

# The Bond Ratings Process

## Introduction to Municipal Bonds

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**S&P Global**  
Ratings

# Agenda

- What is a Credit Rating and Why Do We Care?
  - Our Role
  - The Rating Scale
- The Rating Process
- Credit Analysis
  - Example of U.S. Local Government General Obligation Criteria
- Ohio Means and Medians
- Local Government and Ohio Outlook

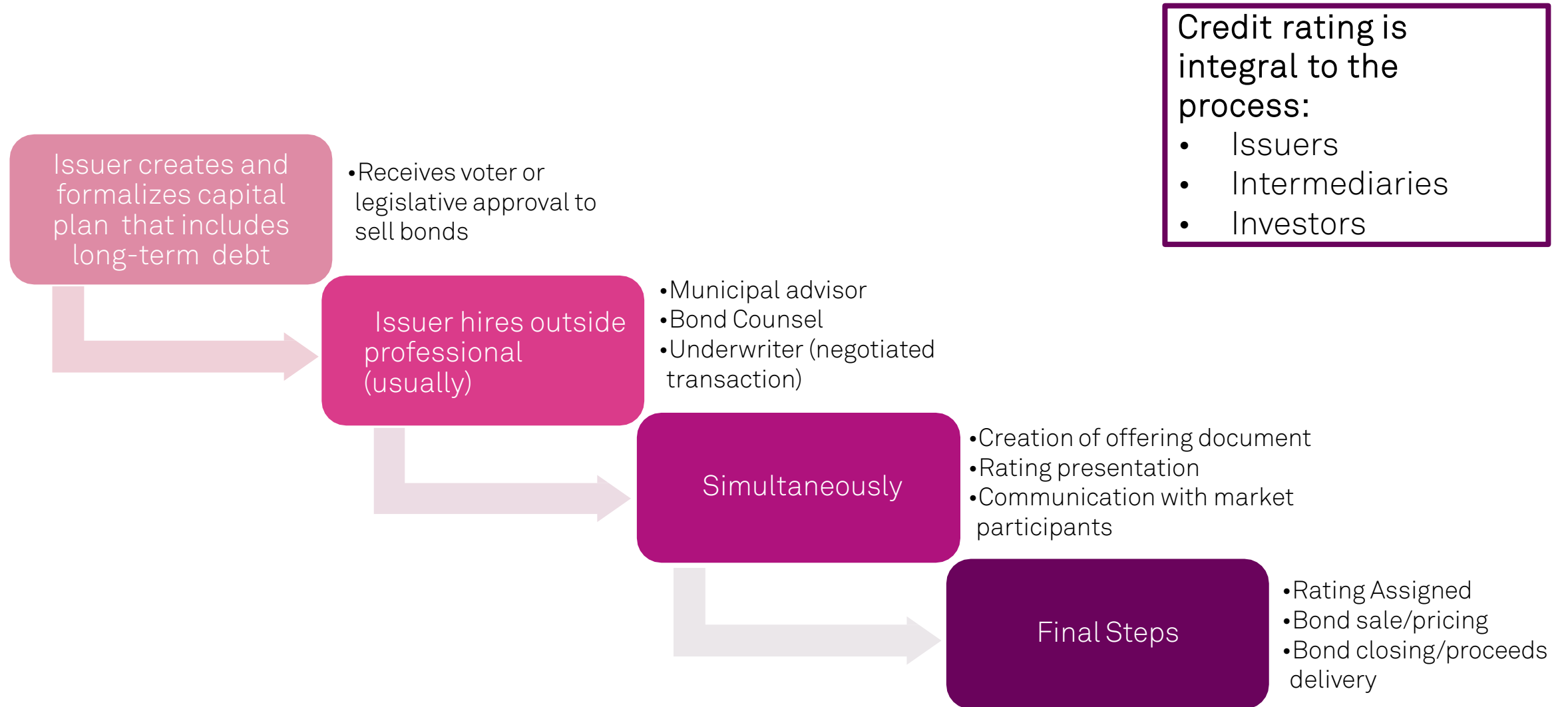
# Credit Ratings: What's the Big Deal?

