Credit Rating Strategies and Tips for Rating Presentations

Presentation to the
Illinois Community College Chief Financial Officers
Spring Conference – April 17, 2008
Starved Rock State Park

Joanne Malinowski
Part 1  Current Market Conditions
Why your credit rating matters so much now

Part 2  Advice to Community Colleges
Even if you aren’t planning to issue debt now

Part 3  Tips for Rating Presentations
PART 1 – Current Market Conditions

Why your credit rating matters so much now
Current Market Conditions
Rating Agencies

- Rating Agencies provide independent, objective and expert evaluation of credit
- Insured Ratings – Based on rating of bond insurer
  - Until January, 2008, were 7 AAA-rated insurers.
- Underlying Ratings – Based on rating of issuer and source of repayment of bonds; often used in addition to AAA rating from insurance
- Improve efficiency of market
- Intermediary between issuer and purchaser
- Additional source of information for investors on suitability of investment
Current Market Conditions

Who are investors of municipal bonds?

- The underwriter will be marketing your bonds to investors across the country.
- Investors may not know who you are.
- Credit rating enables investors to make investment decision and compare you to other issuers in the market.
Current Market Conditions

*Strong credit ratings matter now more than ever*

- Only 33% of issues sold in the first quarter of 2008 were insured, compared to 49% last year.
- Why? Sub-prime mortgage market impact on bond insurance companies
- Investors are relying more on underlying credit rating of issuers.
- Higher underlying credit ratings will help you lower your borrowing costs.

### Long-Term Municipal Issuance (March 2008 YTD, $bn)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Issuance</td>
<td>$107.5</td>
<td>$80.3</td>
<td>-25</td>
</tr>
<tr>
<td># of Issues</td>
<td>2,908</td>
<td>2,259</td>
<td>-22</td>
</tr>
<tr>
<td>Bond Insurance</td>
<td>$55.2</td>
<td>$21.4</td>
<td>-61</td>
</tr>
<tr>
<td># of issues</td>
<td>1,422</td>
<td>748</td>
<td>-47</td>
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</tbody>
</table>

**Insured As Percentage of:**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
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</thead>
<tbody>
<tr>
<td>$ Amount</td>
<td>51%</td>
<td>27%</td>
</tr>
<tr>
<td># of Issues</td>
<td>49%</td>
<td>33%</td>
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</tbody>
</table>

*Source: The Bond Buyer*
Credit strength of municipal bond insurers has been impaired due to losses in their business in asset-backed securities and collateralized debt obligations.

Loss of the triple A rating by several insurers has resulted in the wholesale dumping of the affected municipal bonds in the secondary market, driving down prices and increasing borrowing costs for issuers.

The current ratings of all municipal bond insurers as of April 14, 2008 is as follows:

<table>
<thead>
<tr>
<th>Moody's Rating</th>
<th>S&amp;P Rating</th>
<th>Fitch Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACA</td>
<td>NR</td>
<td>CCC</td>
</tr>
<tr>
<td>Ambac</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td></td>
<td>Outlook Negative</td>
<td>Negative Outlook</td>
</tr>
<tr>
<td>Assured Guaranty</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td></td>
<td>Stable</td>
<td>Stable</td>
</tr>
<tr>
<td>CIFG</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>Stable</td>
<td>Negative Outlook</td>
</tr>
<tr>
<td>FGIC</td>
<td>Baa3 Review for Downgrade</td>
<td>BB</td>
</tr>
<tr>
<td></td>
<td>Stable</td>
<td>Negative Outlook</td>
</tr>
<tr>
<td>FSA</td>
<td>Aaa</td>
<td>AAA</td>
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<tr>
<td></td>
<td>Stable</td>
<td>Stable</td>
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<tr>
<td>MBIA</td>
<td>Aaa</td>
<td>AAA</td>
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<td></td>
<td>Negative Outlook</td>
<td>Negative Outlook</td>
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<tr>
<td>Radian</td>
<td>Aaa3 Negative Outlook</td>
<td>AA</td>
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<td></td>
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<tr>
<td>XLCA</td>
<td>A3 Review for Downgrade</td>
<td>A-</td>
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<tr>
<td></td>
<td>CreditWatch Negative</td>
<td>Negative Outlook</td>
</tr>
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Current Market Conditions
Municipal Interest Rates Have Risen Recently

- Long-term interest rates have exhibited significant volatility.
- Municipal interest rates have risen compared to U.S. Treasury securities.
- Since Fall 2007, there has been a disconnect between Municipal and Treasury rates.

