Moody's Investors Service

Global Credit Research
New Issue
15 JUL 2008

New Issue: Nevada (State of)

MOODY'S ASSIGNS Aa1 TO $297 MILLION STATE OF NEVADA GENERAL OBLIGATION BONDS; OUTLOOK REVISED TO NEGATIVE

NEGATIVE OUTLOOK APPLIES TO $1.9 BILLION OF NET TAX-SUPPORTED DEBT OUTSTANDING

State
NV

Moody's Rating

ISSUE		RATING
General Obligation (Limited Tax) Capital Improvement and Cultural Affairs Bonds, Series 2008C		Aa1
Sale Amount	$273,115,000	
Expected Sale Date	07/16/08	
Rating Description	General Obligation Limited Tax	
General Obligation (Limited Tax) Natural Resources Bonds, Series 2008D		Aa1
Sale Amount	$12,705,000	
Expected Sale Date	07/16/08	
Rating Description	General Obligation Limited Tax	
General Obligation (Limited Tax) Open Spaces, Parks, and Cultural Resources Bonds, Series 2008E		Aa1
Sale Amount	$7,365,000	
Expected Sale Date	07/16/08	
Rating Description	General Obligation Limited Tax	
General Obligation (Limited Tax) Safe Drinking Water Act Revolving Fund Matching Bonds, Series 2008F		Aa1
Sale Amount	$3,390,000	
Expected Sale Date	07/16/08	
Rating Description	General Obligation Limited Tax	
General Obligation (Limited Tax) Water Pollution Control Revolving Fund Matching Bonds, Series 2008G		Aa1
Sale Amount	$1,015,000	
Expected Sale Date	07/16/08	
Rating Description	General Obligation Limited Tax	

Opinion

NEW YORK, Jul 15, 2008 -- Moody's has assigned a rating of Aa1 to the State of Nevada's General Obligation (Limited Tax) Bonds, Series 2008C-G, totaling $297 million and scheduled to price the week of July 14. The rating outlook has been revised to negative from stable.

The negative outlook reflects the following factors: the severe revenue, economic, and budgetary stress the state is experiencing; the planed full drawdown of the Rainy Day Fund, reducing flexibility if revenues continue to underperform; and the decline in gaming and related revenues. The rating also incorporates the following strengths and challenges:

CREDIT STRENGTHS:

- An economy whose growth in recent years has been virtually unparalleled among the states.

- Conservative management that reacts quickly during periods of both weakness and growth, and has responded with budget solutions quickly during the current downturn.

- Debt ratios on both a per capita basis and personal income basis below Moody's 50-state medians.

CREDIT CHALLENGES:

- A highly concentrated economy, which is inherently more risky than that of a more diverse one.

- A weak economy resulting from the housing market downturn, national slowdown, high gas prices, and decline in gaming.

- Sharp decline in revenues that has led to large budget gaps and resulted in the planned full drawdown of the Rainy Day Fund.

- Potential for decline in visitors given announced reductions in nonstop flights to Las Vegas and increased fuel costs.

- Potential erosion of Nevada's steady stream of visitors from California as a result of the expansion of tribal gaming in California.

ECONOMY HURT BY HOUSING DOWNTURN, HIGH OIL PRICES

The Nevada economy has been the fastest-growing in the nation for years. Recently, however, a number of things have brought that growth rate down significantly. In the past year, the housing market crash and high oil prices have all taken their toll on the state economy.

Nevada experienced a larger housing boom than most states in recent years, and has experienced a proportionate fall. In June 2008, Nevada had the highest foreclosure rate in the nation for the 18th month in a row. The median new home price declined 13% from May 2007 to May 2008. New home sales declined 50% from May 2007 to May 2008. Existing home closings were a bright spot in the housing market, with closings increasing 5.2% from May 2007 to May 2008.

As a result of decreased travel to Las Vegas and decreased spending once there, gambling and related industries are experiencing a downturn. Casino gaming win was down 15.7% in May 2008 compared to May 2007. Visitor volume was essentially flat through March 2008 (on a year-over-year basis). Hotel occupancy rates were still high at 88-89% through April. As oil prices continue to increase, airlines are cutting back on direct flights to Las Vegas. Remaining flights may cost more, possibly deterring visitors.

While the housing market downturn has been severe, the non-residential real estate market appears to be holding up. At present 30,000 new hotel rooms are being constructed. The Palazzo Hotel, with approximately 3,000 rooms, and the Encore at Wynn, with 2,000 rooms, are expected to open this year. Other large projects, including City Center and Echelon Place, are in the construction or site development stage.

FISCAL 2008 REVENUES DOWN; FISCAL 2009 FORECAST GLOOMIER

The state's General Fund is dependent on sales taxes and gaming revenues, which each make up approximately one-third of revenues. The other third of revenues includes the modified business taxes (9%), insurance taxes (9%), real property transfer taxes (3%), and cigarette taxes (4%). For fiscal year 2008, the Economic Forum is currently (June 2008) projecting sales tax revenues to be down 3.6%. It is projecting gaming revenues to be down 4.3%, and real property transfer tax revenues to be down 30%. Sales tax collections through April are down 3.3% compared to the same period of last year. Gaming collections through May are down 5.9%, and real property transfer taxes are down 28.3%. In a possible sign of future deterioration in gaming revenues, May 2008 gaming tax collections were 22% below the collections received in May 2007.

The forecast for tax revenues in 2009 (according to the June 2008 Economic Forum) projects growth in gaming taxes of 2.8%, which may be optimistic. Sales and use tax revenues are projected to decline 3.7%, and real property transfer taxes are expected to decline 34%. Total tax revenues are expected to decline 0.9%.

