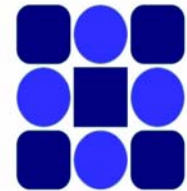


# Perspectives

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## Moody's Investor Services - Municipal Bond Rating Recalibration

September, 2008

### History of Municipal Bond Ratings

Since the early 1900's, Moody's Investors Service (Moody's) rated municipal bonds based on a scale that was distinct from its Global Scale Ratings (GSR), the primary rating methodology for corporations, financial institutions and governmental entities throughout the world. The municipal scale reflected the usually lower level of credit risk for municipal debt and the fact that the tax-exempt bond market has operated independently, with its own investor, issuer and broker-dealer communities. In the late 1990's as "cross-over" investors who purchased both taxable and tax-exempt securities became more prevalent, Moody's investigated the possibility of adjusting its municipal bond ratings to the GSR. Market research performed by Moody's demonstrated, however, that the public finance community was not interested in any such recalibration at that time.

Market sentiment changed in early 2008 due in large part to the credit deterioration of certain financial guarantors of municipal bonds, which had a negative ratings impact on the related insured securities. Market participants called for Moody's to re-rate municipal issuers to the GSR, arguing that the new rating would allow investors to better gauge the security's credit risk. Initially, Moody's agreed to rate new municipal bond issues at the issuer's request according to both the municipal scale and GSR. This decision was announced in a "Request for Comment", a publication in March 2008 that also asked for feedback on the new dual rating plan. Over the next three months, Moody's received comments from over 150 market participants. After reviewing the responses, Moody's determined that a majority of those surveyed had a strong preference for a single rating scale, feeling that maintaining two ratings for municipal issuers would be confusing. As a result, Moody's amended its proposal indicating that it would transition all municipal ratings to the GSR. More time was given to the public finance community to react to the updated proposal.

In early September, Moody's concluded its review and formally announced its intention to recalculate the ratings of US municipal bond issues and issuers based on the GSR. The distinct municipal ratings scale would be eliminated. Moody's stated that the transition to one ratings scale will allow comparability of credit quality across Moody's entire rated universe.

### Rating Transition

As Moody's assigns municipal ratings to over 28,000 securities, the planned transition to the GSR represents a significant undertaking for the agency. The ratings migration is due to commence in October 2008 with state and local government general obligation bonds and continue according to the timeline presented in the table below. To carry out the transition, Moody's selected a number of municipal credits to represent the various public finance sectors. The selected credits are then to be rated according to the GSR by committees of analysts from across Moody's analytical spectrum, including corporate, sovereign, project finance and structured finance. Finally, these credits will serve as benchmarks by which all other credits in their related sector will be rated.

### Result of Transition

Moody's indicates that, on average, ratings for state and local general obligation bonds will likely be two notches higher under the GSR than their current ratings under the municipal scale. Credits in the enterprise sectors, such as housing and airports, are expected to be one notch higher, on average, under the GSR. Additionally, as intended, the ratings recalibration will now provide for the direct evaluation of all Moody's rated bonds. Previously, a bond issued by a hospital system rated "A" under the municipal scale could be viewed, inaccurately, as having similar credit risk to a corporate bond rated "A" under the GSR; although, the hospital bond would most likely be rated higher under the GSR.

## **Conclusion**

We welcome Moody's decision to re-rate the public finance sector as we have long held the belief that the separate municipal scale when compared to the GSR caused investor misunderstanding. When the recalibration is complete, bond investors will have the ability to make an apples to apples comparison of municipal bonds to their taxable counterparts. Overall, rating municipal bonds under the GSR will bring necessary clarity and simplification to the public finance investment process.

## **Migration Timeline – US Municipal Bond Ratings**

<b>Recalibrated ratings issued by end of:</b>	<b>Sectors / Credits</b>
October 2008	<ul style="list-style-type: none"><li>•State Governments – General Obligation (GO) and GO Related Ratings</li><li>•50 Largest Local Government Debt Issuers – GO and GO Related Ratings</li></ul>
November 2008	<ul style="list-style-type: none"><li>•Higher Education</li><li>•Health Care</li></ul>
December 2008	<ul style="list-style-type: none"><li>•Housing</li><li>•Airports</li><li>•Ports</li><li>•Toll-Roads</li><li>•Public Power</li><li>•Mass-Transit</li></ul>
January 2009	<ul style="list-style-type: none"><li>•Local Government GO and Related Ratings, Local Government Water/Sewer Enterprise and State and Local Government Sales/Special Tax Ratings and all remaining credits.</li></ul>

*Sources: Announcement: Moody's to Recalibrate its US Municipal Bond Ratings to the Company's Global Rating Scale, September 2008  
Announcement: Moody's Extends Comment Period on US Public Finance Rating Scale, June 2008  
Request for Comment: Assignment of Global Ratings to Tax-Exempt Municipal Obligations, March 2008*