

Bond ratings can significantly impact a municipality's financing costs. We have compiled a list of the key factors that are used by Fitch Ratings, Moody's Investors Services, and Standard and Poor's to develop these ratings:

1. Sector Risk Profile
2. Local Economy & Tax Base
3. Management
4. Financial Environment
5. Liabilities

1. Sector Risk Profile

Rating agencies look at the larger environment (e.g. the state, country) in which the municipality operates. They consider the stability of this larger environment, as well as the regulatory pressures which exist within this environment since these factors may have a significant impact on the local municipality. More specifically these include:

- Country where the municipality operates*
- State credit rating
- State budgetary pressures
- State demographic trends
- Resources within the state
- Level of state funding that is provided to local governments and the stability of this funding
- Restrictions on ability to impose taxes & the level of debt that can be issued
- State laws which incentivize debt repayment

*US municipal bond ratings are positively influenced by the fact that they operate in the US.

2. Local Economy & Tax Base

While the sector risk profile looks more broadly at the environment in which a local government operates, it is important to analyze the economy and tax base of the local government itself. This includes examining the municipality's:

- Equalized or Full Value on aggregate, as well as per capita
- Median income as well as incomes that vary significantly from the norm
- Opportunities for growth and development
- Expectations regarding spending growth and the ability to support this growth
- Unemployment rates
- Composition of the tax base*

*The composition of the tax base includes factors such as the proportion of the tax base that is commercial vs. residential, the presence of institutes which may provide stability, the diversity of types of employers, & the age of the population.



5 Factors That Drive Local Government Bond Ratings

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3. Management

Sector risk profiles are difficult to change, and a local government may face significant restraints when it comes to its local economy and tax base, but a municipality has significantly more control over its management. Rating agencies evaluate a local government's ability to implement sound and timely decisions in response to economic and fiscal demands. More specifically they consider the following:

- Ability to execute approved structural reforms
- Ability to prioritize the municipality's needs
- Management's understanding of the municipality's financial position
- Political gridlocks
- High liabilities without a credible plan to address these liabilities
- Turnover of a key manager, with a lack of people qualified to take on the departed manager's duties
- Budget management, particularly in times of economic recovery

4. Financial Environment

A local government's financial position is a key indicator of its ability to endure economic downturns and adjust to new financial responsibilities. When evaluating a local government's financial position, rating agencies consider the following:

- Present and historical fund balances
- Present and historical cash balances
- Overall liquidity
- Volatility of the revenue structure and reliability of receivables
- Available fund balances as compared to expenditures
- Ability to raise additional revenue or reduce spending

5. Liabilities

Rating agencies explore the magnitude of a local government's debt relative to its resources and operating costs. This includes considerations such as:

- Debt relative to equalized value (EQV), expenditures, and revenue
- Debt structure and amortization
- Historic missed debt payments
- Net Pension Liability & Net OPEB Liability relative to EQV, expenditures, and revenue
- Plan (or lack thereof) to address pension and OPEB liabilities
- Expectations regarding future Net Pension Liability & Net OPEB Liability*

*Pension and OPEB liabilities are sometimes weighted differently, as the long-term costs for OPEB (particularly cost trends of healthcare) are significantly more uncertain than in the case of pensions. Additionally, OPEB are much easier to change.

If you have any further questions, please reach out to Sarah at srothenberg@odysseyadvisors.com or any Odyssey consultant.

For more information about managing your Net Pension Liability & Net OPEB Liability to ensure that this piece of your bond rating is viewed positively, visit our website at OdysseyAdvisors.com.