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# How and Why Do Rating Agencies Arrive at Different Conclusions?

**Alan Schankel**
**Managing Director**
**Municipal Strategy and Research**

aschankel@janney.com
215-665-6088

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# The Rating Agencies

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 coinstraints

## Financial Strength (30%)

Revenue diversity, volatility, growth, fund balances as % 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

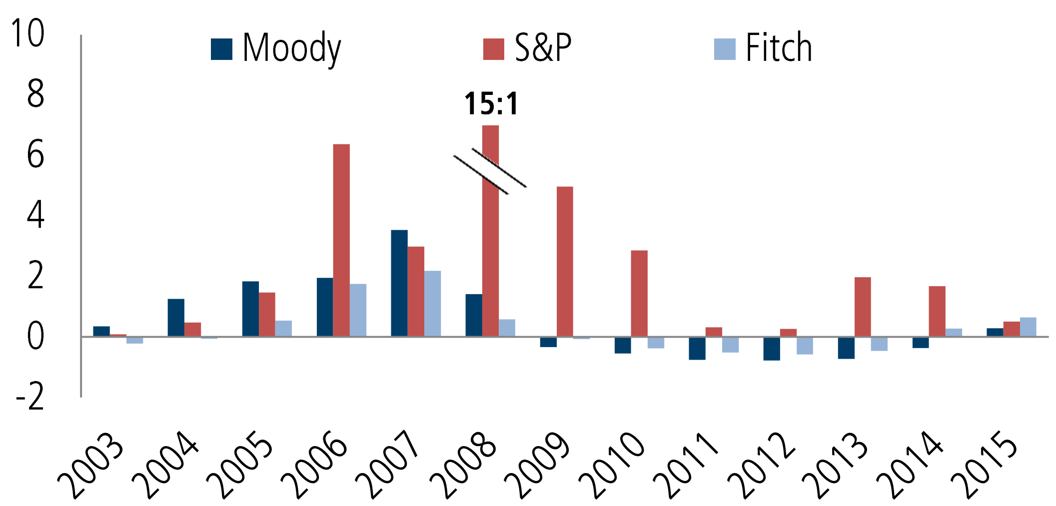
- Moody's places heavier weight on debt and pensions than S&P (20% vs 10%)

- 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.

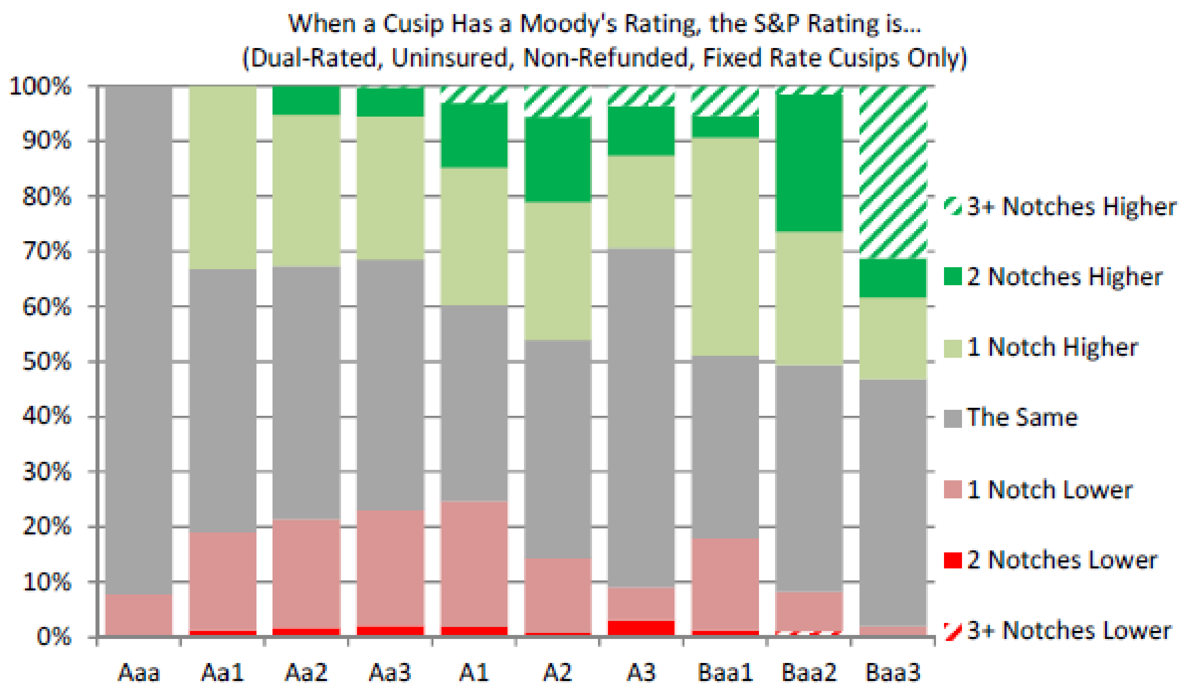



*Figure 1. 45.5% of the 200,000 outstanding dual-rated, uninsured, non-refunded municipal CUSIPs have different ratings from Moody's & S&P. 6.8% are different by two or more notches, frequently lower on the scale. The implication: more uncertainty over credit quality, more exposure to headline risk, less sector-wide liquidity.*

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?

