Your Town’s Credit & Bond Rating

Massachusetts Assoc. of Town Finance Committees
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Franklin, MA

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Boston, MA 02110
Credit Ratings: What They Are And Are Not

Are:

- Opinions about relative credit risk
- Opinion about ability & willingness of an issuer to meet financial obligations in full & on time
- Forward looking and regularly evolving
- Intended to be comparable across different sectors and regions

Are not:

- Investment advice
- Indications of market liquidity or price
- Guarantees of future credit risk
- Absolute measures of default probability
- Expected ultimate loss given default
Rating Definitions

Standard & Poor’s Ratings Scale

**Investment-Grade**

- AAA → Strongest
- AA+ → Very Strong
- AA → Very Strong
- AA- → Strong
- A+ → Strong
- A → Strong
- A- → Adequate
- BBB+ → Adequate
- BBB → Adequate
- BBB- → Adequate

**Speculative-Grade**

- BB+ → Least Speculative
- BB → Least Speculative
- BB- → Least Speculative
- B+ → Speculative
- B → Speculative
- B- → Speculative
- CCC → Highly Speculative
- CC → Highly Speculative
- C → Highly Speculative
- D → In Default
Summary of the Factors

The Local GO Criteria Factors
Analytical Framework

Institutional Framework 10%
Economy 30%
Management 20%
Financial Measures
- Liquidity 10%
- Budgetary Performance 10%
- Budgetary Flexibility 10%
Debt & Contingent Liabilities 10%

Indicative Rating

Positive Overriding Factors
- High income levels (1 or 2 notch adjustment)
- Sustained high fund balances (1 notch adjustment)

Negative Overriding Factors
- Weak liquidity (caps rating at A- or BB+)
- Weak management (caps rating at A or BBB-)
- Lack of willingness to pay obligations (caps rating at BBB- for leases and B for debt)
- Low market value per capita (1 notch adjustment)
- Large or chronic negative fund balances (caps rating at A+, A-, or BBB)
- Budgetary flexibility score of 5 (cap at A+)
- Low nominal fund balance (1 notch adjustment)
- Structural imbalance (caps rating at BBB+)

Final Rating

Source: Standard & Poor’s Ratings Services.
Institutional Framework (1 of 7 Factors)

Assesses the legal and practical environment in which the local government operates

The score is based on the average of four discretely scored areas

- **Predictability**: the extent to which a local government can forecast its revenues and expenditures on an ongoing basis (Table 4)

- **Revenue and expenditure balance**: the extent to which a local government has the ability to finance the services they provide (Table 5)

- **Transparency and accountability**: the overall institutional framework’s role in encouraging the transparency and comparability of relative financial information (Table 6)

- **Systemic support**: the extent to which local governments receive extraordinary support from a state government when the local government is under extreme stress (Table 7)
Institutional Framework (1 of 7 Factors)

All governments of the same type within the same state receive the same score

- Cities and counties can differ
  - Municipalities of the same type can differ based on home rule status

The institutional framework scores will be reviewed and maintained on an ongoing basis

### Table 3: Institutional Framework Score Outcomes

<table>
<thead>
<tr>
<th>Score Range</th>
<th>Institutional Framework Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 – 1.5</td>
<td>1 (very strong)</td>
</tr>
<tr>
<td>1.75 – 2.75</td>
<td>2 (strong)</td>
</tr>
<tr>
<td>3.0 – 3.75</td>
<td>3 (adequate)</td>
</tr>
<tr>
<td>4 – 4.5</td>
<td>4 (weak)</td>
</tr>
<tr>
<td>4.75 – 5</td>
<td>5 (very weak)</td>
</tr>
</tbody>
</table>

The institutional framework score results from the average of the scores for predictability, revenue and expenditure balance, transparency and accountability, and systemic support (see paragraphs 36-39). Each score receives equal weight in the average.

