中証鵬元國際
CSPI Ratings

Chinese Local Government Rating Criteria

Contents

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Summary

*(**Editor's Note**: We originally published this criteria article on June 29, 2021. Following our review on 29 June 2022, we republished this article with minor revisions to provide readers with better clarity.)*

These rating criteria describe CSPI Ratings' approach in assigning issuer credit ratings (ICRs) to local governments (LGs) in China and issuance credit ratings to their debt obligations. The criteria are not intended to provide an exhaustive description of all factors that may affect the creditworthiness of Chinese LGs in all circumstances. However, they should help markets and their participants better understand our analytical framework of assessing the credit risks of Chinese LGs and our ratings that reflect such risks.

These criteria will be effective immediately on the date of final publication. We intend to complete the review of all affected ratings within six months thereafter.

Framework-based Approach to Rating Chinese LGs

China has developed a highly centralised governance system with a central government and four levels of LGs. Each level of LGs operates in a unified system with similar organisational structure and taxation policies. However, the institutional framework for LGs varies significantly across China's various administrative levels, which determine the ranges of possible LG ratings in our approach. We believe that the political and fiscal relationships of a Chinese LG with higher-level government are critical determinants of its ability to meet debt service obligations. As a result, our approach emphasises the critical nature of the LG's institutional frameworks and intergovernmental relationships with its higher-level government.

To determine an LG's standalone credit profile (SACP), we take into account economic conditions, fiscal performance, debt burden, and liquidity, among other factors. In addition to a few static indicators to reflect the LG's static condition, we also use a variety of dynamic indicators to reveal the LG's current and future status by combining the historical data and our forward-looking projection. Qualitative factors are also employed to capture the characteristics that are difficult to quantify.

We derive the LG's issuer credit rating (ICR) by considering the extraordinary support provided by its higher-level government. We believe that a higher-level government in China would generally keep the creditworthiness of LGs in its jurisdiction within a closer distance to its own creditworthiness, as the latter perform important economic, political and social functions for the former. A higher-level government, on the other hand, may tolerate differentiation in the creditworthiness of LGs and even welcome market differentiation in the creditworthiness of its LGs to help maintain credit discipline among its LGs.

The framework-based approach to assigning ratings to Chinese LGs and our approach in assessing and scoring key rating factors (including but not limited to the weights of key rating factors and the choice of anchor indicators) reflect our belief that such approaches provide practical and meaningful ways to capture the creditworthiness of LGs in China, a country with no default of LGs so far and limited available statistics about local public finances.

Definition of Local Governments

On the basis of the constitution, China is divided into provinces, autonomous regions, and direct-controlled municipalities, all of which have the same administrative rank in the Chinese government system, so we consider them all to be provincial-level administrative regions. Each of these provincial-level regions is further subdivided into various cities and autonomous prefectures, which share a common administrative rank in most cases. We refer them as prefecture-level administrative regions. These prefecture-level cities and autonomous prefectures are further subdivided into districts, counties and autonomous counties, which are subdivided further into townships and villages.

China has a centralised government structure. China's central government is known as the Central People's Government of the People's Republic of China (PRC). The country has government bodies, such as provincial governments, autonomous regional governments, municipal governments and county governments, in line with each level of administrative regions. We consider all non-central governments in China as local governments, and apply the criteria in this article when assessing the creditworthiness of these LGs.

The Chinese government has also established various economic development zones (EDZs), such as national economic new zones, special economic zones and districts, and high-tech industrial zones. Most of these EDZs do not have full-fledged governments. Instead, they are mostly overseen by provincial or regional governments and managed by administrative committees. We assess these administrative committees in conjunction with the supervising governments since we view them as an extension or subordinate part of the relevant local governments.

Issuer Credit Rating of Chinese Local Governments

Our analytical approach to rating Chinese LGs begins with assessing the institutional framework and other five key rating factors. We evaluate the strength of an LG's institutional framework by investigating its relationship with higher-level governments and the framework's sustainability. The institutional framework is scored on a scale of "1" (weakest) to "5" (strongest).

