

3. FACTORS TAKEN INTO ACCOUNT IN ASSIGNING RATINGS

"Ratings are not a reflection of bond maturity or marketability except in rare cases where the combination of maturity and marketability itself has a direct bearing on the prospects of payment. Security, or safety (relative certainty of the payment of interest and principal) remains as the principal, almost the sole ingredient of the ratings."¹ Agency ratings are not derived through the use of statistical formulas. Though statistics are used, great weight is given to numerous economic and nonfinancial factors which can effect the long-term future performance of the bonds. Ratings are reviewed periodically and changed whenever the rating agency is convinced that long-term risks have diminished or increased.

Bonds are appraised according to two basic risk factors. They are:

(1) *The risk that bond quality will be diluted by inordinate increase in debt.*—In recent years many States have come to relax or expand legal debt limits; special taxing districts and authorities are more frequently being used to finance projects beyond municipal limitations. For example, Moody's will be satisfied that bond quality will not be diluted by inordinate debt increases, only when municipal debt is modest and governmental facilities adequate for immediate and prospective needs.

(2) *The risk that ability to meet maturing bond principal and interest may be impaired under depressed business conditions.*—The investor wants assurance not only that a community is able to pay today, but also that it shall be able to meet obligations in the future. Though debt service may be secured by law, the whole community budget structure must be sound if a high credit standing is to be provided.

An appraisal of the role of management is still another important factor considered by rating agencies before a final rating is given. Management administers present day policies and forms plans and policies which are to be followed in the future. Management's role is that of executor of debt proceeds and developer of the economy.

A city's history of debt policy and administration is a key to credit standing. How willing is management to face its responsibilities? How aggressive and how capable? Economic development very much depends upon the governmental environment created by city managers. To maintain and improve credit, agencies look to how well management attracts new business and residents and instills in them a social consciousness which can be called upon to shoulder community responsibilities. Communities must not be targets for exploitation. Business and residents will come when a community is known to give fair, equitable property assessments, provide adequate facilities, and insure that spending (and taxing) results only after careful and complete analysis.

Moody's expects effective management to be a good public relations officer. Information provided by managers is relied upon by bondholders, and for them, by Moody's. A former top Moody's official has stated, "Management is appraised by how well its reports tell its story, as well as by the story itself."

Moody's, particularly, asks management to tell its story through municipal records, histories, and statistics, as well as all documents

¹ D. M. Ellinwood, former vice president, Moody's Investor Service, "Bond Ratings and Bond Prices," Public Works magazine, October 1965.