# Understanding S&P Global's Ratings

- Credit ratings are **forward looking**
- Credit ratings are not a recommendation to buy or hold a security instrument
- S&P Global ratings are **opinions**, not guarantees of credit quality or exact measures of the probability that a particular issuer or particular debt issue will default
- The Ratings scale **is relative** and based on the creditworthiness of an issuer or credit quality of an individual debt issue, from strongest to weakest, within a universe of credit risk
- Criteria provide the analytic framework to derive the rating opinion

[www.understandingratings.com](http://www.understandingratings.com)

# I'm Just a Bond



# Ratings' Role in the Municipal Bond Market

## Issuers

- Optimize the cost of funding
- Expand the pool of investors and available capital
- Lengthen the terms of financing
- Diversify funding sources

## Intermediaries

- Benchmark the relative credit risk of different debt issues
- Set the initial pricing for individual debt issues they structure
- Determine the interest rate issues will pay
- Package assets into securities or structured finance instruments to market to investors

## Investors

- A third-party opinion of credit quality
- A basis for comparison across asset classes, geographies, and peers
- Information and metrics to make informed decisions, such as supplementing their own credit analysis or establishing thresholds for credit risk and investment guideline

# S&P Global's Ratings Scale

## Investment-Grade

AAA → Strongest

AA+ }  
AA } Very Strong  
AA- }

A+ }  
A } Strong  
A- }

BBB+ }  
BBB } Adequate  
BBB- }

## Speculative-Grade

BB+ }  
BB } Least Speculative  
BB- }

B+ }  
B } Speculative  
B- }

CCC }  
CC } Highly  
C } Speculative

D → In Default

**Short-term U.S. Public Finance note ratings: SP-1+, SP-1, SP-2 & SP-3**

# Outlooks and CreditWatch

## • Outlooks

- Potential rating change within 1 to 2 years
- At least 1-in-3 likelihood of rating action
- Outlooks can be:
  - Stable
  - Positive
  - Negative
  - Developing

## • CreditWatch

- Potential rating change within 60 to 90 days
- At least 1-in-2 likelihood of rating action
- CreditWatch can be:
  - Positive
  - Negative
  - Developing



# Key Takeaway

- An issuer's *ability* and *willingness* to pay debt in a *timely* manner
- Ability
  - At its most fundamental level, an issuer's **ability** to meet its debt obligations depends on its financial resources available to pay debt service.
- Willingness
  - **Willingness**, although more elusive (art of credit analysis), relates an issuer's priority of debt service over other competing demands on financial resources.
  - What is given up in order to pay debt? Payroll? Paying pensions and healthcare costs?
  - What is the political cost of doing one over the other?
- **Timeliness** = availability (liquidity) of resources at a point in time

# The Rating Process

# Rating Process

## Overview

- Rating Request
- Analyst Assignment
- Initial Analysis and Management Meeting
- Rating Committee Preparation
- Rating Committee
- Rating and Rationale Released to Market
- Rating Surveillance

# Rating Process

## Initial Analysis & Management Meeting

- Review of bond offering documents, audits, budgets, and news articles
- Schedule meeting with issuer's management team

### Best practices:

- Gather key management documents in advance of the meeting (long-term financial forecast, capital improvement plan, mid-year budget reports and investment reports, key management policies)
- Come prepared to speak on prior year financial performance in main operating funds.
- Discuss projected and budgeted financial performance along with factors which are influencing the projected results.

# Rating Process

## Management Meeting

- Typically a 60 minute phone call
  - May request more time for more complicated structures, or less time for frequent issuers
- Discuss bond provisions and key criteria factors
- Provides valuable forward-looking and qualitative information used in the rating analysis and committee decision
- Qualitative analysis supplements the quantitative portion of our criteria
- Robust management responses better inform the rating committee
- Be prepared for follow-up questions from analyst
- It is okay if the issuer does not have answers to every question. Follow-up items are common.

