Municipal Bond Rating Overview and Recent Developments

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SEPTEMBER 13-15 IN SPRINGFIELD

Introduction

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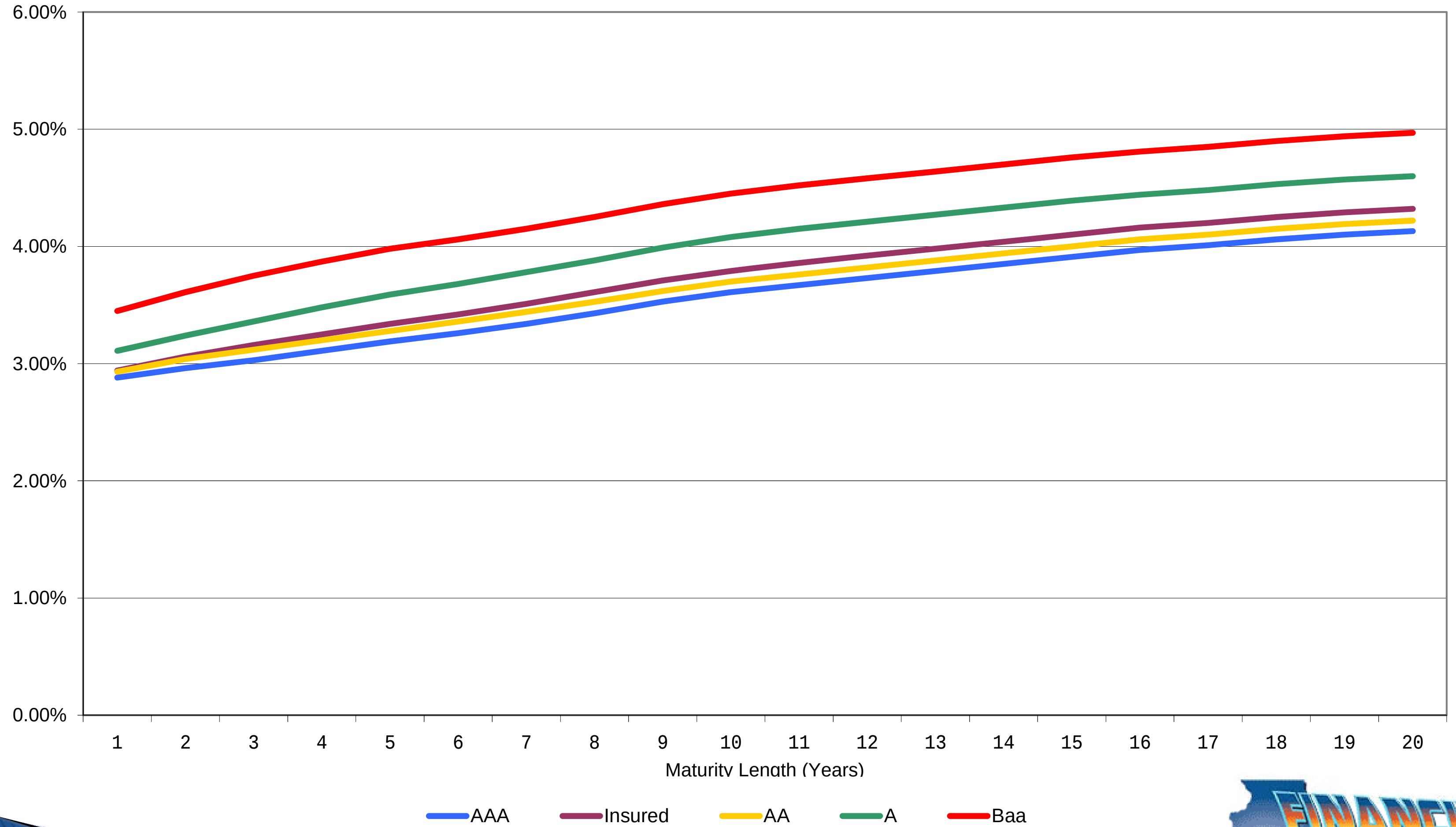
Rating Scales