Source: Bond Buyer and Bloomberg
PART 2 – Advice to Community Colleges

Even if you aren’t planning to issue debt now
Develop a rating strategy early in the financing process

- Consider the impact your planned bond issue will have on your credit rating as you develop your plan of finance.

Developing a rating presentation is a good opportunity for self-evaluation.

A good credit rating presentation:

- Can make the rating agency analyst’s job easier. This person can be your advocate with the credit committee.
- Draws attention to your credit strengths
- Demonstrates the strength of your organization’s management
Advice to Community Colleges
Even if you aren’t planning to issue debt now

Don’t wait for bond issue to do things that are helpful to your credit rating. Work the things that are within your control.

- Monitoring revenues/expenditures and making mid-year budget adjustments
- Maintaining financial flexibility
- Cost-saving measures
- Rainy day fund
- Written financial policies - debt, fund balance goal, balanced budgets, tuition, cash/liquidity, investments, inter-fund transfers
- Multi-year projections
- Master Plan
PART 3 – Tips for Rating Presentations
Tips for Rating Presentations
Making strong credit rating presentations

- Review your previous rating report.
- Develop an agenda – cover all 4 key subjects – see next slide.
- Tell your story – go beyond the numbers.
- Prepare narrative/charts/graphs that explain your debt issuance plans and/or highlight financial performance and positive credit qualities.
- Be prepared to discuss credit weaknesses, “hard questions” or “warning signs”.
  - You don’t have to have all the answers.
- Provide documents in advance (3 years of audits, budget, year-to-date results, capital improvement plan, multi-year projections.)
- Describe written financial policies.
- Consider an in-person meeting and tour.
Rating agencies are concerned with 4 key subjects:

1) Economic Factors
2) Financial Information
3) Debt
4) Management

As a community college, you may not have much control over #1.

However,

- What are you doing about the things that ARE under your control?
- How are you responding to the things that ARE NOT within your control?
4. Management – a qualitative rating factor

How Management factors into the rating process

- Content and substance of the presentation
- Past performance of the issuer (financial results, etc.)
- Administrative/Managerial structure
- Professional experience of management staff
- Impressions gained during the presentation

- Your financial professionals (underwriter or financial advisor) can assist you in preparing the presentation
- But, rating agencies want to hear from you
- You want to demonstrate
  - Professionalism and competence
  - Planning – eye on the future
  - Proactive, not reactive
1. Economic factors

Examples

- Historical EAV trends
- Property tax collections
- Taxpayer concentration – 10 largest taxpayers’ EAV as % of total
- Have you observed any changes due to current economic conditions?
  - Lower property tax collections due to mortgage foreclosures or financial stress on taxpayers
  - Slow down in new development – smaller increases in property tax base
  - If the college is subject to tax caps, reduced ability to extend more property taxes (less “new property” in tax extension calculations)
2. Financial information

Examples

- Historical trends in General Fund balance
- Current year budget status – monitoring revenues/expenditures and making mid-year budget adjustments?
- How does your budget reflect your educational/curriculum goals?
- Liquidity – measure by General Fund cash and current investments as % of General Fund current liabilities
- Reserves – have a “rainy day fund”?
- Tuition – tuition policy (e.g., % of total operating revenues), historical rates, planned tuition increases, comparisons to other community colleges
- Cost-saving measures
- Multi-year projections
3. Debt

- Explain your plan of finance – demonstrate that you have a thoughtful plan for issuing debt

- How will the planned bond issue affect:
  - Total debt and debt retirement (over time)
  - Total debt per capita and as % of EAV
  - Operating budget
  - Enrollment
  - Tax levy and taxpayers

- How does your debt plan of finance relate to your college’s Master Plan and your educational/curriculum goals?

- Explain any creative financing approaches – e.g., public-private and public-private partnerships
Final thoughts

Rating process is a dialogue

- Ask questions of the rating agency analysts.
- After the rating is determined, discuss it in detail with the rating agency analysts.
- Get a good understanding of
  - Positive credit factors
  - Things that prevented you from being rated in a higher category
  - Things you can address that may improve your rating in the future
- Keep in contact with rating agencies – e.g. provide copies of annual audits.
Use your credit report

- Internally – to assist you in setting policies and procedures
- With College Board of Trustees – to discuss financial policy issues and to determine future steps to improve financial performance.
- With stakeholders (taxpayers, students, faculty, community, media) – to demonstrate strong management and good stewardship of the public funds
Any questions or comments?

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