The LG's preliminary strength score (PSS) is then determined using a weighted average of the other five key rating factors: economic strength, budgetary strength, debt burden, liquidity and governance and management. Each key rating factor is assigned a numerical value ranging from a scale of "1" (weakest) to "9" (strongest). Economic strength is usually weighted at 30%, budgetary strength at 20%, debt burden at 20%, liquidity at 20%, and governance and financial management at 10%. The rating committee has the discretion to apply different sets of weights, if the standard set of weights is deemed to understate or overstate the LG's creditworthiness. Typically, we would round up the weighted average score to the nearest integer. When the weighted average score is close to the middle of two integers, we would choose the one that better captures the LG's creditworthiness as the PSS.

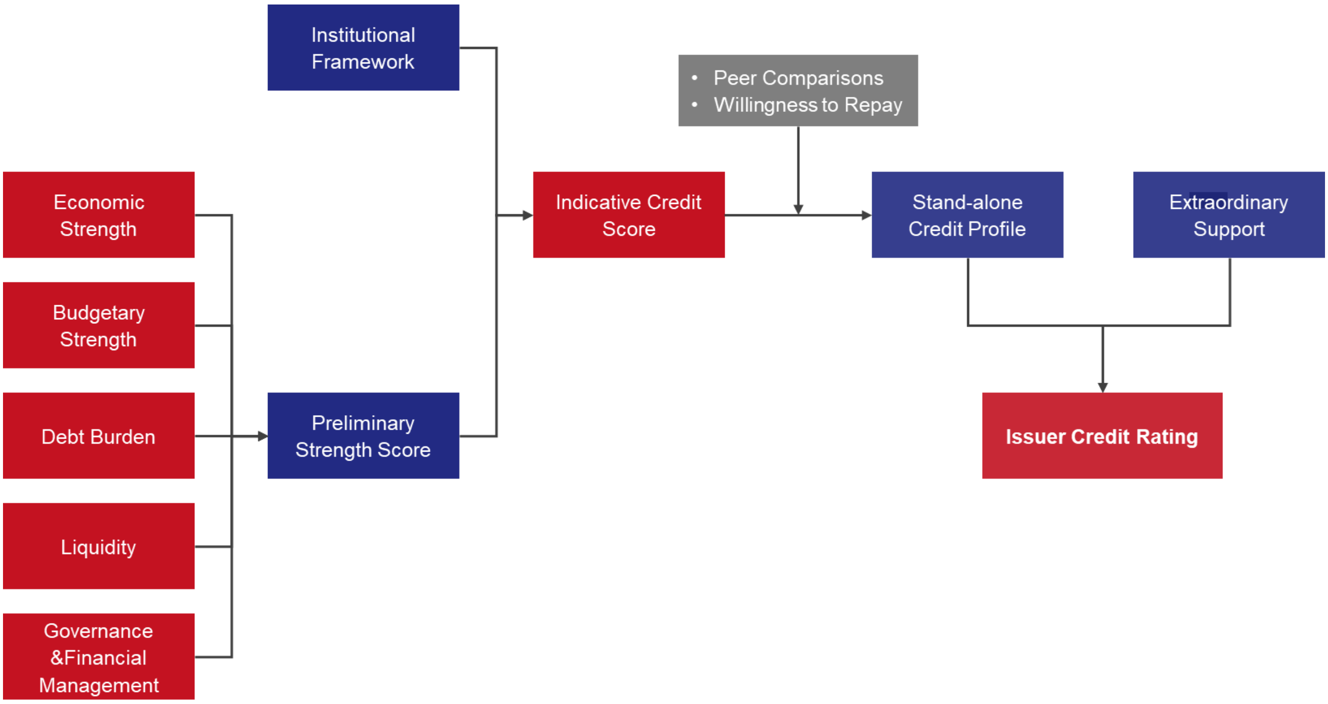
We combine the institutional framework assessment and the PSS to arrive at the LG's indicative credit score (ICS) using the matrix below (Table 1). The LG's stand-alone credit profile (SACP) would be equal to the ICS, unless we believe that the SACP should be one or two notches lower or higher than the ICS, based on *peer comparisons* (comparing the credit profile of the LG with those of similarly-rated LGs in China). In addition, we assess if the LG has seen weaker willingness to service the debt. Track record of default and other signs of less willingness to pay would lead to one or two notches downward adjustment of the SACP.