# Rating Process

## Complete Rating Analysis

- Gather additional information, as needed
- Compare key credit characteristics of issuer to credit characteristics of peers with a similar security
- Write rating rationale and prepare presentation for rating committee

### Best practices:

- As quickly as possible, provide follow-up requests or documentation to be incorporated into the final rating consideration.

## Rating Committee

- Gathering of senior level analysts and democratic process to assign rating
- Analysts presents bond features and key criteria factors

# Rating Process

## Rating and Rationale Released to Market

- Initial rating notification to Issuer and Financial Advisor

### Best practices:

- Communicate to your analyst if you or your representative financial advisor will be absent when rating decision is expected, and appropriate designated contacts.

- Publication and dissemination of rating and rating rationale

### Best practices:

- Provide prompt commentary on the draft of the rating report as to not delay the public release of the rating and report to the market.
  - Note: Purpose of review is to ensure factual accuracy and avoid inadvertent inclusion of confidential information. We will use our sole discretion in making editorial changes to the document, which represents our independent opinion.

# Rating Process

## Surveillance

- Routine review of ratings to ensure accuracy and timeliness of rating
- Annual requests for financial statements
- Periodic requests for additional information
- **Best practices:**
  - Upload continuing disclosure documents (financial statements and other info relevant to credit quality) in a timely manner each year.
  - Respond promptly to additional information and document requests from S&P Global Ratings employees.



# Credit Analysis

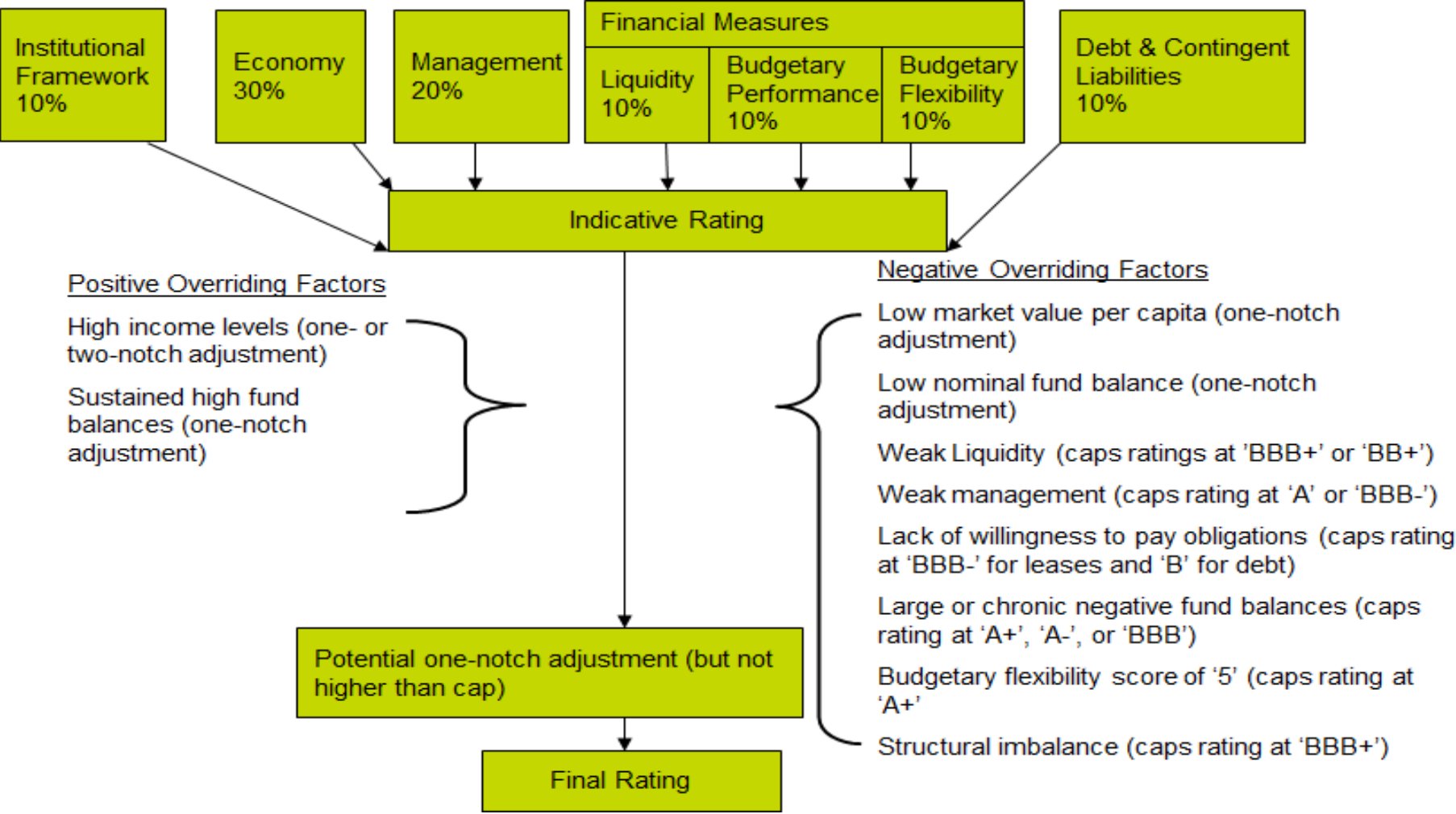
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Ratings

