

Seifried & Brew Municipal Bond Rating Discussion

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Many investors approach municipal credit research primarily from a cash perspective. Does the credit have surplus cash and investment holdings in its General Fund compared to its liabilities and debt service expenses? While cash can be an indicator of a municipality's ability to make current payments, it does not necessarily predict long-term solvency. It can create the appearance of high performance without disclosing significant weaknesses. Seifried & Brew has developed a method for understanding municipal credit quality that is robust and highly quantitative, taking into consideration multiple financial indicators. Through the development of this method, we have created several models that Seifried & Brew believes are essential to interpreting financial data in an accurate and consistent manner.

While the levels of cash and current assets mentioned earlier certainly enter into our analysis, such numbers are weighed among an array of financial indicators. These indicators serve to determine credit quality in the near and long terms. Seifried & Brew believes that a municipality's financial statements, presented according to GAAP, reveal an underlying performance level that is indicative of the municipality's financial management and, therefore, its investment grade ranking. Typically, through conservative management, the municipalities that are at the highest level of investment grade ranking will prosper financially and will most likely provide the most services to their communities.

Seifried & Brew analyzes financial indicators collectively to develop a sense of significant patterns in the overall movement in financial levels and trends. Our models assign general scoring to the more static values, such as financial ratios, as well as to changes in revenues and expenses, or flows. Seifried & Brew takes advantage of the variety of data provided in standard GAAP financial statements and comprehensive annual financial reports. Determining the credit worthiness of a municipality involves a rigorous interaction with this data, including time spent inputting and interpreting data.

Our models each operate differently as to interpret data from alternate perspectives. Generally speaking, the model scores financial ratios and flows on a scale. These scores are then weighed into an overall score. Of primary weight in the model are the data inputs evaluating primary government net financial position and tracking changes in net position over time. Another model breaks the scores into individual categories similar to those requested by the regulators for the determination of "Investment Grade" credit quality. These categories would include, for example, "Revenue Capacity" or "Budgets." Of course, there are a variety of red flags that would override the model's scoring and alert our analysts of potential significant weakness in financial management. Additionally, our analysts use supplementary financial information, including budget reports, state and county economic data, or tax collection data, to finalize the overall rating.

It is Seifried & Brew's goal to continually advance the analysis of financial management in municipalities across the nation. It is our hope that our clients are certain that "investment grade" rankings not only meet the regulatory requirements, but give greater confidence in the management of their municipal bond investment portfolios.