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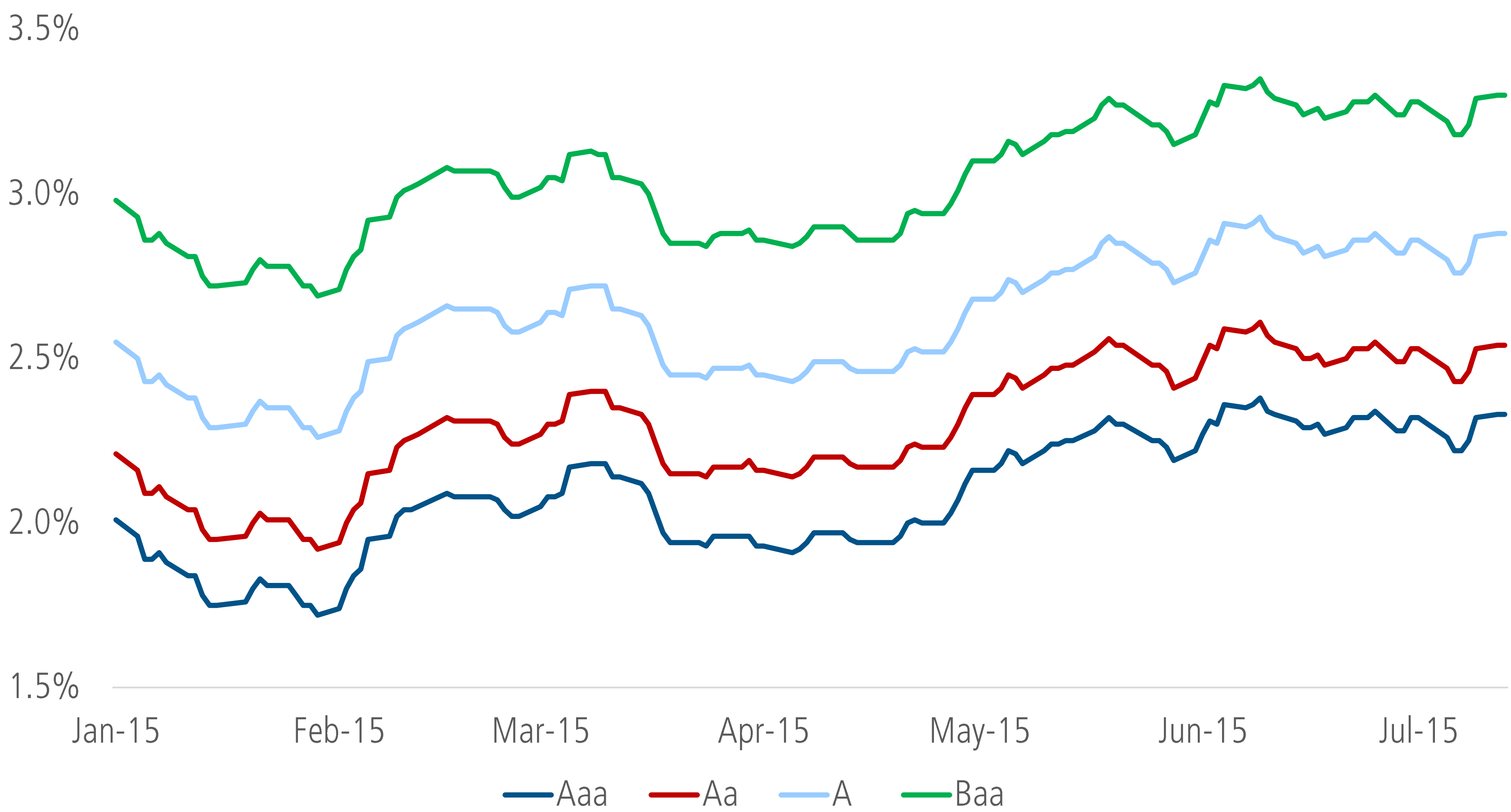
# Ratings Determine Interest Rates




Source: Janney FISR, Thomson Reuters MMD

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