# First Things First

- How are the bonds secured? What resources can an issuer use to pay debt service?
  - **General Obligation (GO)**
  - **Limited GO**
  - Appropriation
  - **Revenue Bonds (Sales tax, Gas Tax, Personal Income Tax, W&S)**
  - Moral Obligation
- Credit analysis is quantitative and qualitative measures
- **Criteria** provides transparency, comparability, and forward-looking measures

# Overall Analytical Framework Local Government



# How Does it All Work– Example

## Economic Score

Projected per capita effective buying income as a % of U.S. projected per capita EBI	Total Market Value Per Capita				
	>\$195,000	\$100,000 to \$195,000	\$80,000 to \$100,000	\$55,000 to \$80,000	≤\$55,000
>150	1	1.5	2	2.5	3
110 to 150	1.5	2	2.5	3	3.5
85 to 110	2	2.5	3	3.5	4
70 to 85	2.5	3	3.5	4	4.5
≤70	3	3.5	4	4.5	5

A score of '1,' '2,' '3,' '4,' and '5' means very strong, strong, adequate, weak, and very weak, respectively.

Due to the presence of a university, we apply our 'Stabilizing Institution (where market values may be understated)' adjustment.

## Financial Management Assessment

Score	Characteristics
1 (very strong)	FMA score of "Strong" and none of the factors in scores '4' or '5' are present.
2 (strong)	FMA score of "Good" and none of the factors in scores '4' or '5' are present.
3 (adequate)	FMA score of "Standard" and none of the factors in scores '4' or '5' are present.
4 (weak)	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 within 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.
5 (very weak)	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 is exhibiting an unwillingness to support a debt or capital lease obligation; or the government is actively considering bankruptcy in the near term.

# How Does it All Work– Example

## Budgetary Flexibility

**Table 10**  
Assessing The Budgetary Flexibility Score (see paragraphs 59-64)

	Available Fund Balance As A % Of Expenditures				
%	>15	8-15	4-8	1-4	≤1
Score	1	2	3	4	5

A score of '1', '2', '3', '4', and '5' means very strong, strong, adequate, weak, and very weak, respectively.

## Liquidity Score

**Table 12**  
Assessing The Liquidity Score (see paragraphs 69-77)

	Total Government Available Cash As % Of Total Governmental Funds Debt Service				
Total Government Available Cash As % Of Total Governmental Funds Expenditures	>120	100 to 120	80 to 100	40 to 80	≤40
>15	1	2	3	4	5
8 to 15	2	2	3	4	5
4 to 8	3	3	3	4	5
1 to 4	4	4	4	4	5
≤1	5	5	5	5	5

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

## Budgetary Performance

**Table 11**  
Assessing The Budgetary Performance Score (see paragraphs 65-68)

	Total Governmental Funds Net Result (%)				
General Fund Net Result (%)	> -1	-1 to -5	-5 to -10	-10 to -15	≤ -15
(> 5)	1	2	3	3	4
(-1 to 5)	2	3	3	4	5
(≤ -1)	3	4	4	5	5

A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak, and very weak, respectively.

