

S&P Global Ratings:

Rating Agencies, What Are They Looking For From Municipalities To Improve Their Rating

Massachusetts Collectors & Treasurers
Association Conference

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S&P Global
Ratings

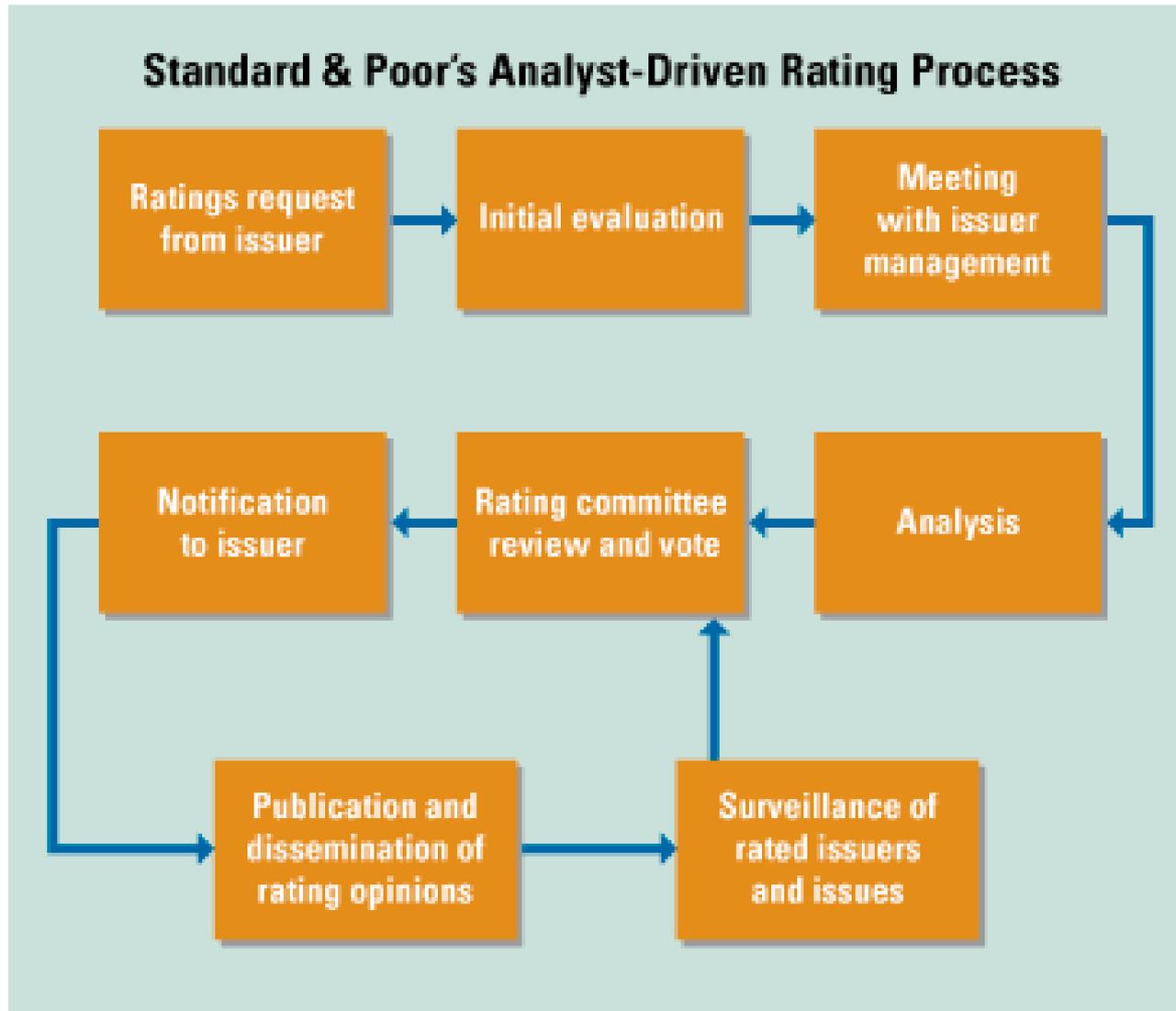
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Agenda

