

The Value of a “Aaa” Debt Rating

Moody’s Investors Services currently rates Wayland’s approximately \$80 million of long-term general obligation debt “Aaa”. The questions are periodically asked,

“What is the value of the “Aaa” rating?” and

“What would the impact on the Town’s finances be if the rating were lower?”

Background

First, using Moody’s website as the source, it is important to understand what the debt ratings mean and then, specifically, the components that are reviewed for municipal debt ratings.

- Moody’s credit ratings are opinions of the credit quality of individual obligations or of an issuer’s general creditworthiness (without respect to individual debt obligations or other specific securities).
- Municipal Ratings are based upon the analysis of five primary factors related to municipal finance: market position, financial position, debt levels, governance, and covenants. Each of the factors is evaluated individually and for its effect on the other factors in the context of the municipality’s ability to repay its debt.

For municipal debt, Moody’s describes the rating as

Aaa Issuers or issues rated Aaa demonstrate the strongest creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Aa Issuers or issues rated Aa demonstrate very strong creditworthiness relative to other US municipal or tax-exempt issuers or issues.

What is the value of the “Aaa” rating?

To determine the value of the Aaa rating, one needs to understand the incremental cost to the Town of Wayland if the debt rating were “Aa” instead of “Aaa.” When issuers (like Wayland) issue debt, the interest rate that investors are willing to earn is based on many factors, with the debt rating being one of, if not the most important, factor. Issuers with the highest debt rating (Aaa) pay the lowest interest rates. To quantify the potential incremental cost to Wayland, one needs to know the incremental expense (higher interest rate) that Wayland would have to pay if the Town were rated “Aa”.

Recently (February 2012), the spread differential between generic “Aaa” rated municipal securities and “Aa” rated municipal securities has been approximately 15 to 30 basis points (0.15 to 0.30 percent). This incremental cost can be measured in two ways – over the whole portfolio of debt, which assumes ongoing infrastructure maintenance and development -- and for a specific project.

Over time, as the Town’s debt is refinanced, the incremental cost would likely rise to be somewhere around \$120,000 to \$240,000 a year (\$80 million times either 0.15 to 0.30 percent). This is about an additional \$30 - \$60 per household per year. Another example is to think about

the cost of borrowing to fund a new DPW building. Assume for illustrative purposes, that the DPW building is financed with \$13,000,000 of debt. The incremental cost to the Town would be somewhere around \$19,500 to \$39,000 a year (\$13 million times either 0.15 or 0.30 percent) for the twenty-year life of the bond.

What would the impact on the Town's finances be if the rating were lower?

What would the impact be on the Town's finances if we had a lower rating? Or, in other words, would the Town save money by having less free cash (one component of determining financial position) and a possibly lower rating? The answer is there is no savings to the Town that is quantifiable. An argument that is often put forth to support having a lower debt rating is that Wayland would be able to maintain lower levels of free cash. The presumption here is that maintaining lower levels of free cash will somehow lower the tax burden on taxpayers.

Maintaining a steady level of free cash, regardless of the level chosen, has no impact on the Town's expenses and, therefore, has no impact on the tax burden. Free cash is not an expense of the Town. It is the Town's expenses that drive the tax burden. In fact, a lower debt rating will raise the Town's debt expenses as explained above.