

CHAPTER 14

Municipal Bond Ratings*

1. NATURE—FUNCTIONS OF BOND RATINGS

In 1955 the volume of the tax exempt securities outstanding was \$42.8 billion. As of June 30, 1965, the total had reached \$97.8 billion. Annual new issue sales of \$10 or \$11 billion are now taken for granted.

Ratings have become indispensable as more issues come to the market. Each year, the dealer and investor in tax exempts is confronted by hundreds of unfamiliar names. They need to know the quality of a bond before they will purchase it. In some cases, firsthand information is readily obtainable. A simple issue, such as the tax secured bonds of a central school district in New York State, may be offered and explained through a nontechnical one-page circular. Many issues, however, because of their size, technical aspects and unusual security provisions require more study and detail. When an issue of Rocky Reach Hydro-Electric System revenue bonds was offered some 10 years ago, the offering was accompanied by a 68-page official statement, a 65-page volume of basic documents, three separate engineering reports totaling 130 pages covering the economic and financial feasibility and construction of the project, and a 40-page brochure describing the Northwest Power Pool. Clearly, few investors would have been willing or able to carefully investigate and evaluate the credit of the Rocky Reach offering. Rather, investors have come to depend upon the "quality" ratings issued by a number of major investment advisory services.

Ratings for municipal bonds are basically an outgrowth of corporate bond ratings. The first ratings for corporate bonds appeared in 1909 when Moody's began rating railroads. In 1914, Moody's expanded its services to cover public utilities and industrials. In 1922, Poor's began rating all industries, Standard Statistics and Fitch followed in 1924. Thus, four ratings were available for most large issues from 1924 through March 1941, when Poor's was merged with Standard Statistics. Three ratings were then usually available. Ratings were often not assigned by the agencies to small issues of little public interest, to private placements or situations in which sufficient information was not available.

Since 1909, when Moody's Investor Service began rating corporate bonds, ratings assigned by the various investment agencies have constituted an important device for evaluating the quality of corporate bonds. In the period 1924-35 ratings were assigned to over 98 percent of the total par amount of all straight corporate bond issues outstanding. Thereafter, with the growth of private placements (not usually rated by the agencies), the extent of coverage declined. Nevertheless,

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