Table 1: Determining Indicative Credit Score

Preliminary Strength Score	**Institutional Framework Score**				
	5	**4**	**3**	**2**	**1**
9	aa and above	aa-	a+	a	a-
8	aa-	a+	a	a-	bbb+
7	a+	a	a-	bbb+	bbb
6	a	a-	bbb+	bbb	bbb-
5	a-	bbb+	bbb	bbb-	bb+
4	bbb+	bbb	bbb-	bb+	bb-
3	bbb	bbb-	bb+	bb-	b+ and below
2	bbb-	bb+	bb and below	b+ and below	b and below
1	bb and below	bb- and below	b+ and below	b and below	b- and below

The LG's ICR is then determined taking into account the extraordinary support. LGs in China normally receive extraordinary support from the higher-level government which directly supervises them. When assessing the likelihood of the extraordinary support, we consider both the higher-level government's capacity to support (i.e., the higher-level government's own creditworthiness) and the higher-level government's willingness to support. Chart 1 summarises the analytical framework for assigning a Chinese LG's ICR.

Chart 1: Framework of Chinese Local Government Rating



Institutional Framework

The institutional framework under which an LG operates is the legal and practical environment that shapes the LG's responsibilities and authority. A supportive institutional framework enables the LG to manage and mitigate risks more effectively during times of stress. Our assessment is primarily focused on the impact that the predictability, stability and sustainability of the institutional framework are likely to have on the LG's creditworthiness.

In China, LGs of the same tier are subject to similar laws and regulations and have comparable organisational networks and governance structures. Their institutional frameworks are very similar in terms of taxation system, level of responsibilities and intergovernmental relations, etc. In most cases, the institutional framework assessment is identical across LGs of the same government level. Any discrepancies would be the result of the LG's specific position within the government system.

The relationship between a Chinese LG and higher-level governments is crucial in assessing the institutional framework under which the LG operates. We examine an LG's relationship with its higher-level governments in light of the legal and fiscal policy framework that determines the LG's service responsibilities and revenue raising capacity, as well as the specific division of tax authorities, revenue sources and service responsibilities. The predictability and stability of the LG's operating environment are assessed based on how frequently and to what extent the LG's responsibilities and authority change, and how difficult it is to make those changes. The predictability and stability of the resulting expenditures and revenues are also taken into consideration. Moreover, we assess the LG's policies and objectives in relation to those of its higher-level governments, and the LG's ability to influence those policies.

The fiscal sustainability is evaluated based on the strength of the LG's fiscal policy framework and its ability to raise revenue. China's fiscal policy framework is established by the central government, with fiscal rules that apply to all levels of governments. We generally assess the fiscal framework's prudence and effectiveness. Chinese LGs primarily rely on their own revenue and transfers from the higher-level governments to meet their expenditure needs. When assessing its revenue-raising ability, we take into account both the LG's own revenue flexibility and the predictability and stability of the transfers it receives from the higher-level governments. Additionally, we consider the extent to which the LG receives exceptional systemwide support from the higher-level governments during times of extreme stress.

The following table provides the key factors when assigning an institutional framework score. We evaluate the institutional framework qualitatively and holistically, assigning a score ranging from "1" (lowest) to "5" (highest).