## Debt and Contingent Liabilities

**Table 14**  
Assessing The Debt And Contingent Liabilities Score (see paragraphs 78-84)

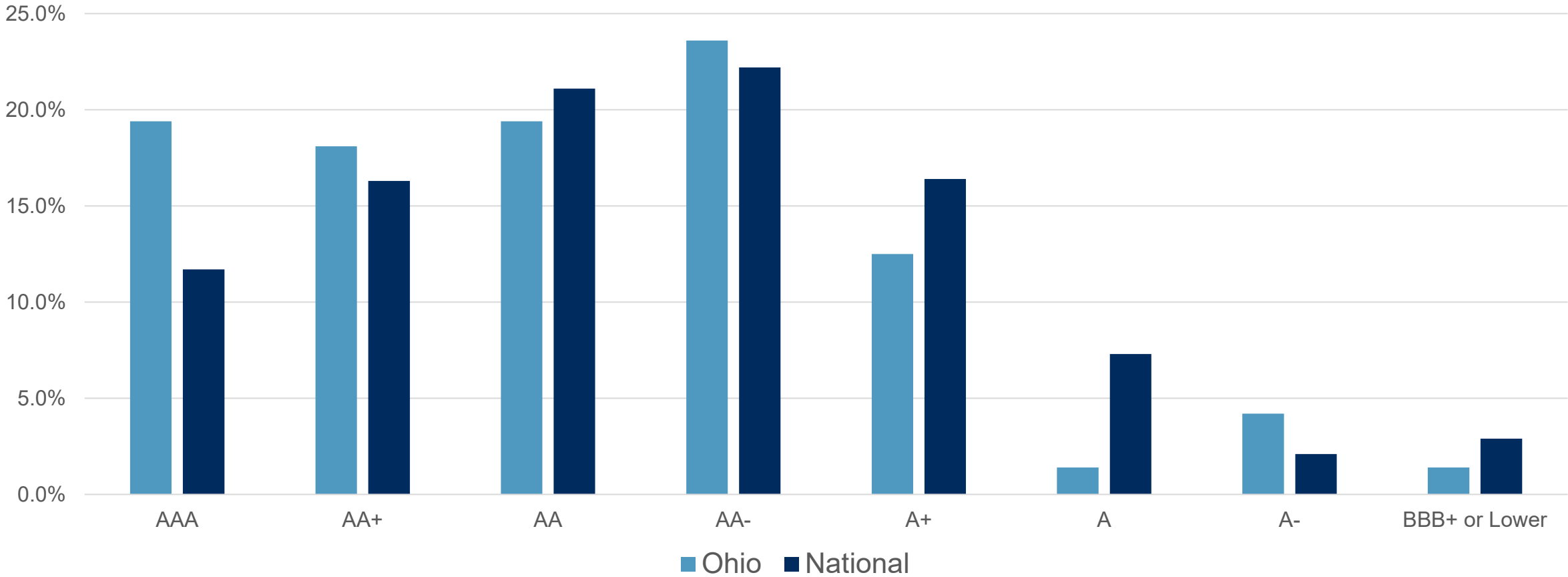
	Net Direct Debt As % Of Total Governmental Funds Revenue				
Total Governmental Funds Debt Service As A % of Total Governmental Funds Expenditures	<30	30 to 60	60 to 120	120 to 180	≥180
< 8	1	2	3	4	5
8 to 15	2	3	4	4	5
15 to 25	3	4	5	5	5
25 to 35	4	4	5	5	5
≥35	4	5	5	5	5

A score of 1, 2, 3, 4 and 5 are very strong, strong, adequate, weak and very weak, respectively.

Amortization is rapid (66% over the next 10 years) however pensions are a pressure as the plan is 62.9% funded with a net pension liability of \$24.3 million and pension and OPEB contributions were 17.7% of the total budget in FY2022.

