How and Why Do Rating Agencies Arrive at Different Conclusions?

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Moody’s – 1900
15,700 municipal issuer ratings

S&P – 1860
≈ 16,500 municipal issuer ratings

Fitch – 1913
≈ 2,800 municipal issuer ratings

Kroll - 2010
< 100 municipal issuer ratings
Moody’s State Rating Framework

Economy (20%)
Per capita income, industrial diversity, employment volatility

Governance (20%)
Budget development and management practices, financial best practices, financial flexibility, constitutional constraints

Financial Strength (30%)
Revenue diversity, volatility, growth, fund balances as % of revenue, cash management and liquidity

Debt/Pensions (20%)
Debt as % of revenue, unfunded pension liabilities as % of revenue

Source: Janney FISR, Moody’s US States Rating Methodology 4-17-13
Rating Framework Comments

State Rating Framework
• S&P uses a state rating framework which is similar to Moody’s

• Framework is only the starting point. It generates a score which may be adjusted for a variety of factors

• Although weighting for pension liabilities is about same for both agencies, Moody’s uses a more aggressive approach to calculating unfunded pension liabilities.

Local Government Rating Framework
• Moody’s places more weight on economy and less on management/governance than state framework

• Moody’s places heavier weight on debt and pensions than S&P (20% vs 10%)

• S&P places heavier weight on institutional framework and management than Moody’s (30% vs 20%)
Moody’s vs S&P

- Both Moody’s and Fitch “recalibrated” state and local government ratings in April 2010 with most GO ratings increasing by one to three notches (not reflected in graph).

- Before and after recalibration, S&P has had more upgrades than downgrades. In only two post-recession quarters did S&P have more downgrades (compared to 23 quarters of downs for Moody’s).

- S&P’s September 2013 local government methodology revision led to upgrades for about 30% of local government issuers and downgrades for 10% (reflected in graph).

S&P Has Had Much Higher Net Ratio of Ups to Downs

Source: Janney FISR, Moody’s, S&P, Fitch
Rating Differentials Today

- At state level Moody’s tends to have higher ratings, with 10 states rated a notch higher than S&P compared to 3 higher for S&P.

- S&P local government ratings skew higher than Moody’s. Green shows where S&P is higher than Moody’s.

Source: Janney FISR, Municipal Market Analytics
Market View on Ratings

- Large Institutional investors rely primarily on internal research, but ratings may matter for liquidity purposes

- Retail investors focus more on ratings

- My experience is that underwriters and financial advisors increasingly choose S&P when only one rating is sought

- Newcomer Kroll Ratings is sometimes used to replace Moody’s. KBRA ratings tend to be the same or higher than those of other rating agencies, although Kroll rates only a few issues

- Chicago is most prominent example of divergent ratings
  - Ba1/BBB+/BBB+ and Kroll at A-
  - School District – Ba3/BBB/BBB- and Kroll at BBB+
  - For most recent deals, Chicago did not use Moody’s

- The Big Question – Are the higher ratings of S&P (and Kroll) part of stealth marketing campaign?
Ratings Determine Interest Rates

Source: Janney FISR, Thomson Reuters MMD
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**Marketweight**: Janney FISR expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return

**Underweight**: Janney FISR expects the target asset class or sector to underperform the comparable benchmark (below) in its asset class in terms of total return

**Benchmarks**

**Asset Classes**: Janney FISR ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the “Barclay’s U.S. Aggregate Bond Market Index” as a benchmark.

**Treasuries**: Janney FISR ratings employ the “Barclay’s U.S. Treasury Index” as a benchmark.

**Agencies**: Janney FISR ratings employ the “Barclay’s U.S. Agency Index” as a benchmark.

**Mortgages**: Janney FISR ratings employ the “Barclay’s U.S. MBS Index” as a benchmark.

**Investment Grade Credit**: Janney FISR ratings employ the “Barclay’s U.S. Credit Index” as a benchmark.

**High Yield Credit**: Janney FISR ratings for employ “Barclay’s U.S. Corporate High Yield Index” as a benchmark.

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