Table 2: Institutional Framework Score

	5	3	1
Predictability and Stability	The institutional framework is solid and is regarded as predictable and stable. The service expenditures are well defined and budgeted. The LG's own revenues and transfers from the higher-level government are predictable and stable over time. The institutional framework is transformed in a generally systemic and predictable manner. The LG is able to challenge undesirable changes.	The institutional framework is overall solid and is regarded as largely predictable and stable. The service expenditures are mostly defined and budgeted, but there may be some mismatches. The LG's own revenues and transfers from the higher-level government are relatively predictable and stable. The institutional framework can be changed relatively quickly. The LG is able to somewhat influence undesirable changes.	The institutional framework is developing and is regarded as highly unpredictable and volatile. The service expenditures are not clearly defined and budgeted. Generally, structural imbalances exist. The LG's own revenues and transfers from the higher-level government are highly unpredictable and volatile. The changes of the institutional framework are unpredictable. The LG has a limited capacity to influence undesirable changes.
Fiscal Sustainability	The fiscal policy framework is prudent and well defined in order to keep the debt and deficit levels in check. The LG has largely discretion over its revenues and expenditures. There are sufficient indications that the LG will receive exceptional systemwide support from the higher-level governments during times of extreme stress.	The fiscal policy framework is relatively prudent, but it may not be sufficient enough to prevent rapid debt accumulation. The LG has a limited amount control over its revenues and expenditures. There are some exceptional systemwide support to the LG from the higher-level governments during times of extreme stress. But the track record of providing timely support is not sufficient.	There is no well-established fiscal policy framework that limits the debt and deficit levels. The LG has limited amount of discretion over its revenues and expenditures. The framework provides the LG with limited exceptional systemwide support from the higher-level governments during times of extreme stress.

Preliminary Strength Score

This section explains how we assess and score the key rating factors that lead to an LG's preliminary strength score. We assign a preliminary score to each key rating factor based on the weighted average of sub-factor scores, which are in turn based on key indicators. All sub-factors are measured on a scale of "1" to "9". If necessary, we notch up (or down) the preliminary score according to additional considerations to arrive at the final score. In the preliminary score, the weights assigned to sub-factors are typical weights that we use. The rating committee has the discretion to apply alternative weighting schemes, if the typical set of weights is deemed to understate or overstate the LG's creditworthiness. When the value of an indicator falls on or lies very close to a threshold between two different scores, we will choose the one that best captures the credit risk in our opinion. The notching of the preliminary score on each key rating factor is accumulative. However, the final score would be restricted to the range of "1" to "9".

Economic Strength

We believe economic strength is the most useful barometer and an important factor in determining a Chinese LG's creditworthiness. A strong economy provides an LG with a larger revenue base, more influence in shaping inter-governmental arrangements with its higher-level government, a stronger ability to mobilise financial resources and fewer contingent liabilities from loss-making government-related entities (GREs), which are typically state-owned enterprises (SOEs) that include local government financing vehicles (LGFVs) in a broad sense.

We assign a preliminary economic score (PES) based on three sub-factors: economic development stage, economic scale and economic growth (Table 3).

Table 3: Assigning Preliminary Economic Score

Sub-factor	Indicator	Weight
Economic Development Stage	GDP per capita[1]	30%
Economic Scale	GDP[2]	30%
Economic Growth	Real Growth Rate of GDP[3]	40%

Note: 1. Local GDP divided by total number of residents, $year_{t-1}$, with $year_t$ being the current year. 2. The registered local GDP of $year_{t-1}$. 3. Five-year average from $year_{t-2}$ to $year_{t+2}$.

Additional Considerations

- **Investment-driven growth**: We would lower the PES by up to two points if the dependence of the LG's economy on investment is high (capital formation accounts for two-thirds of local GDP or above, or the regional fixed assets investment is excessively high compared to GDP), especially when a substantial portion of the investment involves the local public sector (LG and local SOEs). Such investment is unlikely to be sustainable and may include sizable low-productivity or loss-making projects, which dampens the economy's prospects for sustainable growth and the LG's fiscal health.
- **Economic concentration**: We would lower the PES by up to two points if the local economy has high dependence on a single volatile industry or sector, unless the industry or sector appears to be close to the bottom of the medium to long term economic cycle and the downside risk is limited.
- **Business environment**: We would lower (or raise) the PES by up to two points if we believe the local business environment is significantly worse (or better) than the peers'. This adjustment would be applied only to outliers, and thus would be limited to a very small number of LGs.
- **Demographic profile**: We would lower (or raise) the PES by up to two points if the local demographic profile is significantly worse (or better) than the peers'. Large and prolonged net outflows of population, substantial drainage of talent, and a high share of the dependent population all dampen the growth prospects of the local economy and increase fiscal pressure in stress scenarios. In contrast, a young population and substantial inflow of talent could boost local economic growth. This adjustment would be applied to outliers only, and thus would be limited to a very small number of LGs.
- **Quality of economic statistics**: We would lower the PES by up to two points if there is evidence that the quality of economic statistics of the LG is significantly worse than that of its peers. This adjustment would be applied to outliers only, and thus would be limited to a very small number of LGs.