- S&P Global Ratings Process
- S&P Global GO Methodology and Framework
- Financial Management Assessment (FMA) and Top Ten Management Characteristics of Highly Rated State and Local Borrowers
- Typical Meeting Agenda: How to make meaningful presentations, what are S&P analysts focused on?
- Q&A

Ratings Process

The Ratings Process



ABCs of Ratings Scale

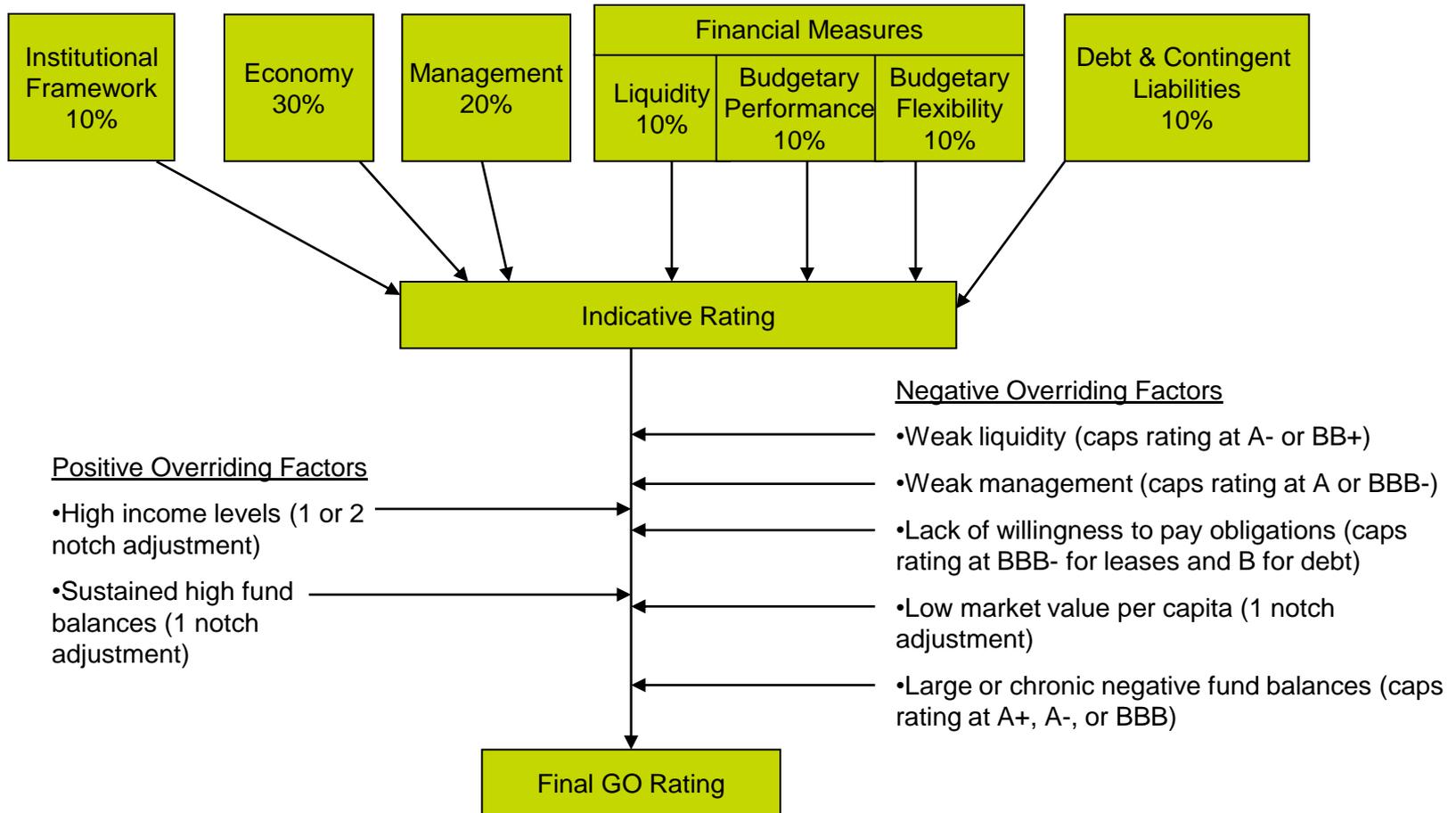
Investment Grade*	AAA	Extremely strong capacity to meet financial commitments. Highest rating.
	AA	Very strong capacity to meet financial commitments.
	A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.
	BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
Speculative Grade*	BB	Less vulnerable in the near term, but faces major ongoing uncertainties or exposure to adverse business, financial and economic conditions
	B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
	CCC	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments.
	CC	Highly vulnerable ; default has not yet occurred, but is expected to be a virtual certainty.
	C	Currently highly vulnerable to non-payment, and ultimate recovery is expected to be lower than that of higher rated obligations.
	D	Payment default on a financial commitment or breach of an imputed promise; also used when a bankruptcy petition has been filed or similar action taken.