# Ohio Means & Medians

# Municipality General Obligation Rating Distribution



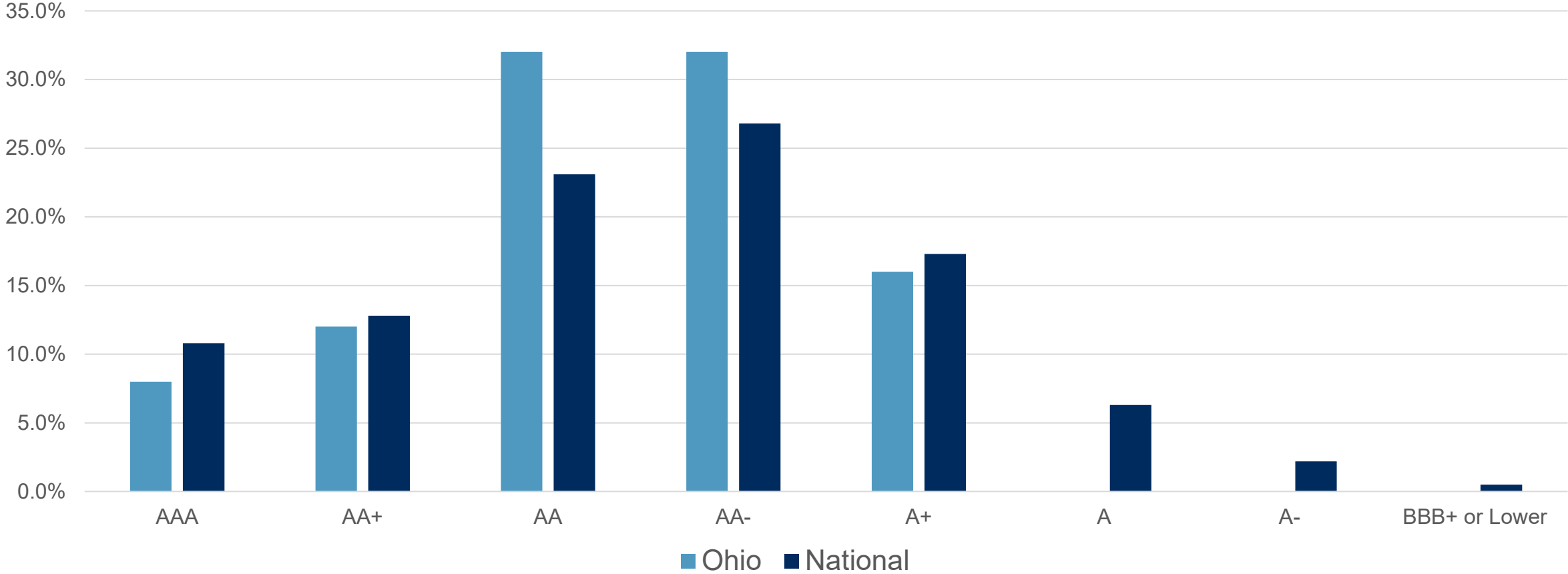
Source: S&P Global Ratings

# Ohio Municipalities: Medians

	AAA	AA+	AA	AA-	A+	A	A-	BBB+ or Lower
Projected per capita EBI (%)	170%	113%	101%	85%	76%	69%	62%	96%
Market value per capita (\$)	142,614	93,325	75,690	55,111	55,203	43,504	40,281	121,572
Available general fund (%)	123%	108%	82%	68%	54%	18.4%	14.8%	0.7%
General fund performance (%)	14.9%	9.7%	8.8%	6.4%	3.3%	6.6%	(12.3)%	(1.1)%
Cash and expense (%)	130%	124%	112%	99%	132%	116%	7.2%	1.9%
Carrying charge (%)	8.6%	4.8%	4.5%	6.5%	7.5%	4.2%	5.1%	25.6%
Pension ARC + OPEB as % expense	5.7%	6.8%	8.7%	7.5%	7.3%	9.8%	7.9%	3.1%
EBI--Effective buying income. ARC--Annual required contribution. OPEB--Other postemployment benefits. As of May 5, 2023								