Budgetary Strength

We assign the preliminary budgetary score (PBS) based on four components of budgetary performance (Table 4), with budgetary flexibility treated as an additional factor, since simple indicators may not provide sufficient information about LGs' budgetary flexibility in China. Budgetary strength, which includes both budgetary performance and budgetary flexibility, is a key component of an LG's creditworthiness. Budgetary performance (typically measured by budgetary balance) has an impact on an LG's debt and fiscal reserves, while budgetary flexibility (the ability to raise additional revenue or reduce expenditure) assists an LG in dealing with stress scenarios.

We begin by evaluating an LG's budgetary strength based on its revenue scale and revenue level (as measured by revenue per capita). A larger revenue scale typically indicates a more stable revenue stream and a greater ability of an LG to service its debt obligations. In addition, we use the revenue per capita to provide an alternative view of an LG's revenue level that takes population into account.

Our assessment of budgetary revenue focuses on the aggregate *general public budget* and *government fund budget* of all LGs under an LG's jurisdiction, including lower-level LGs that do not report directly to the LG. Generally, an LG has some authority to manage and affect its subordinate LGs' finances by adjusting the amount of transfer and refund or the tax-sharing mechanism. Under China's current fiscal policies, an LG is directly responsible for the repayment of debt on-lent to its subordinate LGs.

We take into account the potential funding gap of the *social security fund budget* (SSFB) of LGs in our assessment of debt and contingent liabilities, mainly because the limited data availability, especially about transfers from other budgets to the SSFB, may make an aggregate balance of SSFB and other budgets misleading on the budget performance.

We consider the budgetary balance (surplus or deficit) as one of the essential factors reflecting the budgetary performance of a Chinese LG. In our approach, we measure the budgetary balance in relation to the LG's revenue, which provides insight into the LG's budgetary pressure and fiscal robustness. A positive or slightly negative budgetary balance for an LG not only indicates a low level of budgetary pressure on the LG, but also, to some extent, the prudent fiscal management and the fiscal flexibility.

Table 4: Assigning Preliminary Budgetary Score

Sub-factor	Indicator	Weight
Budgetary Balance Ratio	Average Budgetary Balance to Revenue[1]	30%
Revenue Scale	Operating Revenue	30%
Revenue Level	Revenue per capita[2]	20%
Revenue Growth	Average Revenue Growth	20%

Note: 1. The sum of general budgetary balance and government fund budget balance, exclusive of carry-forward revenues and expenditures; five-year average from year_{t-2} to year_{t+2} 2. The sum of general budgetary revenue and government fund revenue divided by total number of residents; data of year_{t-1}.

Additional Considerations

- **Budgetary flexibility**: We would lower (or raise) the PBS by up to two points if we believe the budgetary flexibility of an LG is significantly weaker (or stronger) than that of its peers. This adjustment would be applied only to outliers, and thus would be limited to a very small number of LGs.

  Our assessment of budgetary flexibility consists of two components: an assessment of revenue flexibility and an assessment of expenditure flexibility. In China's tax-sharing system, LGs generally lack flexibility in modifying tax revenue. Certain LGs may have significant influence over non-tax revenues, for example, by increasing the price of state-owned land. However, such ability may be limited in stress scenarios except for very few LGs. On the expenditure side, while non-discretionary spending accounts for the majority of some LGs' expenditures, some LGs appear capable of reducing capital spending when necessary.

