How to Improve Your Bond Rating and Current Trends in the Municipal Bond Market

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What is a Bond Rating?

A bond or credit rating is opinion about the ability and willingness of an issuer, such as a state or city government, to meet its financial obligations in full and on time.
A rating will impact the interest rate the debt issuer will pay and will also influence investor demand for the issuer’s bonds.

Many municipal bond insurers have exited the market and/or experienced rating downgrades. Many investors now require an issuer (uninsured) bond rating prior to purchasing an issuer’s bonds.

Interest spread between high investment grade bonds and lower investment grade bonds has widened.
## Ratings Categories

<table>
<thead>
<tr>
<th>Credit Risk</th>
<th>Moody's</th>
<th>Standard &amp; Poor's</th>
<th>Fitch</th>
<th>20 Year Rates (9/29/10)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prime</td>
<td>Aaa</td>
<td>AAA</td>
<td>AAA</td>
<td>3.28*</td>
</tr>
<tr>
<td>Excellent</td>
<td>Aa</td>
<td>AA</td>
<td>AA</td>
<td>3.47</td>
</tr>
<tr>
<td>Upper Medium</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>4.04</td>
</tr>
<tr>
<td>Lower Investment Grade</td>
<td>Baa</td>
<td>BBB</td>
<td>BBB</td>
<td>4.76</td>
</tr>
<tr>
<td>Speculative</td>
<td>Ba</td>
<td>BB</td>
<td>BB</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*Rates based on unenhanced (uninsured) rating
### Current Municipal Bond Insurer Ratings

<table>
<thead>
<tr>
<th>Insurance Company</th>
<th>Moody’s Rating/Outlook</th>
<th>Date of Last Rating Action</th>
<th>Standard &amp; Poor’s Rating/Outlook</th>
<th>Date of Last Rating Action</th>
<th>Fitch Rating/Outlook</th>
<th>Date of Last Rating Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACA</td>
<td>NR</td>
<td></td>
<td>NR</td>
<td>12/15/08</td>
<td>NR</td>
<td>08/13/04</td>
</tr>
<tr>
<td>AMBAC</td>
<td>Caa2/Under Review for Possible Downgrade</td>
<td>03/26/10</td>
<td>R - (Under Regulatory Supervision)</td>
<td>03/25/10</td>
<td>NR-Withdrawn</td>
<td>06/26/08</td>
</tr>
<tr>
<td>Assured Guaranty</td>
<td>Aa3/Negative Outlook</td>
<td>11/12/09</td>
<td>AAA/Negative Outlook</td>
<td>07/01/09</td>
<td>NR-Withdrawn</td>
<td>02/24/10</td>
</tr>
<tr>
<td>Berkshire Hathaway Assurance Corp</td>
<td>Aa1/Stable Outlook</td>
<td>04/08/09</td>
<td>AA+/Stable</td>
<td>02/04/10</td>
<td>NR</td>
<td></td>
</tr>
<tr>
<td>CIFG</td>
<td>Withdrawn</td>
<td>11/11/09</td>
<td>NR-Withdrawn</td>
<td>02/16/10</td>
<td>NR-Withdrawn</td>
<td>10/21/08</td>
</tr>
<tr>
<td>FGIC</td>
<td>Caa3/Negative Outlook/Withdrawn</td>
<td>03/24/09</td>
<td>NR-Withdrawn</td>
<td>04/23/09</td>
<td>NR-Withdrawn</td>
<td>11/24/08</td>
</tr>
<tr>
<td>Assured Guaranty Municipal (FSA)</td>
<td>Aa3/Negative Outlook</td>
<td>11/12/09</td>
<td>AAA/Negative Outlook</td>
<td>04/21/09</td>
<td>NR-Withdrawn</td>
<td>02/24/10</td>
</tr>
<tr>
<td>National Public Finance Guarantee Corp. (formerly MBIA Illinois)</td>
<td>Baa1/Developing Outlook</td>
<td>06/25/09</td>
<td>A/Developing Outlook</td>
<td>06/05/09</td>
<td>NR-Withdrawn</td>
<td>06/26/08</td>
</tr>
<tr>
<td>Radian</td>
<td>Ba1/Outlook Stable</td>
<td>03/12/09</td>
<td>BB/Negative Watch</td>
<td>11/24/09</td>
<td>NR-Withdrawn</td>
<td>05/02/08</td>
</tr>
<tr>
<td>Syncora Guarantee Inc. (formerly XL Capital)</td>
<td>Ca/Developing Outlook</td>
<td>03/09/09</td>
<td>R - (Under Regulatory Supervision)</td>
<td>04/27/09</td>
<td>NR-Withdrawn</td>
<td>09/05/08</td>
</tr>
</tbody>
</table>
**General Obligation Bonds**

- The issuer pledges its full faith and credit to repay the financial obligation. Unless certain tax revenue streams are specifically restricted, the GO issuer frequently pledges all of its tax-raising powers.

- Usually local governments secure the obligation with their ability to levy an unlimited ad valorem property tax.

- Most common type of debt issued by Texas counties
GO BOND RATING FACTORS

- Economic indicators
- Financial performance
- Debt burden
- Management
**ECONOMIC INDICATORS**

- Demographic characteristics including population trends, wealth and income levels relative to the state and nation.

