Pension Liabilities
- Unfunded OPEB Liabilities



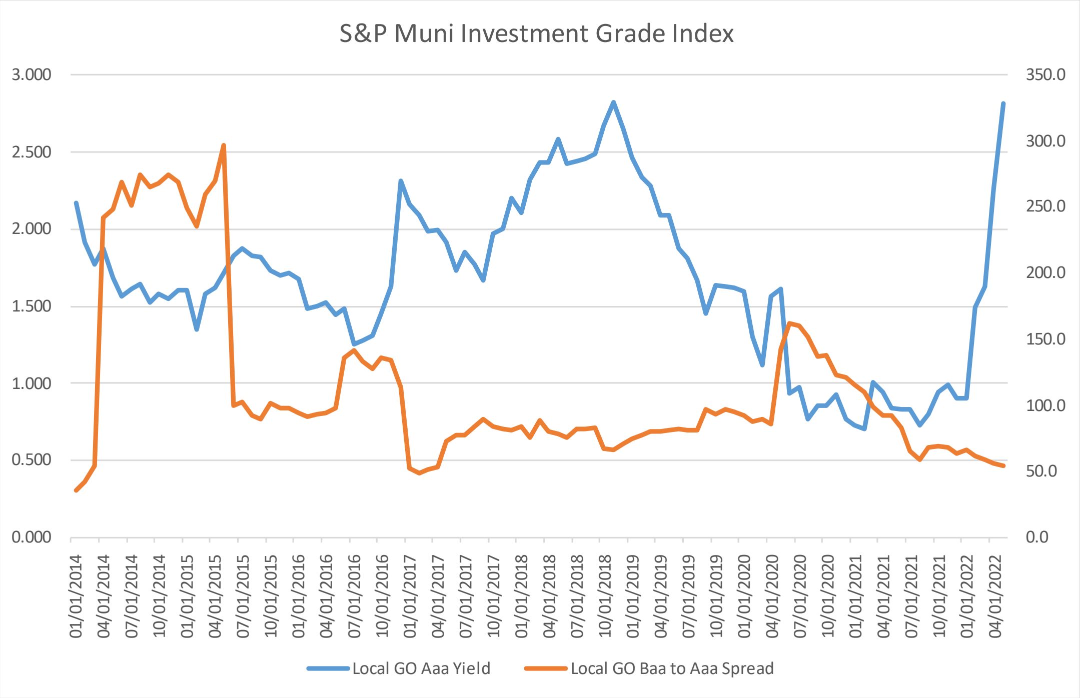
Source: Merritt Research Services, an Investortools Company. Data derived from Audited Comprehensive Finance Reports as of July 15, 2022.

Increase in full market value of city real estate mitigates burden in recent years.

FY 2021 Audit Reports are still being received.

4. LGDV: “Recognized by the Municipal Market in Terms of Higher Spreads”

Historically Low Municipal Rates Mostly Suppressed Spreads in Recent Years



Source: Investortools, Inc. Data derived from Standard & Poor’s Investment Grade Index as of 5/1/2022. Comparing average Yield to Worst from Aaa-rated and Baa-rated bonds from the Local GO sector of Standard & Poor’s Municipal Bond Investment Grade Index.

Inconsistent Market Recognition of Negative Net Position

- Other Issues Unique to Municipal Bond Market Complicate Spread Discussion
- Tax Exemption
- Supply/Demand
- Rating Recalibration Based on Low Default Rate
- State Protections
- Security Provisions

5. LGDV: "Market Values of Equity are Highly Correlated with Book Values"

Comments:

- LGDV Calculations in the study use sophisticated modeling to derive valuations; approach draws on corporate style techniques.
- LGDV: Paper states that ACFR "Book valuations are more backward looking"; "Market values are more forward looking."
- LGDV market valuations price the main components of local governments balance sheet. Formula is based on total revenues plus cash and total expenditure cash flow plus all liabilities, including debt, unfunded pension and OPEB liabilities.
- These elements are available in GASB 34 financial accounting statements and are often used in conventional municipal credit analysis. Many analysts would argue that they are included in their credit analysis and scoring models.

6. LGDV: "We attribute the limited distinction in credit to the belief in implicit insurance by the state and federal government."

- Contention that a high level of leverage reflects presence of "Equity Insurance" (by state and federal governments) has some historical significance.
  - Munis historically viewed as second only to Treasuries. Perception dates back to Depression experience based on default recovery experience.
  - Barney Frank similarly suggested the prospect of bailouts or workouts in the hearings at the onset of the Great Financial Crisis.
  - This concept does not hold true for all municipals and is less popular in recent years.
- The built-in legal, political and economic support bases for Municipals do provide a support system that often cushions fiscal risk. Overlooking those factors, risks underestimating muni credit resiliency.
- Still, leverage trends are unprecedented and hazardous if municipal credit risk is dismissed, and safety is taken for granted.