- **Potential changes in inter-governmental arrangements**: We believe that the Chinese government generally takes a granular approach to reforming inter-governmental arrangements, and thus that any future changes to such arrangements would typically have a limited impact on the relative budgetary strength of. If in rare cases a potential change in inter-governmental arrangements has a significant impact on the relative budgetary strength of LGs, we could lower the PBS of the LGs that are significantly impacted by the change by up to two points and raise the PBS of the LGs that are significantly benefited by the change by up to two points.

- **Revenue Volatility**: We would lower the PBS by up to two points if we believe the LG's revenue is expected to be significantly more volatile than that of its peers. Our assessment on an LG's budgetary strength mainly focuses on its average performance over the recent past and immediate future, which may underestimate the fiscal stress and credit risk that an LG faces in any given year. We believe that examining LG's revenue volatility is critical for capturing this significant downside risk and ensuring that all LGs are compared fairly.

- **Quality of budgetary data**: We would lower the PBS by up to two points if there is evidence that the quality of budgetary statistics of the LG is significantly worse than that of its peers.

Debt Burden

Debt burden is a key factor to differentiate the creditworthiness among LGs in China, as the central government's motivation for promoting differentiation among LGs' creditworthiness is to rein in the rapid debt growth of some LGs.

We assign the preliminary debt score (PDS) in this way:

- If the LG's debt ratio exceeds the debt ceiling established by the higher-level government, the PDS is "3".
- Otherwise, the PDS will be a weighted average of sub-scores on debt level and debt growth (Table 5).

Table 5: Assigning Preliminary Debt Score

Sub-factor	Indicator	Weight
Debt Level	Debt-to-Revenue Ratio[1]	30%
	Debt-to-GDP Ratio	30%
Debt Growth	Average Change in Debt-to-GDP Ratio[2]	40%

Note: 1. Revenue = general budgetary revenue + government fund revenue. 2. Five-year average of yearly changed in the Debt-to-GDP ratio from year_{t-2} to year_{t+2}

The debt includes the debt of all subnational governments under the jurisdiction of the LG, plus all contingent liabilities of all these subnational governments that can be quantified with a reasonable degree of accuracy. Typical contingent liabilities include debt guaranteed by the LG, urban facilities mandated by the LG and debt incurred by important entities associated with the LG (local GREs) that are unlikely to be self-supporting. Contingent liabilities may also include debt incurred by GREs from investing in not-for-profit infrastructure, urban facilities and the potential spending gap of the local social security system (especially pension funds).

We assess LGs' debt levels using debt-to-revenue and debt-to-GDP ratios. The former directly reveals the LGs' financial ability to pay back their debt obligations and the latter measures the debt burden related to the local economic activity. Due to the economic cyclicality and land market volatility, Chinese LGs often see their revenue collections fluctuate substantially from time to time, distorting the debt-to-revenue performance in a specific short time period. To depict an objective and comparable trajectory of debt change, the debt growth is assessed in relation to the local GDP.

Additional Considerations

- **Debt ratio volatility**: If an LG's debt ratios are substantially more volatile than those of its peers and there is significant downside risk to the economic growth and revenue collections, we would lower the PDS by up to two points. In this case, assessing the LG's debt burden using the $year_{t-1}$ debt ratio may underestimate its vulnerability, and we believe that such volatility also weakens the LG's ability to service and manage its debt.
- **Large hard-to-quantify contingent liabilities**: When the size of contingent liabilities cannot be accurately quantified and is very likely much higher than the peers', we would lower the PDS by up to two points. For instance, if local SOEs are heavily indebted and have very weak financial profiles, they can impose substantially greater contingent liabilities on an LG, justifying the PDS's two-point downward adjustment.
- **Quality of debt statistics**: We would lower the PDS by up to two points if there is evidence that the quality of debt statistics of the LG is significantly worse than that of its peers.

Liquidity

We assign the preliminary liquidity score (PLS) based on the internal liquidity position of an LG and the coverage of its liquidity sources over liquidity usages in the current or next year (Table 6). All other things being equal, the stronger an LG's internal liquidity position and liquidity coverage ratio are, the lower the risk of default.