Credit Rating Scales and Definitions

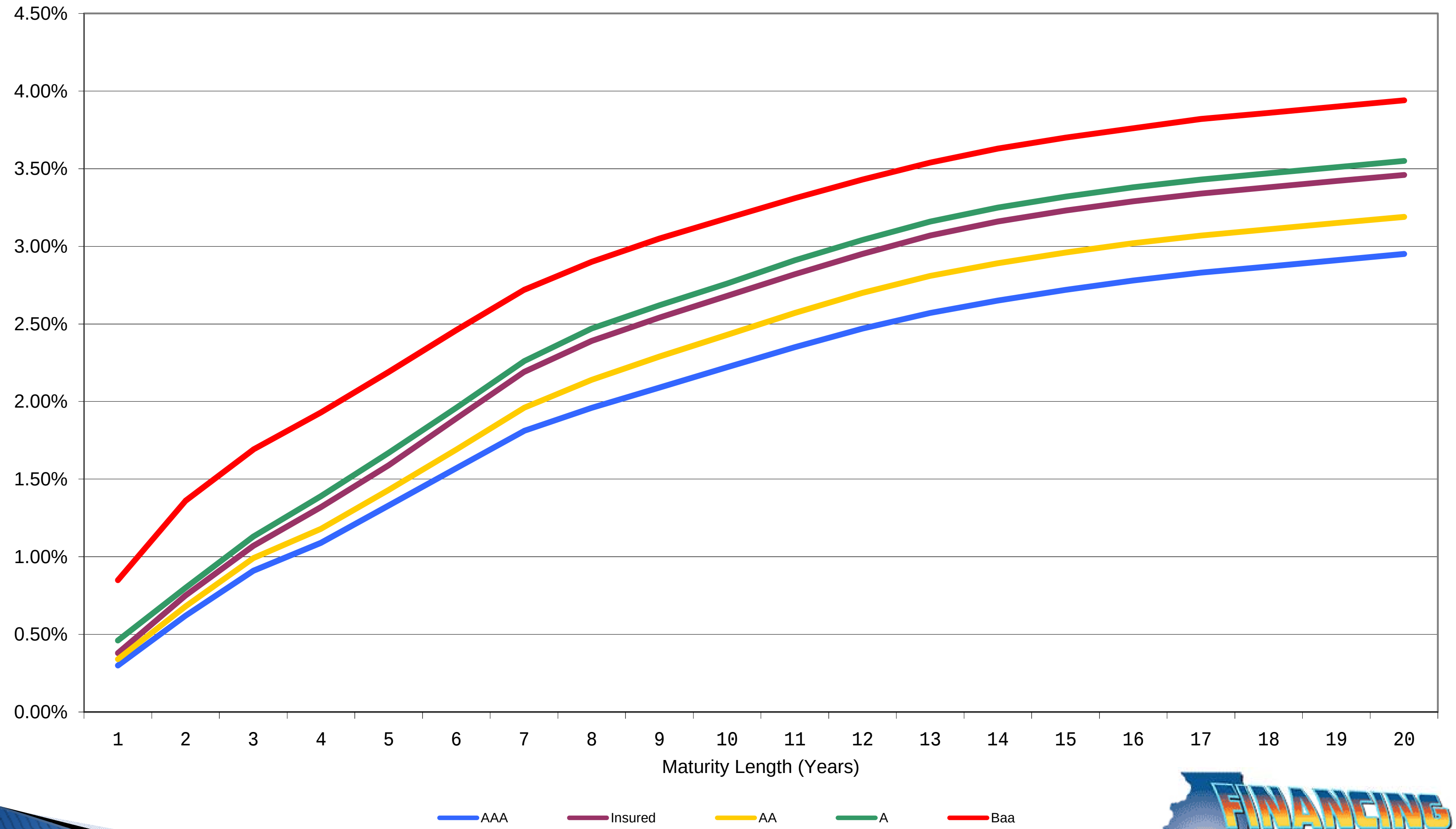
	Moody's	S&P	Fitch	Kroll	
	Aaa	AAA	AAA	AAA	Extremely strong capacity to meet financial obligations.
	Aa1	AA+	AA+	AA+	
Investment Grade	Aa2	AA	AA	AA	Very strong capacity to meet obligations.
	Aa3	AA-	AA-	AA-	
	A1	A+	A+	A+	
	A2	A	A	A	Strong financial capacity but susceptible to adversity.
	A3	A-	A-	A-	
	Baa1	BBB+	BBB+	BBB+	
	Baa2	BBB	BBB	BBB	Adequate financial capacity but adverse conditions will lead to
	Baa3	BBB-	BBB-	BBB-	weakness.
Non-Investment Grade	Ba1	BB+	BB+	BB+	
	Ba2	BB	BB	BB	Non-Investment Grade Speculative
	Ba3	BB-	BB-	BB-	
	B1	B+	B+	B+	
	B2	B	B	B	Highly Speculative
	B3	B-	B-	B-	
	Caa	CCC+		CCC+	
	Ca	CCC	CCC	CCC	Extremely Speculative
	C	CCC-		CCC-	
			DDD	CC	
			DD	C	
		D	D	D	Default

