Rating Agency Overview

Introduction:

Due to the market environment and new governmental regulations over the past few years, the rating agencies have implemented many changes affecting local government issuers. While local governments have a low default rate compared to many other issuers, public sector investors are looking for more transparency in these credit assignments. We've all heard about bankruptcies in California and in our own backyard of Rhode Island-to name a few. While similar situations in Massachusetts are highly unlikely, never say never.

One of the most important components of issuing public sector debt is the credit rating that is assigned to your issue of notes or bonds. Many of you are familiar with Moody's Investors Services and Standard & Poor's Ratings Services as well as Fitch Ratings Group. Have you heard of Kroll Bond Ratings? While writing about these agencies, and the role they play in your debt issuance could entail a college- length thesis, we thought we'd briefly hit on a few highlights for each entity, what changes have been made recently and what changes may be in store for the future. As always, we encourage you to contact your UniBank financial advisor for a more in depth discussion regarding what rating agency options would be most beneficial to you and your community.

Standard & Poor's Ratings Services

In 2010, Standard & Poor's revised its rating methodology on Bond Anticipation Note ("BAN") ratings to reflect the type of debt used to retire the BAN as well as the risk profile of the issuer. This led to aligning the Note rating to be keyed-off the long-term bond rating. The following chart shows the symmetry between the short and long-term ratings:

Table 1
Determining BAN Rating From The Long-Term Takeout Rating And The Market Risk Profile

Long-term rating	Market risk profile		
	Low	Neutral	High
AAA	SP-1+	SP-1+	SP-1
AA+	SP-1+	SP-1+	SP-1
AA	SP-1+	SP-1+	SP-1
AA-	SP-1+	SP-1+	SP-1
A+	SP-1+	SP-1	SP-1
A	SP-1	SP-1	SP-2
A-	SP-1	SP-2	SP-2
BBB+	SP-2	SP-2	SP-2
BBB	SP-2	SP-2	SP-3
BBB-	SP-2	SP-2	SP-3
Noninvestment grade	SP-3	SP-3	SP-3

Overriding factors:

- Absence of authority to issue takeout debt = SP-3
- Security for takeout debt not specified = SP-3
- Need for tax base growth to legally issue debt = SP-3
- High market confidence exposure = one rating level lower than that suggested by the long-term rating and the market risk profile

Currently, Standard & Poor's is in the process of revising/updating their Bond rating criteria on General Obligation Bonds for cities and towns (special districts such as school, water, sewer and fire districts are excluded from this analysis). Some of you may have already received an on-line questionnaire requesting your financial and demographic information ,which is part of the framework of the new criteria. The on-line questionnaire will, in some cases, eliminate the need for a surveillance call. However, the issuer still has the option of a surveillance call, if it so chooses. S&P will continue to focus on the four main components of its rating criteria-Demographic, Financial, Debt & Management. However, within these areas, the agency is seeking to provide more transparency, global comparability and a more forward-looking rating analysis.

Standard & Poor's expects that the new criteria will impact approximately 3,800 credits with many issuers maintaining their current rating status. We'll be sure to keep you updated when the criteria has been finalized in order to discuss how your current Standard & Poor's rating may be impacted.

Moody's Investors Service

Like Standard & Poor's, Moody's Investors Service is well-known in the New England area. In 2010, the agency initiated a global re-calibration of most of public sector credits, aligning them with the corporate rating scales, in essence, putting the public sector credits on the same scale as corporate debt. This "re-calibration" caused many issuer ratings to be revised upwards by one or two notches. There was initially some confusion (euphoria) that this was designated as an "upgrade". However, Moody's made it clear, through presentation material and issuer conversations, that these rating re-calibrations were not to be considered upgrades to the issuer's rating. Unfortunately, no financial reviews were performed by Moody's analysts in the process of the issuer re-calibrations. As a result, when a future rating was requested by an issuer, the rating was sometimes downgraded. Such rating assignment had to be noted as a downgrade and a corresponding Material Events notification had to be filed with the Municipal Securities Rulemaking Board's EMMA (repository site) notifying the market of the new bond rating. Issuers should be aware of their current state of their financials and discuss them with their UniBank financial advisor prior to any rating request.

In reference to Moody's BAN rating criteria, the agency is placing a greater emphasis on issuer liquidity and market access in order to assure the underwriters, and subsequently the investor, that the notes will be able to be re-paid through the issuance of permanent debt. If no market access exists, then the issuer should be able to demonstrate the ability to pay through available cash.

US MUNICIPAL SHORT-TERM vs. LONG-TERM RATINGS

SHORT-TERM	LONG-TERM RATING
	Aaa
	Aa1
MIG-1	Aa2
	Aa3
	A1
	A2
MIG-2 ←	A3
	Baa1
MIG-3	Baa2
	Baa3
	Ba1, Ba2, Ba3
SG	B1, B2, B3
	Caa1, Caa2, Caa3
	Ca, C

•*Source: Moody's Investors Service, September, 2012.*

Fitch Ratings Group

While Fitch Ratings has been issuing credit ratings to public sector debt for many years, they are not well-established in the Massachusetts municipal credit market. The City of Worcester /UniBank Fiscal Advisory Services currently works with Fitch as well as Moody's and Standard & Poor's on the City's credit ratings. Fitch rates the City of Worcester an AA- which is the equivalent of the City's Aa3 rating by Moody's. Fitch also rates the Commonwealth of Massachusetts and has assigned its AA+ rating to the Commonwealth's GO debt. Fitch has also assigned its AAA rating to the City of Cambridge, MA., as well as an AA+ rating to the Boston Water & Sewer Commission's revenue bonds.

Like its counterparts, Fitch applies its short-term rating methodology to link to its long-term credit ratings with an emphasis on the importance of issuer liquidity and market access. While short-term performance is not a guarantee of long-term success, it is likely that an issuer with positive liquidity trends will have access to markets and will have an asymmetrical long-term rating.

Fitch Rating Correspondence Table

Long-Term Rating	Short-Term Rating
AAA	F1+
AA+	F1+
AA	F1+
AA-	F1+
A+	F1 or F1+
A	F1
A-	F2 or F1
BBB+	F2
BBB	F3 or F2
BBB-	F3
BB+	B
BB	B
BB-	B
B+	B
B	B
B-	B
CCC	C
CC	C
C	C
RD/D	RD/D

Source: Fitch Ratings Group, August 2012.

Kroll Bond Ratings

Founded in 2010, Kroll Bond Ratings is the newest rating agency to enter into the municipal credit environment. In April 2012, Kroll assigned its first public securities rating to the state of Connecticut's $555 million GO Bonds as well as $14 billion of the State's outstanding debt obligations. Kroll assigned an AA rating, matching the ratings of Fitch and Standard & Poor's.

According to Kroll, the agency's mission is to bring more accountability and transparency to the rating process. Like their competitors, Kroll's analysis focuses on management/policies, economic base, debt, financial performance and liquidity. Similar to S&P's proposed revised analysis, the institutional framework will be a factor in the rating process, as State mandates ultimately have a cause and effect on the local government operations.

Is there room or issuer demand for another major rating agency? Time will tell. What is certain is that, with the changes in the rating agency environment, market pressures and federal regulations, issuers will be accountable for providing accurate and timely financial statements to these agencies and the review cycles will be more frequent and more in-depth.