We consider both the endogenous and exogenous liquidity sources to measure an LG's liquidity states. Typically, an LG's primary liquidity sources include bank deposits for the budget stabilisation fund and carry-forward surpluses under the general government budget and government fund budget, as well as the holding of stocks of listed SOEs that the LG is willing to sell in order to meet debt obligations. Bank deposits are, in fact, the LG's most direct and immediate endogenous liquidity source, as they are highly flexible and prompt to meet any liquidity needs. We use the fiscal deposit to debt interest payment ratio to measure the LG's relative position of cash.

Other possible sources of liquidity include new external debt issuance if the LG is able to access the domestic bond market at reasonable costs. The central government allows provinces and cities under separate state planning to issue bonds directly and sets debt-ceiling for them. The issuance of LG bonds has historically been massively oversubscribed, indicating the market's high demand for them and their high liquidity generation capacity. As a result, we consider the difference between an LG's debt balance and debt ceiling as an important source of external liquidity. Likewise, the higher-level governments on-lend the proceeds from bond issuance to their subordinated LGs and set debt-ceilings for them. On the other hand, the LG's liquidity usages may include the short-term debt obligations and potential deficit funding needs. Eventually, we attain the liquidity coverage ratio so as to demonstrate the LG's comprehensive liquidity.

The liquidity analysis focuses on the aggregate liquidity sources and usages of all subnational governments under the LG's jurisdiction.

Table 6: Assigning Preliminary Liquidity Score

Sub-factor	Indicator	Weight
Internal Liquidity Position	Fiscal Deposit to Interest Payment Ratio	50%
Liquidity Coverage Ratio	Liquidity Source to Liquidity Usage Ratio	50%

Note: For rating action taking place in the first quarter of a year, we use the liquidity coverage ratio of $year_t$. For rating action taking place in the last quarter of a year, we use the liquidity coverage ratio of $year_{t+1}$. Otherwise, we use the average liquidity coverage ratio of $year_t$ and $year_{t+1}$.

Additional Considerations

- **Debt and liquidity management**: If an LG's debt and/or liquidity management of an LG are very weak, the risk of failing to making timely debt payments may be significantly higher than suggested by the liquidity coverage ratio. Then, we would lower the PLS by up to two points.
- **Access to external financial resources other than that from HLG**: If an LG's economy and SOE sector are significantly larger and stronger than those of its peers, the LG may be in a much stronger position to mobilise external financial resources to meet its debt obligations or support GREs experiencing liquidity shortages. In such cases, we would raise the PLS by up to two points. This adjustment would be applied to outliers only, and thus would be limited to a very small number of LGs.
- **Quality of liquidity statistics**: We would lower the PLS by up to two points if there is evidence that the quality of statistics about the LG's liquid assets is significantly worse than that of its peers.

Governance and Financial Management

Governance and financial management are key factors of an LG's long-term economic and fiscal performance. We believe that the level of governance and financial management of Chinese LGs is generally correlated with the local economic strength, and thus is partly captured by our economic score.

The governance and financial management score (GFS) is based on our assessment of four sub-factors: budgetary management, GRE management, transparency, and accountability (Table 6). The management of debt and liquidity, as well as the quality of data have been discussed in previous sections of this report.

Table 6: Assigning Governance and Financial Management Score

Sub-factor	Weight
Budgetary Management	30%
GRE Management	30%
Transparency	30%
Accountability	20%

Our assessment of budgetary management focuses on how well the budget implementation meets budget planning and budgetary discipline, and whether there is a meaningful medium-term budget, i.e., whether the LG has reasonably planned its fiscal budget and promptly announced it at the beginning of a fiscal year—typically in the first quarter. The budget should be comprehensive, at least including the budgets of general public budgetary revenue and expenditure, as well as government fund revenue and expenditure. The budget should be consistent, which means the divergence between the current year's budget and budget implementation in the previous year should not be excessive. We would consider an LG's budgetary management to be underperforming if there appeared to be a significant and persistent budget overrun problem, indicating the LG's inability to balance and control its revenue and expenditure. The improvement or setback of the LG's budgetary management and the higher-level government's evaluation on the LG are also factors in our assessment.