Why do you Care – Credit Spreads Pre-Financial Crisis



*The Municipal Market Data “MMD” is a munic[illegible]market index produced by TM3. As of January 2, 2008.

Why do you Care – Credit Spreads (Current)



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Overview of Criteria

Broad Rating Criteria

Moody's

- Economy
- Debt
- Finances
- Management

Standard & Poor's

- Institutional framework;
- Economy;
- Management (through FMA);
- Budgetary flexibility;
- Budgetary performance;
- Liquidity; and
- Debt and contingent liabilities

MOODY'S RATING CRITERIA

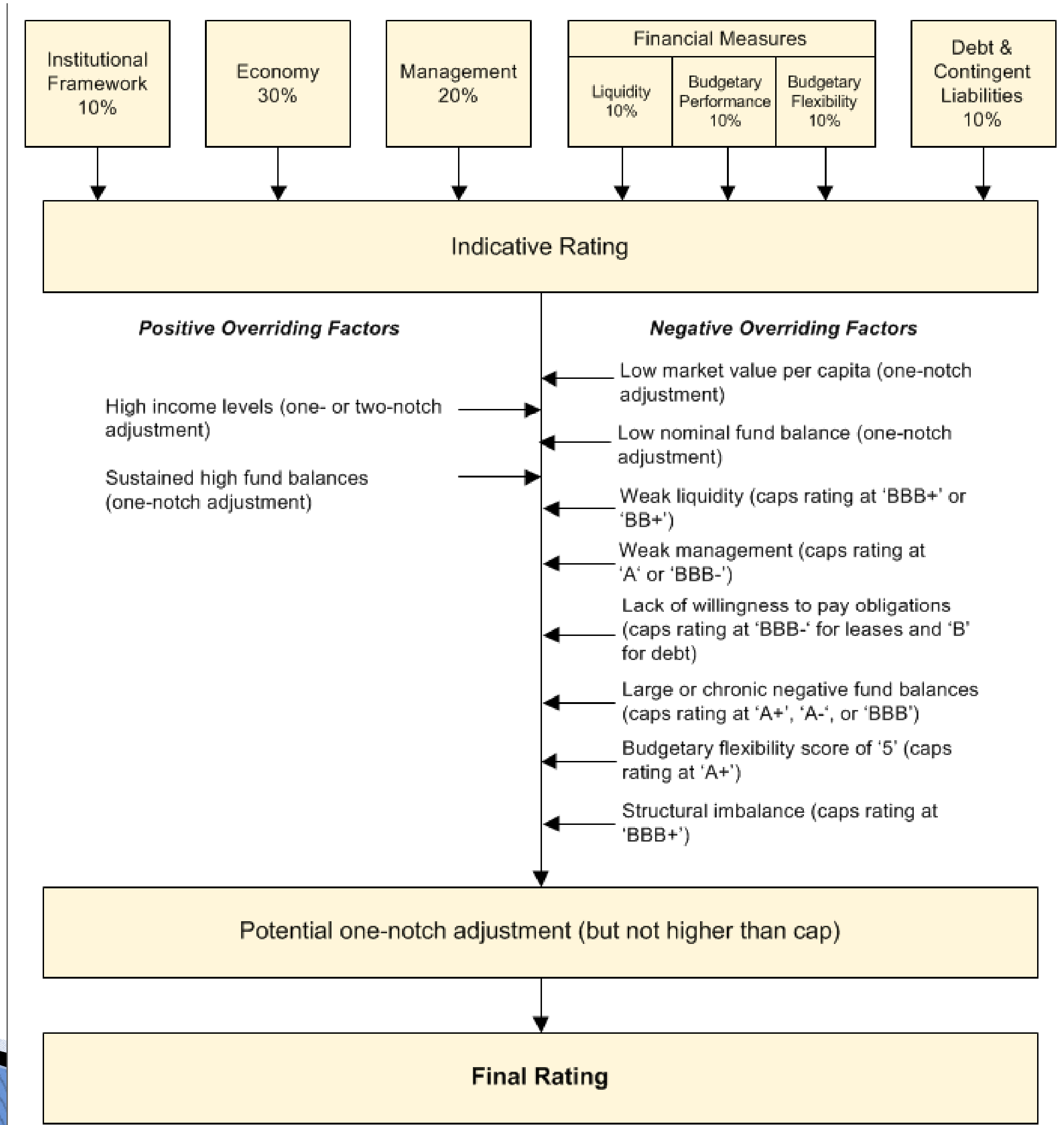
EXHIBIT 1

Scorecard Factors and Weights

Local Governments

Broad Rating Factors	Factor Weighting	Rating Subfactors	Subfactor Weighting
Economy/Tax Base	30%	Tax Base Size (full value)	10%
		Full Value Per Capita	10%
		Wealth (median family income)	10%
Finances	30%	Fund Balance (% of revenues)	10%
		Fund Balance Trend (5-year change)	5%
		Cash Balance (% of revenues)	10%
		Cash Balance Trend (5-year change)	5%
Management	20%	Institutional Framework	10%
		Operating History	10%
Debt/Pensions	20%	Debt to Full Value	5%
		Debt to Revenue	5%
		Moody's-adjusted Net Pension Liability (3-year average) to Full Value	5%
		Moody's-adjusted Net Pension Liability (3-year average) to Revenue	5%

S&P RATING REVISED CRITERIA–
ONLY APPLIED TO STATES, MUNICIPALITIES AND COUNTIES



GASB 67/68 and Rating Agency Pension Analysis

GASB 67/68 – Standard and Poor's

- S&P will incorporate the new pension data into their analysis
- "According to the criteria, the primary focus of our analysis of a local government's pension or OPEB liability is not that the liability will grow or the funded ratio will fall," said Standard & Poor's credit analyst Katilyn Pulcher, "but whether it requires significant—or significantly increasing--contributions over the medium term."
- S&P will focus on a the following: commitment to funding, investment performance, trend analysis, affordability, and efforts at maintaining plan sustainability