# County General Obligation Rating Distribution

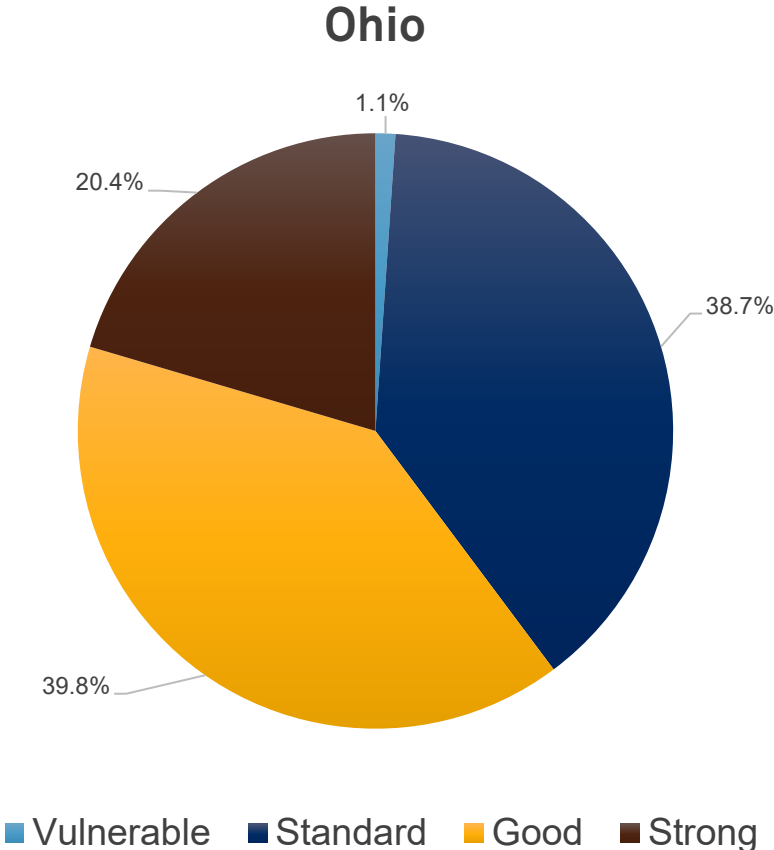


Source: S&P Global Ratings

# Ohio Counties: Medians

	AAA	AA+	AA	AA-	A+
Projected per capita EBI (%)	126%	105%	91%	80%	68%
Market value per capita (\$)	100,848	87,429	75,428	73,013	62,818
Available general fund (%)	72%	56%	79%	60%	64%
General fund performance (%)	12.4%	2.3%	7.1%	11.5%	10.1%
Cash and expense (%)	67%	114%	105%	110%	76%
Carrying charge (%)	3.3%	2.8%	2.0%	2.5%	0.7%
Pension ARC + OPEB as % expense	4.2%	4.9%	4.8%	5.1%	5.6%
EBI--Effective buying income. ARC--Annual required contribution. OPEB--Other postemployment benefits. As of May 5, 2023					

# Financial Management Assessment (FMA)



# 2023 Credit Outlook For Ohio & U.S. Public Finance

# What We're Watching - Local Government

## What We're Watching -- U.S. Local Governments



### Federal stimulus

ARPA and other federal stimulus can help maintain credit quality and provide liquidity for many LGs



### Looming recession

Federal aid helps with downside cushion, but a deteriorating economy could still disrupt stability



### Inflation implications

Higher costs affect labor, materials, borrowing, etc., and could have long-term implications



### Housing market

Slower housing market should cool prices, but an extended slowdown could affect tax base



### State credit health

State credit strength lessens the chance for cuts to locals and supports economic stability



### Wildcards

- RTO/downtown core
- Unemployment
- Infrastructure needs

# What We're Watching

## U.S. Local Governments: By The Numbers

**45,310**

Number of LG projects where ARPA funds were deployed



**69%**

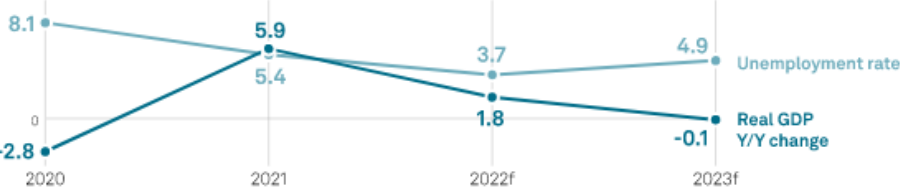
Finance officers reporting being better able to meet needs in FY2023 vs. FY2022