Our assessment of GRE management focuses on how effective is the division of roles between the local government and GREs (typically SOEs) in managing the GREs' strategy and operation; whether the LG intervenes in the operations of SOEs in relation to the legal rights of creditors; whether the major local SOEs have reasonably well-defined business portfolios; and whether the LG appoints capable professionals to the SOEs' management teams.

Our assessment of transparency focuses on the extent and timeliness with which economic, financial, and fiscal statistics and information about the local economy and the LG are disclosed.

Our accountability assessment focuses on whether officials who violate laws and regulations governing budgetary management, GRE management, debt and liquidity management, data and disclosure receive appropriate discipline.

Willingness to Repay

Default history and other indicators of less willingness to repay debt would lead to a reduction of the SACP by one or two notches. The Chinese governments have been deemed having strong willingness to service their debts and maintain their credit reputation. Failing to meet the debt obligations of an LG or the default of one or more agencies or proxies of an LG can devastate the LG's credit profile dramatically. The reputation of the LG will be dampened and the creditors, vendors and even residents will begin to doubt the LG's creditworthiness. It will be difficult for an LG to raise new funds and roll over maturing debts and the liquidity will be in drain. Government investment and operations will also be adversely affected since the counterparties will be reluctant to do business with the LG when the suspicion of the LG's ability to pay prevails. Even if an LG does not have a record of default, we would apply such downward adjustments if we believe that the LG's willingness to fulfil its financial obligations has substantially weakened.

Peer Comparison

Since China is a huge country with dozens of provincial-level governments, hundreds of prefecture-level city governments, and thousands of county-level governments, the creditworthiness of these local governments can vary significantly. However, we believe that the creditworthiness should vary less among provincial governments than among prefecture-level city governments, and the difference will be even greater among lower district and county-level governments. Our approach employs a large number of rating factors, which are typically assessed against predefined cutoff points. We take a holistic view when determining an LG's SACP, since bits of rating information may be lost at each step of the analysis. Such information loss may accumulate to a point where it has a material impact on an LG's credit profile. We believe that a comparison of an LG to other similarly rated LGs across the country is crucial for ensuring the consistency in our analysis.

Typically, following the cross-regional peer comparison, we allow the SACP of a provincial-level government to be up to one notch lower or higher than the ICS, and the SACP of a prefecture-level city and a lower local government to be up to two notches lower or higher than the ICS.

Extraordinary Support

In assessing the likelihood of extraordinary support, we analyse the capability of a higher-level government and its willingness to support. We measure the higher-level government's capability to provide extraordinary support to its LGs by its ICR. In general, the stronger a higher-level government's creditworthiness is, the more support it can provide to its LGs. The higher-level government's willingness to support, on the other hand, is much more complicated and subtle. If an LG is more important to its higher-level government than its peers, as a result of the LG's unique status or role in achieving national or regional economic, political or security objectives, the higher-level government may provide significantly stronger support to the LG than to other LGs. We take the above factors into consideration when assessing the higher-level government's willingness to support a particular LG. We believe that the stronger the higher-level government's capability and willingness to support, the closer the creditworthiness of an LG is to the higher-level government . Extraordinary support can substantially enhance the creditworthiness of those LGs with significantly lower standalone creditworthiness than their higher-level government. For LGs whose standalone creditworthiness is already comparable to that of their higher-level government, or whose higher-level government has a lower willingness to support, the extraordinary support will have little effect on their creditworthiness.

Assigning Issuance Rating

We set the issuance credit rating of a senior unsecured LG foreign-currency debt equal to the LG foreign-currency ICR, unless the debt is fully guaranteed, in which case we assign issuance rating based on our applicable criteria.

We set the issuance credit rating of a senior unsecured LG local-currency debt equal to the LG local-currency ICR, unless the debt is fully guaranteed, in which case we assign issuance rating based on our applicable criteria.

Related Criteria and Research

- Rating Symbols and Definitions, 7 May 2018
- General Principles of Credit Ratings, 21 November 2017
- Sovereign Rating Criteria, 30 May 2018

DISCLAIMER

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