Source: Standard & Poor’s Ratings Services.
Economic Score (2 of 7 Factors)

- Assess both the health of the asset base relied upon to provide both current and future locally derived revenues as well as the likelihood of additional service demands resulting from economic deterioration.

- The initial score (1 through 5) is based on market value per capita and projected per capita income as a % of U.S. (Table 8).

- Per capita income is based on a 5-year projection.

- Especially high income will lead to a positive override and especially low market value per capita will lead to a negative override.

<table>
<thead>
<tr>
<th>Projected Per Capita EBI as a % of U.S. Projected Per Capita EBI</th>
<th>Total Market Value Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>&gt;$195,000</td>
</tr>
<tr>
<td>&gt;150</td>
<td>1</td>
</tr>
<tr>
<td>110 to 150</td>
<td>1.5</td>
</tr>
<tr>
<td>85 to 110</td>
<td>2</td>
</tr>
<tr>
<td>70 to 85</td>
<td>2.5</td>
</tr>
<tr>
<td>&lt;70</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
## Economic Score Adjustments

<table>
<thead>
<tr>
<th>Qualitative factors with a positive impact on the initial score</th>
<th>Qualitative factors with a negative impact on the initial score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation in a larger broad and diversified economy (see paragraphs 44 and 45).</td>
<td>Negative budget impact from demographic profile: population decrease and/or high share of dependent population (&gt;55%) have a material negative impact on future revenue growth and expenditure needs.</td>
</tr>
<tr>
<td>A stabilizing institutional influence with a longstanding role as a major employer, such as higher education, health care, military, or large and stable corporate presence.</td>
<td>High county unemployment rate (&gt;10%).</td>
</tr>
<tr>
<td>If employment concentration where an individual sector (excluding education/health, government, and transportation, trade and utilities) represents more than 30% of the nonfarm work base, or tax base concentration where the top 10 taxpayers represent more than 35% of the tax base, the score worsens by one point. If the top 10 taxpayers exceed 45% of the tax base, the score worsens by two points.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
Management Score (3 of 7 Factors)

- Assess the impact of management conditions on the likelihood of repayment
- The proposed Financial Management Assessment (FMA) is based upon our current methodology

<table>
<thead>
<tr>
<th>Rounded Score</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Very strong)</td>
<td>FMA score of &quot;strong&quot; and none of the factors in score ‘4’ or ‘5’ is present.</td>
</tr>
<tr>
<td>2 (Strong)</td>
<td>FMA score of &quot;good&quot; and none of the factors in score ‘4’ or ‘5’ is present.</td>
</tr>
<tr>
<td>3 (Adequate)</td>
<td>FMA score of &quot;standard&quot; and none of the factors in score ‘4’ or ‘5’ is present.</td>
</tr>
<tr>
<td>4 (Weak)</td>
<td>FMA score of “vulnerable” or any of the following is present: there is a financial reporting restatement that has a material negative impact; any of the conditions in score ‘5’ existed in the past three years; the structural imbalance override condition exists or existed within the past three years; or a very high debt, pension and OPEB burden.</td>
</tr>
<tr>
<td>5 (Very weak)</td>
<td>Regardless of the FMA score, any of the following is present: a management team that lacks relevant skills resulting in a weak capacity for planning, monitoring, and management; an auditor has delivered a going concern opinion; the government appears unwilling to support a debt or capital lease obligation; or the government is actively considering bankruptcy in the near term.</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
Financial Measures

• Three components factor into our assessment of a municipality’s financial credit characteristics

• Budgetary flexibility, budgetary performance, and liquidity

• Each factor is weighted 10% — all financial measures together are 30%

<table>
<thead>
<tr>
<th>Financial Measures</th>
<th>Liquidity 10%</th>
<th>Budgetary Performance 10%</th>
<th>Budgetary Flexibility 10%</th>
</tr>
</thead>
</table>

STANDARD & POOR’S RATINGS SERVICES
The budgetary flexibility initial score measures the degree to which the government can create additional financial flexibility in times of stress

