## RIDF Section 13. Sensitivity to Assumptions

### Sensitivity of the Credit Rating to Assumptions Made by Fitch as Required by Paragraph (a)(1)(ii)(M) of Rule 17g-7

The major assumptions made by Fitch in determining the announced credit ratings are discussed below, along with examples that illustrate the effect of the violation of those assumptions, where determinable.

**Assumption**

Fitch assumes the continued normal operation of relevant financial and/or funding markets, which may include a moderate amount of short-term disruption or volatility.

- *The vast majority of municipal debt is fixed rate, long term and amortizing; however, some borrowers possess capital structures with variable rate debt or commercial paper supported by liquidity provided by bank agreements and sometimes accompanied with hedging instruments - for example, swaps. These debt instruments expose issuers to various market related risks including: interest rate, basis, remarketing/refinancing and counterparty risks, as well as acceleration and termination costs. Those that issue short-term notes (BANs, RANs, TRANs, etc.) or direct bank loans, are exposed to refinancing or funding risks.*

  *During the disruptions in the financial markets in 2007-08, the municipal auction rates securities (ARS) market collapsed, resulting in a loss of market liquidity for such bonds and substantially higher interest payments for a period of time. Bank remarketing desks or investors stepped in to purchase the notes at higher interest rates, often capped. Since then, most ARS have been refinanced with other debt securities, including fixed rate bonds, LOC-backed securities or direct bank placements. Also, those issuers with variable rate debt, including ARS linked with distressed bond insurers or banks, experienced stepped up interest rates and accelerated principal amortization on the bonds put to the liquidity providers. In many situations, an underwater swap complicated and increased the cost of extrication from such adverse agreements. Nevertheless, issuers were ultimately able to refinance obligations and no defaults occurred on Fitch rated debt.*

**Assumption**

Fitch assumes all parties to the rated transaction will abide by their contractual obligations.

- *In 2008, a natural gas supplier issued bonds to prepay Lehman Brothers Commodity Services Inc. (LBCS) for the delivery of natural gas, a contractual obligation guaranteed by Lehman Brothers Holdings Inc. (LBHI). Fitch's rating on the bonds reflected, in part, its rating on LBHI. The bond rating, initially at AA-, was lowered over several months as LBHI's creditworthiness declined. The rating was downgraded to C when LBCI failed to deliver gas in accordance with its contractual obligation. When LCBS failed to make a required termination payment to the bond issuer, Fitch lowered the rating to D and subsequently withdrew it.*

**Assumption**

Fitch assumes no fundamental and unexpected change in the legal and regulatory framework, including, but not limited to, changes in law and tax regime.

- *Fitch downgraded the rating of a U.S. territory's dedicated tax bonds from 'A-' to 'BB' in December 2016 following passage of federal legislation that created an avenue for the creation of a bankruptcy-like process and recovery regime, which had not previously existed. In Fitch's view, this legislation fundamentally altered the premise used to rate the dedicated tax bonds as it exposed bondholders to a potential restructuring or default by the issuer.*

**Assumption**

Fitch assumes no fundamental and unexpected change in the operating environment as a consequence of significant events, including, but not limited to, the rapid deployment of new technology, natural disasters, and other events such as terrorism during the debt repayment period.

- *Fitch downgraded the ratings of five Texas electric and gas utilities in 2021 in the wake of a severe and prolonged winter weather event that rendered generating units inoperable and limited fuel supplies. The resulting spike in demand and unanticipated outages forced utilities to purchase power and gas necessary to serve customers at exorbitant prices, straining available liquidity and creating significant liabilities. One issuer, unable to meet a multi-billion liquidity requirement, filed for bankruptcy and was immediately* *downgraded to 'D'; four other issuers, facing storm-related liabilities as high as $1.0 billion, were downgraded one- to two-notches reflecting suddenly higher debt burdens and repayment obligations. The remaining rated utilities in the state affected by the weather event were able to avoid operating failures and preserve credit quality by raising rates to ensure the timely recovery of lower and more manageable incremental costs.*

**Assumption**

Fitch assumes that information provided by issuers and their agents, including legal opinions, and operating and financial information provided by third parties is valid, accurate and meets widely accepted levels of professional standards, subject to reasonable investigation by Fitch.

- *A U.S. city's general obligation bonds were downgraded to BB; RWN from A+; ROS in August 2010, then to B and withdrawn in September 2010. Prior to the first downgrade, the State Controller determined that the city's pension property tax was capped at its 1984 rate, requiring the city to pay $2.9 million to the overlapping school district. This payment reduced the city's financial cushion, liquidity, and flexibility. In addition, an increased general fund contribution was needed in the future to fully fund pension obligation bond debt service. The city's finances showed a sizable general fund balance, although the reserve included large advances from other city funds that had no apparent established or expected repayment schedule. Both downgrades also incorporated our concern that the city might default on a $35 million privately placed lease revenue bond obligation. While the obligation was disclosed in the city's annual report, no information about the possibility of default or measures to avoid it were available.*
- *The three-notch downgrade to 'A-' from 'AA-' in May 2011 of a U.S. school district reflected the sharp change in the district's reported financial results due to prior-year accounting misstatements that artificially elevated reserve levels and masked a growing structural imbalance. The fiscal 2009 audited statements prepared by the former auditor show a restatement of the fiscal 2008 unreserved ending fund balance to $985,000 or 3% of spending compared to originally reported results of $3.9 million or 12% of spending. The restatement was the result of a sizable delayed payroll expenditure and unverifiable receivables.*