- Tax base data including assessed value growth (or declines) over time, per capita market value, tax base concentration by sector, industry and leading taxpayers. Is the property tax base diverse or is it concentrated in one industry or major property holders?
ECONOMIC INDICATORS

- Employment base and labor force indicators including industry mix and employment by sector, employment concentration by industry and employer, unemployment rate and labor force trends

- Per capita retail sales as well as growth trends over time

- Regional participation: Does the county or city participate in a larger regional economy (Tarrant County) or is it a regional employment, trade and retail center for a larger geographic area (Lubbock)?
FINANCIAL FACTORS

- Revenue and expenditure structure and patterns; are revenues diversified, are expenditures growing at a faster rate than revenues?

- Annual operating and budgetary performance; are operating budgets balanced or do they rely on draw-downs from fund balance, are budgeted revenues and expenditures in line with actual performance, are transfers from other funds rational and per policy?

- Financial equity (fund balance) position and trends; the availability of unencumbered reserves or contingency funds. Are fund balances used for one-time expenditures such as capital or emergencies, not to fill an operating budget gap or for on-going expenses such as salary increases?
FINANCIAL FACTORS

- Budget and financial planning; does the county perform multi-year financial forecasting and capital planning?

- Contingent financial obligations, such as off-balance sheet debt, pension liabilities and other post-employment benefits. Does the issuer have contingent financial obligations, and if so, is there a plan for meeting those obligations?
Debt Factors

- Debt repayment structure; does debt's term matches the useful economic life of the financed assets? Is the maturity schedule average (50% of principal retired in 10 years) or is back-loaded?

- Current debt-service burden, as measured by debt to market value, debt per capita and debt as a percentage of operating expenditures. Debt is considered high when debt-service payments represent 15%-20% of the combined operating and debt-service fund expenditures. A high debt burden can impede an issuer’s ability to finance future capital projects and raise taxes if necessary.

- Future capital needs of an issuer; does the county have significant unmet capital needs such as state mandated jail improvements? Does the county have a plan for funding future capital projects?
Standard & Poor's analyzes the impact of financial management policies and practices through the use of a Financial Management Assessment (FMA). The Financial Management Assessment focuses on seven factors most likely to affect credit quality:

- Revenue and expenditure assumptions
- Budget amendments and updates
- Long-term financial planning
- Long-term capital planning
- Investment management policies
- Debt management policies
- Reserve and liquidity policies
HOW CAN I IMPROVE MY COUNTY’S BOND RATING?

“Grant us the serenity to accept the things we cannot change, courage to change the things we can, and wisdom to know the difference.”

Identify rating factors that management can influence and improve; management policies and practices:

- Revenue and Expenditure Assumptions: Are the organization's financial assumptions and projections realistic and well grounded from both long-term and recent trend perspectives?

- Budget Amendments and Updates: Are there procedures for reviewing and amending the budget based on updated information and actual performance to ensure fiscal targets are met?
HOW CAN I IMPROVE MY COUNTY’S BOND RATING?

- Long-Term Financial Planning: Does management have a long-term financial plan that allows them to identify future revenues and expenditures as well as address upcoming issues that might affect these?

- Long-Term Capital Planning: Has the organization created a long-term capital improvement program?
How Can I Improve My County’s Bond Rating?

- Investment Management Policies: Has the organization established policies pertaining to investments, such as the selection of financial institutions for services and transactions; risk assessment; investment objectives; investment maturities and volatility; portfolio diversification; safekeeping and custody; and investment performance reporting, benchmarking, and disclosure?

- Debt Management Policies: Has the organization established policies pertaining to the issuance of debt, such as projects that may or may not be funded with debt (including economic development projects); maturity and debt service structure; use of security and pledges, credit enhancement, and derivatives; and debt refunding guidelines?
CURRENT TRENDS IN THE BOND MARKET

Selected Interest Rate History

10 Year Comparison

20 Year Treasury and 20 Year General Obligation Bond Interest Rates

- 20 Year Treasury
- 20 Year GO

8/2010
Build America Bonds

- Authorized by the American Recovery and Reinvestment Act; program will expire December 31, 2010 unless Congress acts to extend it.

- Provides federal subsidy of 35% of the interest cost for eligible bonds, proposed legislation will reduce the subsidy.

- The IRS can and has withheld the subsidy payment in instances when the IRS believes the issuing municipality owes back taxes.

- Interest on bonds is taxable.

- Increased probability of IRS audit to determine compliance with program requirements. Example: Davis-Bacon wage requirements, Buy American Provision, spending guidelines.
**BUILD AMERICA BONDS**

- Bond proceeds must be used for capital projects, not refinancing of existing debt.

- Average yield on a 30 year Build America Bond is 5.72% (3.72% net rate with subsidy) compared to 4.18% for ‘AAA’ rated tax exempt bond.

- Build America Bonds most cost effective for larger issues with long maturities. Rates on municipal tax exempt bonds with shorter maturities (up to 5 or 7 years) are generally lower than subsidized Build America Bond yields.
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Standard & Poor’s Rating Criteria:
www.standardandpoors.com