- Available fund balance as a % of general fund expenditures: the average of the most recently reported fiscal year and our estimate for the following year, which may differ from that shown in the original or amended budget

- When other fund balances outside of the government’s general fund are available beyond the current fiscal year, they are included in the calculation

- This measure can cap a rating or it can be a positive override if extremely strong

### Table 10: Assessing The Budgetary Flexibility Score (see paragraphs 58-62)

<table>
<thead>
<tr>
<th>Available Fund Balance as a percentage of expenditures</th>
<th>%</th>
<th>&gt;15</th>
<th>8 to 15</th>
<th>4 to 8</th>
<th>1 to 4</th>
<th>≤1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
The budgetary performance initial score measures the current fiscal balance of the government

- Total governmental funds net result: the most recent year’s net total governmental funds on a budgetary basis as a percent of expenditures
- General fund net result: the most recent year’s general fund operational balance as a percent of expenditures

<table>
<thead>
<tr>
<th>General fund net result (%)</th>
<th>Total Governmental Funds Net Result (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>&gt; -1</td>
</tr>
<tr>
<td>(&gt; 5)</td>
<td>1</td>
</tr>
<tr>
<td>(-1 to 5)</td>
<td>2</td>
</tr>
<tr>
<td>(≤ -1)</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
Financial Measures: Liquidity Score (6 of 7 Factors)

The initial score measures the availability of cash and cash equivalents to service both debt and other expenditures

Initial liquidity score: combination of two measures (table 12)

- Total government cash as % of total governmental funds debt service
- Total cash % of total governmental funds expenditures

<table>
<thead>
<tr>
<th>Total Government Available Cash As % Of Total Governmental Funds Debt Service</th>
<th>&gt;120</th>
<th>100 to120</th>
<th>80 to100</th>
<th>40 to 80</th>
<th>≤40</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;15</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>8 to15</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4 to 8</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>1 to 4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>≤1</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Ratings Services.
Debt and Contingent Liability (7 of 7 Factors)

Initial debt score: combination of two measures (table 14)

- Total governmental funds debt service as a percentage of expenditures
  - Measures the annual fixed cost burden that debt places on the government
- Net direct debt as a percentage of total governmental funds revenue
  - Measures the total debt burden on the government's revenue position rather than the annual cost of the debt, which can be manipulated by amortization structures

<table>
<thead>
<tr>
<th>Total Governmental Funds Debt Service As A % of Total Governmental Funds Expenditures</th>
<th>&lt;30</th>
<th>30 to 60</th>
<th>60 to 120</th>
<th>120 to 180</th>
<th>≥180</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 8</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>8 to 15</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>15 to 25</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>25 to 35</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>≥35</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Table 14: Assessing The Debt And Contingent Liabilities Score (see paragraphs 77-81)

Source: Standard & Poor’s Ratings Services.
## Debt and Contingent Liability Adjustments

Table 14

<table>
<thead>
<tr>
<th>Qualitative factors with a positive impact on the initial score:</th>
<th>Qualitative factors with a negative impact on the initial score:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall net debt as a percentage of market value below 3%.</td>
<td>Overall net debt as a percentage of market value exceeding 10%.</td>
</tr>
<tr>
<td>Overall rapid annual debt amortization, with more than 65% coming due in 10 years.</td>
<td>Significant medium-term debt plans produce a higher score when included.</td>
</tr>
<tr>
<td>Exposure to interest-rate risk or instrument provisions that could increase annual payment requirements by at least 20%.</td>
<td>Unaddressed exposure to large unfunded pension or OPEB obligations leading to accelerating payment obligations over the medium term that represent significant budget pressure (see paragraph 80). If there is a plan to address the obligations, the final score worsens by one point; otherwise the score worsens by two points.</td>
</tr>
<tr>
<td>Speculative contingent liabilities or those otherwise likely to be funded on an ongoing basis by the government representing more than 10% of total governmental revenue.</td>
<td></td>
</tr>
</tbody>
</table>