* As considered by market participants

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

S&P Global GO Methodology and Framework

Analytical Framework For determining the ICR



Financial Management Assessment

Financial Management Assessment

- What is the Financial Management Assessment?
 - S&P Global Ratings has established an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality.
 - This assessment is based primarily on the existence and implementation of management practices, and not necessarily the results achieved by such practices.
 - The purpose of the focus on policies and practices is to evaluate the potential for credit quality to move away from those currently indicated by results.
- What is not included in the Financial Management Assessment?
 - The FMA is not an evaluation of the competency or aptitude of individual finance professionals; nor is it an evaluation of a finance department's ability to handle unique challenges.
 - The nature of the entity's governing body, the effectiveness of its governance practices, and issues of public policy pursued by the government are beyond the scope of this analysis.

Table 1**Revenue And Expenditure Assumptions**

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

Strong	Formal historic trend analysis is performed and updated annually for both revenue and spending; regular effort is made to determine whether revenues or expenditures will deviate from their long-term trends over the next couple of years; evidence of independent revenue forecasting exists(when possible).
Standard	Optimistic assumptions exist that, while supportable, add risk; assumptions are based on recent performance, but little evidence of questioning or validating assumptions exists.
Vulnerable	Assumptions neglect likely shortfalls, expenditure pressures or other pending issues; assumptions exist which enjoy no prudent validation.

Table 2**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?

Strong	At least quarterly budget surveillance is maintained to identify problem areas and enable timely budget adjustments; management exhibits ability and willingness to address necessary intra-year revenue and expenditure changes to meet fiscal targets.
Standard	Semiannual budget reviews exist; management identifies variances between budget and actual performance.
Vulnerable	No formal process exists for regular review and timely updating of budget during the year.

Table 3

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?

Strong	A multi-year financial plan exists where future issues are identified and possible solutions are identified, if not implemented; revenue and expenditure decisions are made primarily from a long-term perspective. Structural balance is a clear goal.
Standard	Multi-year projections are done informally; multi-year projections are done, but without discussion of pending issues, so that issues are not addressed; some one-shot actions exist, but the long-term consequences of these actions are acknowledged and communicated.
Vulnerable	No long-term financial planning exists; operational planning is done on a year-to-year (or budget-to-budget) basis; one-shot budget fixes are used with little attention to long-term consequences.

Table 4

Long-Term Capital Planning

Has the organization created a long-term capital improvement program?

