REPORT TO COUNCIL
City of Sacramento
915 I Street, Sacramento, CA 95814-2604
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Staff Report
July 22, 2008

Honorable Mayor and
Members of City Council

Subject: Municipal Bond Rating Reform

Location/Council District: Citywide

Recommendation: Adopt a **Resolution** authorizing the City Treasurer to take appropriate actions in support of municipal bond rating reform.

Contact: Kimberlie Gladden, Senior Debt Analyst, 808-2675, Russell T. Fehr, City Treasurer, 808-5832

Presenters: Russell Fehr, City Treasurer; Representative, California State Treasurer's Office

Department: Office of the City Treasurer

Division: Finance

Organization No: 0900

Description/Analysis

Issue: Municipal bonds have historically shown a significantly lower level of default than corporate bonds, (Attachment 2[a]). However, public agencies tend to receive lower bond ratings and are often required to purchase bond insurance to obtain what would be equivalent to the higher corporate rating. This happens even when the public agency's credit rating is investment grade, "double A," in the case of the City of Sacramento. Without this higher rating, municipals bonds are subject to higher interest rates due to implied, but not real, default risk, as well as limiting the number of institutional investors permitted to purchase the lower rated bonds.

The economic turmoil experienced by all sectors of the market has brought into focus inequities in municipal and corporate debt ratings and insurance requirements. This has led to calls for rating agency reform from cities and states, Members of Congress, and some investment banking firms.

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[a] Moody's Excerpt – Moody's Municipal Default Study Results (2001-2002)

Policy Considerations: Reform of the current rating system to a method that equitably evaluates the actual risk of paying its obligation will result in minimizing bond related expenses and maximizing the potential proceeds available from a bond issue. California State Treasurer, Bill Lockyer, has been leading a nationwide campaign for rating agency reform that has garnered support from a number of industry sectors, as well as earnest consideration from the rating agencies. Future actions by the City may include letter writing campaigns, feedback to rating agencies and legislation input and support.

Environmental Considerations: None.

Committee/Commission Action: None.

Rationale for Recommendation: Holding municipal bonds to a significantly higher standard than corporate bonds burdens state and local governments with higher costs over the life of the bonds. Rating municipal bonds using the same standard that applies to corporate bonds will reduce the cost of issuing municipal bonds and ensure a broader pool of investors competing to purchase the bonds. Ultimately, this will make more funds available for much needed infrastructure and government services.

Financial Considerations: There are no immediate financial impacts as a result of supporting this effort.

Emerging Small Business Development (ESBD): No goods or services are being purchased.

Respectfully Submitted by: K Gladden

Kimberlie Gladden
Senior Debt Analyst

Approved by: ______________

Janelle Gray
Public Finance Manager

Recommendation Approved:

for Lydia Abreu

Russell Fehr
City Treasurer

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Attachment 1

RESOLUTION NO.

Adopted by the Sacramento City Council

A RESOLUTION SUPPORTING MUNICIPAL BOND RATING REFORM

BACKGROUND

A. The recent turmoil in the municipal bond markets has brought into focus the higher standards imposed by rating agencies on municipal bonds compared to corporate bonds.

B. Historically, municipal bonds default less than corporate bonds, but despite relative default rates, the rating agencies continue to require public agencies to secure expensive bond insurance in order to secure higher bond ratings.

C. The City of Sacramento continues to deliver a balanced budget including the appropriation of its lease obligations and has never defaulted on City or Sacramento City Financing Authority issued debt obligations.

D. A coalition of state and local public agencies, led by California State Treasurer Bill Lockyer, has called on the rating agencies to examine their practices and treat municipal bonds on par with corporate bonds.

E. Rating reform may ultimately lead to a reduced costs and increased funds available for infrastructure and services.

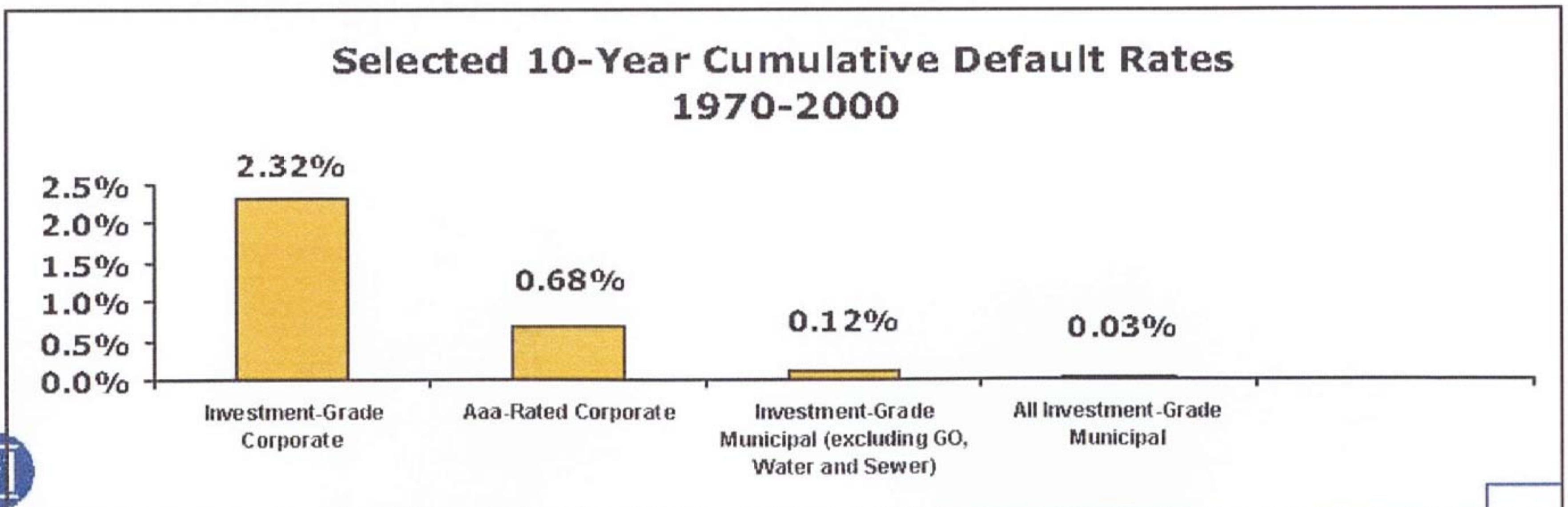
BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

Section 1. The City Treasurer is hereby authorized to participate in and take appropriate actions to support the nationwide efforts to reform how bond-rating agencies rate state and local bonds.

Attachment 2

Moody's Municipal Default Study Results (2001-2002)

- Moody's-rated municipal bonds found to default at much lower rates than similarly rated corporate bonds
- 19 out of approximately 28,000 unique issuers defaulted from 1970-2000



Moody's Investors Service