## Municipal Market Comments



January 22, 2014



## Moody's Reviews Hundreds of Issuers under New Rating Methodology

On January 15, Moody's announced its new rating methodology for local government general obligation (G.O.) bond ratings. The updated methodology applies to local government G.O. bonds issued by cities, counties, school districts and other local taxing entities. Under the new framework, Moody's placed its ratings for 256 issuers under review for either downgrade (124 issuers) or upgrade (132 issuers). Moody's expects to resolve the majority of the rating reviews within the next 90 days and anticipates that most of the reviewed issuers will receive rating adjustments of one or two notches (e.g., from Aa2 to Aa3 [one notch] or A1 [two notches]).

The rollout of Moody's new G.O. framework applies to all local government issuers, though it is expected to have immediate rating impacts on only 3% of the 8,300 local government issuers that Moody's rates. The new approach introduces a scorecard that quantifies some of the rating factors that have historically been evaluated qualitatively. The rating scorecard framework brings Moody's G.O. rating approach closer in line with the methodology the agency uses to rate corporate bonds and municipal enterprise bonds while also providing greater transparency for analysts and investors seeking to understand in detail the factors that determine Moody's bond ratings on specific issuers.

We continue to evaluate Moody's new framework and its impact on bond ratings and market trading levels for individual issues. We do not recommend investors sell bonds solely on the basis of being under review by Moody's. In most cases, we do not expect Moody's rating reviews to have a significant impact on the market values of the bonds if they are downgraded by one notch. The majority of the issuers under review have been noted in the past by the rating agencies as having high debt burdens and/or significant pension funding obligations. Market values for these issuers' bonds have reflected this reality, even if ratings have not.

Moody's new process increases the weighting assigned to debt and pension liabilities (to 20% of the rating score from 10%) while decreasing the weighting of economic factors (to 30% from 40%). Consequently, we expect to see an outsized negative impact from the new framework on those issuers that have significant pension funding gaps or high debt burdens but have economic and financial strengths that overshadow their debt pressures.



Many of these issuers currently have Aaa or Aa1 ratings, though in numerous cases they also have S&P ratings that are one or more notches below the equivalent Moody's rating. Some prominent examples that are currently under review for downgrade under Moody's new framework include:

Issuer	Moody's Rating	S&P Rating
Davenport, IA	Aa2	А
Sioux City, IA	Aa1	AA
Bucks County, PA	Aaa	AA+
Nashville & Davidson County Metro Government, TN	Aa1	AA
Milwaukee Metro Sewerage Dist., WI	Aaa	AA+

Sources: Moody's, S&P

Moody's new analytical approach follows S&P's introduction in September 2013 of updated rating criteria for local government general obligation bonds in the U.S. S&P's new approach is similar in concept to Moody's, though less quantitative, and was expected to result in upgrades to approximately 30% of S&P's local issuer G.O. ratings, with approximately 10% in line for downgrades. To date, we have seen the implementation of S&P's new criteria have the most significant negative impact on highly rated (AAA and AA+), large issuers with strong finances but high debt loads and high pension obligations – exactly the type of issuers singled out by Moody's in its current round of reviews.

We will continue to monitor the implementation of both Moody's and S&P's new analytical approaches and the effects both on the broad municipal market and on specific issuers. As ratings change, up or down, we will continue to carefully assess the underlying credit characteristics of the bonds we buy and hold. We believe that careful credit analysis can uncover significant opportunities to add value and to avoid risk, especially in changing rating and interest rate environments.



## Moody's Local Government General Obligation Rating Methodology Scorecard Factors and Weights

Broad Rating Factors	Factor Weighting	Rating Subfactors	Subfactor Weighting
Economy/Tax Base	30%	Tax Base Size	10%
		Tax Base Value per capita	10%
		Median Family Income	10%
Finances	30%	Fund Balance (% revenues)	10%
		Fund Balance 5-year Trend	5%
		Cash Balance (% revenues)	10%
		Cash Balance 5-year Trend	5%
Management	20%	Institutional Framework	10%
		Operating History	10%
Debt/Pensions	20%	Debt as % of tax base	5%
		Debt as % of revenue	5%
		Moody's Adjusted Net Pension Liability as % of tax base	5%
		Moody's Adjusted Net Pension Liability as % of revenue	5%
		Moody's Adjusted Net Pension Liability as % of revenue	5%
		Moody's Adjusted Net Pension Liability as % of revenue	5%

Source: Moody's Investor Service, "Rating Methodology: US Local Government General Obligation Debt," January 15, 2014.

**Brian Tournier** 

Director of Research

Ascent Investment Partners



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