**81%**

Rate of voter approval for bond referendums in Nov 2022 elections

Unemployment rate vs. GDP growth (%)



**7 years**

until all Baby Boomers will be over **65**



**90%**

Share of MSAs with overvalued home prices



**+50%**

Growth in S&P/Case-Shiller National Home Price Index (2020-2022)

**-14.3%**

Projected 2023 Y/Y change in real residential investment



**15 bil.**

of dollars of weather and climate disasters in the U.S. (Jan-Oct 2022)



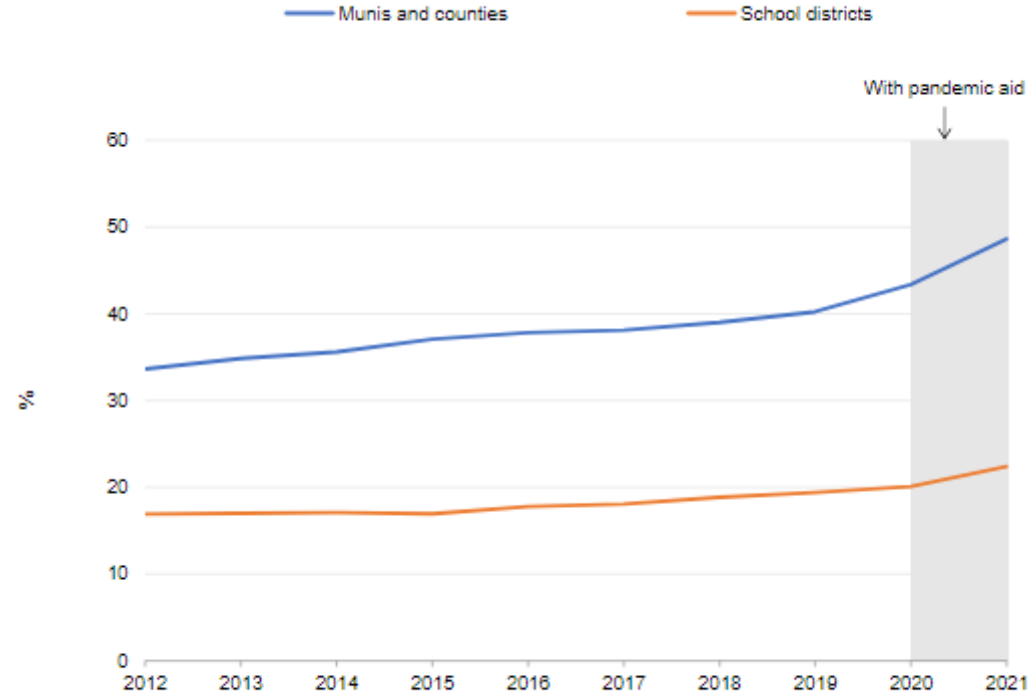
**60%**

Share of households that will not be able to buy a house by 2025

f--Forecast. Sources: S&P Global Ratings; S&P Global Market Intelligence; Bureau of Economic Analysis; Bureau of Labor Statistics; S&P/Case-Shiller; Census Bureau; National Oceanic and Atmospheric Administration; National League of Cities. Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

# What We're Watching

Unassigned General Fund Balance As Share Of General Fund Expenditures



Source: S&P Global Ratings

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# What We're Watching - Ohio

Municipality reliance on income taxes and effects from remote working

County reliance on sales tax and effects from inflation

Diversification of employment base (e.g., Intel)

Manufacturing sector

Oil/gas industry

Tourism/hospitality industry

State's credit (AA+/Stable) and budget cycle

Aging infrastructure

Clean water

Slow population growth, lack of in-migration



# Q&A

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