STATE HAS RESPONDED RAPIDLY TO PROJECTED SHORTFALLS

In September 2007, it was reported that the administration projected a $285 million shortfall over the biennium. In January, the shortfall estimate increased to $565 million. At that time, the governor directed all agencies to reduce their budgets for the biennium by 4.5%. This action resulted in $565 million being cut from the budget. The shortfall estimate for the biennium increased to over $900 million in March. The governor directed additional cuts of $349 million.

As of June 27, 2008, the shortfall hit $1.175 billion for the biennium (out of approximately $3.2 billion in General Fund revenues per year). Solutions include drawing down the Rainy Day Fund from $267 million to $0, as well as across-the-board cuts of 7.8% (the earlier cut of 4.5% plus an additional cut of 3.3%), totaling $363 million.

In July 2008, it was reported that gaming revenues collected in June (reflecting winnings in May), were down 22.8% from the same month of the prior year, the worst drop in at least 10 years. The governor asked state agencies to plan for 14% cuts in their 2010-2011 biennium budgets. If revenues continue to underperform, more cuts may be needed for fiscal 2009. With the Rainy Day Fund depleted, many funds swept of additional cash, and an unwillingness to raise revenues, the state's financial and budgetary flexibility has decreased.

AVAILABLE BALANCES TO BE DRAWN DOWN

After ending fiscal year 2003 with a fund balance of just $109 million, Nevada saw its fund balance rise to $342 million in 2004 and then hit $540 million in 2005 before leveling off at $521 million in fiscal 2006 and $445 million in fiscal 2007. The state showed a negative unreserved GAAP balance through most of the last decade, the result of spending against advance revenues from gaming operations and incurred but unspent Medicaid claims. At its low point in 2002, the fund balance declined to $50.7 million, with an unreserved, undesignated fund balance (UUFB) deficit of $167.3 million. In 2004, the UUFB deficit stood at $6.2 million, in 2005 it was $0, and in 2006 it was positive at $176 million, or 5% of total revenues. In 2007 it was drawn back down to $0.

After having depleted its Rainy Day Fund in fiscal 2003, the state appropriated $34 million in fiscal 2007 (following deposits totaling $86 million in fiscal 2006) bringing the Fund balance to $267.6 million. The Rainy Day Fund will be fully drawn down by the end of fiscal year 2009 to cover revenue shortfalls.

RAPID EXPANSION OF TRIBAL GAMING IN CALIFORNIA POSES LONG-TERM RISK

With the passage of California Proposition 1A, which allowed gaming on state Indian reservations, Nevada's gaming and tourism industries face some competition from the rapidly expanding tribal gaming establishments. Gross revenues from these establishments have been estimated at $3 to $5 billion, as compared to $10 billion for the state of Nevada. Recent reports have confirmed the success and growth of this industry in California, although Nevada has so far evidenced little negative impact from this competition.

Over the longer term, while Nevada and especially Las Vegas will likely remain a popular destination, visitor volume, about 30 percent of which comes from California, could decrease in the face of competition from California tribal gaming. The smaller regional markets close to the California border have felt some impact already. The smaller establishments in these markets are more vulnerable than those in Las Vegas because smaller style casinos will compete more directly with the new tribal casinos. Although legal gaming continues to proliferate outside of Nevada, the expansion of gaming activities in smaller venues outside of the state may actually benefit the state by whetting the appetite of gamblers for the large-scale gaming provided by Las Vegas casinos. In addition, Las Vegas' role as an international gaming center offers some cushion against domestic competition.

HISTORICALLY LOW DEBT LEVELS

Nevada's debt levels have historically been quite low. Throughout the 1980s, the state's debt per capita consistently fell below the median figure for all states, rising just above the median during the 1990s, as Nevada's population explosion prompted more capital needs. Beginning in 1998, Nevada's debt per capita again fell below the state median reflecting strong population and personal income growth. The state's debt as a percent of personal income has only twice since 1980 exceeded the state median. Moody's 2008 State Debt Medians Report shows that Nevada continues its tradition as a state with a low debt burden. Nevada's per capita debt figure of $759 ranks Nevada 30th among states (the state median is $889). Nevada's debt as a percent of personal income (2.0%, with a ranking of 30th among states) is also below the national median of 2.6%. The state has no variable rate debt outstanding.

The state's Public Employees' Retirement System (PERS) currently has a 78% funded ratio, with an unfunded actuarial accrued liability of approximately $6.3 billion.

STATE FORMS OPEB TRUST FUND

Nevada's legislature has formed an OPEB trust fund and approved $22.3 million in OPEB pre-funding (on top of pay-as-you-go costs). An actuarial valuation determined as of July 1, 2007 that the actuarial accrued liability (AAL) will be $3.3 to $3.9 billion for the state, and the annual required contribution (ARC) will be approximately $250 million.

Outlook

The rating outlook for the state of Nevada's General Obligation bonds is negative, reflecting the uncertainty regarding the gaming industry and tourism in general given the national economic downturn and the high cost of fuel, weakness in the housing sector, and the fact that the actions that the state has taken to date have left it with limited remaining budgetary flexibility. Many of the budgetary solutions the state has chosen are one-time in nature, and will leave the state in a weakened financial position for the next biennium.

What could change the rating - UP

- Strengthening of finances with evidence of further diversification of tax structure.

What could change the rating - DOWN

- Continued revenue underperformance, with budgetary solutions that further increase structural imbalance.

- Further economic downturn brought about by gaming decline, high oil prices, or overdevelopment.

- Continued weakness in the housing sector.

- Increased growth and success of the tribal Casinos in California eventually show tangible long-term negative effects in Nevada.

- Severe decline in economic base and tax revenues in the outyears.

- Failure of management to continue to be proactive in expenditure reductions in the face of continuing revenue declines.

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