- Limited resources or no credible plan for how to pay for these benefits could exacerbate the situation

GASB 67/68 – Standard and Poor's

- Under Standard & Poor's new local government General Obligation criteria
  - One point adjustment to a local government's debt and contingent liabilities initial score if the local government has an unaddressed exposure to large unfunded pension or OPEB obligations that leads or potentially leads to an accelerating payment obligation over the medium term that creates significant budget pressure
  - Two point adjustment if there is no specific and credible plan to address this burden in place

GASB 67/68 – Standard and Poor's

- Carrying Charge: The required annual pension payment plus annual OPEB payment as a percentage of total governmental funds expenditures

- A combined carrying charge of 10% or more will be considered elevated, however, S&P will consider whether it expects the elevated payments to result in lower future obligations

- If funding ratio(s) are less than 80%, they will receive further review especially when the carrying charge is elevated

- The degree to which a local government contributes less than its full required contribution(s) could be an indication of either short-term cash flow issues or a willingness of management to defer difficult decisions

- The OPEB costs exceed 5% of total governmental funds expenditures and the local government has limited flexibility to change or amend these benefits

GASB 67/68 – Moody's

- Moody's will analyze the new results, but they make their own pension calculations
- Multiple-employer cost-sharing plan liabilities will be allocated to specific government employers based on proportionate shares of total plan contributions
- Asset smoothing will be replaced with reported market or fair value as of the actuarial reporting date
- Accrued actuarial liabilities will be adjusted based on a high-grade long-term taxable bond index discount rate as of the date of valuation
  - They use the Citibank Pension Liability index as of the date of the asset valuation