Strong	A five-year rolling CIP with funding identified for all years exists and is linked to the operating budget and long-term revenue and financing strategies.
Standard	A five-year CIP is done, but is generally limited to projects to be funded from the current budget plus a four-year wish list; some funding for out-year projects is identified, but not all.
Vulnerable	No five-year CIP exists; capital planning is done as needs arise.

Table 5

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?

Strong	Investment policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning.
Standard	Informal or non-published policies exist; policies are widely communicated and followed.
Vulnerable	Absence of informal or non-published policies

Table 6

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?

Strong	Debt policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning. If swaps are allowed, a formal swap management plan has been adopted (see "Contingent Liquidity Risks in U.S. Public Finance Instruments: Methodology And Assumptions," published on March 5, 2012).
Standard	Basic policies exist; policies are widely communicated and followed. If swaps are allowed there is a swap management plan in place, but it does not follow S&P's guidelines.
Vulnerable	Absence of basic policies or clear evidence that basic policies are followed. Swaps are allowed but there is no swap management plan in place, and/or there is no local (non-FA) knowledge about the swap.

Table 7

Reserve And Liquidity Policies

Has the organization established a formalized operating reserve policy, which takes into account the government's cash flow/operating requirements and the historic volatility of revenues and expenditures through economic cycles?

Strong	A formal operating reserve policy is well defined. Reserve levels are clearly linked to the government's cash flow needs and the historic volatility of revenues and expenditures throughout economic cycles. Management has historically adhered to it.
Standard	A less defined policy exists, which has no actual basis but has been historically adhered to it.
Vulnerable	Absence of basic policies or, if they exist, are not followed.

- To perform its analysis of local government financial practices, S&P Global Ratings will rely on documentation provided by the government and discussions with the organization's management.
- Relevant documents include, but are not limited to, audited financial statements and accompanying notes, budget documents, financial plans, management policy statements, procedure manuals, and periodic reports.

Top 10 Management Characteristics of Highly Rated Credits S&P has observed.

1. Focus on structural balance
2. Strong liquidity management
3. Regular monitoring of revenues and economic trends to identify shortfalls early
4. An established “rainy day”/budget stabilization reserves
5. Prioritized spending plans and established contingency plans for operating budgets
6. Strong long-term and contingent liability management, including pension, OPEB and other obligations and risks
7. A multiyear financial plan in place that considers the affordability of actions or plans before they are part of the annual budget
8. A formal debt management policy in place to evaluate future debt profile
9. A pay-as-you-go strategy as part of the operating and capital budgets
10. Well-defined and coordinated economic development strategies

Meeting Agenda: How to best prepare for a due diligence meeting?

• DEBT

- Discuss bond issue?
- Update on future capital needs and funding.
- Any future debt plans?

ECONOMY

- Tax base
 - Update on economic developments that have occurred in the town– i.e. significant residential or commercial developments, employment etc.?
 - What are you budgeting for new growth?

Meeting Agenda: How to best prepare for a due diligence meeting?

- **FINANCES**

- Fiscal 2016

- Recap the year end result including any significant variations from budget in terms of revenues or expenses.

- Fiscal 2017

- What are your revenue and expenditure projections for 2017 year end?
- Do you expect fund balance will materially change at year end?

- Fiscal 2018

- Highlight concerns or pressures heading into the year or any potential challenges to the budget relative to prior years?
- Are you anticipating appropriating free cash for capital or operations?
- Any changes to Pensions and OPEB
- Are there any out-year budget projections available?

- Labor – Update on contracts?

Meeting Agenda: How to best prepare for a due diligence meeting?

-
- **FINANCIAL MANAGEMENT POLICIES/PRACTICES**
- Discuss changes to any financial management policies/practices
- If applicable, please provide us a copy of your:
 - 5-year capital improvement plan (CIP),
 - Long term financial plan,
 - Reserve policy,
 - Investment management policy or
 - Debt management policy?
- Could we please get a copy of the most recent budget update and/or investment report (if they exist)?

Q&A

Thank you

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