GASB 67/68 – Moody's

- The resulting adjusted net pension liability (i.e. adjusted liabilities less assets) will be amortized over 20 years using a level-dollar method to create a measure of annual burden related to the net pension liability

- Moody's position is they are not suggesting that their adjusted pension figures be used as a guide, standard or requirement for a state or local government to fund these obligations. Instead, they introduced these adjustments solely for the purpose of evaluating pension risk in the context of its credit ratings

- As the GASB 68 numbers come out they will use the sensitivity analysis to estimate duration of liabilities. They currently assume 13 years

GASB 67/68 – Moody's

- Moody's treatment of debt seeks to scale the magnitude of a local government's debt obligations relative to:
  - The local government's resources (using tax base as the proxy)
  - The local government's operations (using operating revenues as a proxy)

Factor 4: Debt/Pensions (20%)

	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Net Direct Debt / Full Value	< 0.75%	0.75% ≤ n < 1.75%	1.75% ≤ n < 4%	4% ≤ n < 10%	10% ≤ n < 15.%	> 15%	5%
Net Direct Debt / Operating Revenues	< 0.33x	0.33x ≤ n < 0.67x	0.67x ≤ n < 3x	3x ≤ n < 5x	5x ≤ n < 7x	> 7x	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value	< 0.9%	0.9% ≤ n < 2.1%	2.1% ≤ n < 4.8%	4.8% ≤ n < 12%	12% ≤ n < 18%	> 18%	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues	< 0.4x	0.4x ≤ n < 0.8x	0.8x ≤ n < 3.6x	3.6x ≤ n < 6x	6x ≤ n < 8.4x	> 8.4x	5%

Preparation for the next rating review

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Steps to address well before the next rating review

- Does the issuer have…
  - A fund balance policy?
  - A debt policy?
  - A capital improvement plan with needs and funding sources identified?
  - Long range projections?
- How often does the administration report investments to the governing body (at least quarterly is suggested)?
- How often does the administration report on intra year trends in revenues and expenditures?
- Is budget amended and for what reasons?

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How to address long-term benefit liabilities in the near term?

- Educate the governing board on pension related liabilities and the consequences of deferring tough decisions (see State of Illinois and the City of Chicago)
  - Establish policies and procedures

- If pension/OPEB liabilities are increasing, create a credible plan to address the liabilities especially if trends are worsening

- Make additional contributions to reduce net pension liabilities
  - Utilize excess fund balances
  - Borrow tax exempt for capital expenditures in lieu of using funds on hand to pay capital expenditures

- Both rating agencies give credit to governments that begin to prefund OPEB liabilities

What information to know for the rating review not in the CAFR or OS?

- Describe the development that is taking place
- Talk to the assessor(s) about expected EAV trends
- Know the status of significant property tax appeals (PTAB)
- Understand your OPEB and pension liabilities and have a credible management plan
- Disclose direct-purchase debt (avoid onerous covenants like acceleration)
- Be ready to explain revenue raising flexibility
  - Know what untapped revenue sources are in $$
  - Discuss willingness and history of raising revenues
- Be prepared to address prior deficits and causes
- Be prepared to provide year-to-date budget-to-actual numbers

Rating Surveillance

What is a Surveillance Call?

- Provides a rating agency with an opportunity to make credit ratings do not become “stale”
  - Accountability to the investor community
  - Regulations and policy require at least a “Passive” review annually
- Frequency of “Active” surveillance may vary, but it is happening much more often than before
- The issuer is provided a list of questions
  - It’s important to be responsive
  - Typically given a couple weeks to prepare for the call

Surveillance Call Best Practices

- Treat the surveillance call like a rating presentation for a bond sale
  - Take time to prepare detailed responses to each question

- Talk the analyst through your written responses

- Consult with your financial advisor as soon as you receive the email or phone call requesting the surveillance call

Surveillance Call Considerations

- Has the issuer done everything communicated the during the last rating review?
  - Review the most recent rating report
  - Be prepared to address differences

- What circumstances have changed since the last rating review?

- Has anything made it difficult to achieve what was anticipated during the last rating review?

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