Rating Methodology

MUNICIPALITY

CREDIT RATING INFORMATION & SERVICES LIMITED

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MEANING OF CREDIT RATING

CRISL defines credit rating as a measure of assessing relative risk of default and the severity of default associated particular securities issue , issuer and/or other financial assets. It is a symbolic indication of current opinion of the relative capability of timely servicing of the debts and obligations as per the terms of contract. It is an independent, impartial best judged professional OPINION on the **ABILITY** and **WILLINGNESS** of a borrower to discharge its debt when due , in case of a debt instrument and assessment of net worth, external liability and earning prospects in case of a corporate Entity.

Rating agencies are perceived as impartial, professional and best judged opinion giving agencies in the investment process to safeguard the interest of the general investors. Rating reflects neutral and influence free professional opinion on the assessment of credit risk associated with an instrument or a corporate. The rating services provide a guideline to the investors as to the degree of certainty of payment of principal and interest in case of debt instrument and the degree of acceptability of the net worth and earning prospects of an entity seeking public finance.

CRISL RATING PERSPECTIVE

Understanding the increasingly important role of ratings, especially in the light of Basel II guidelines, consistent and uniform default definition is critical and it has significant impact on the reliability and comparability of ratings across rating agencies. A rigorous and transparent definition of default makes the ratings assigned by a rating agency meaningful. Ratings can either indicate probability of default (PD) or Expected Loss (EL). The underlying principles guiding each of these approaches are not similar, and ratings that indicate probability of default are not directly comparable with ratings that indicate Expected Loss, especially at lower rating levels. Investors and market participants, thus, will compare only those ratings that are based on similar approaches, or make appropriate adjustments before comparison.

Considering the stage of development of rating environment in Bangladesh CRISL adopted rating definition of "Probability of Default". Therefore, all CRISL ratings indicate the probability of default and not the EL that may arise after the default.

DEFINITION OF DEFAULT

CRISL adopted the international definition of default as being adopted by global rating agencies. Under the above definition, Default is:

A) A missed installment (Principal and or Interest) which has not been discharged / paid as per schedule or within the grace period allowed by the regulators/ creditors.
B) Failure to honour the corporate guarantee obligations as per contract or within the allowed grace period;
C) The legal insolvency or bankruptcy of the issuer/ entity
D) A distress exchange in which the bondholders/ creditors are offered a substitute instrument with inferior terms and conditions
E) Restructuring of a financial obligation substantially disadvantageous to the creditors;

SCOPE AND LIMITATIONS OF CRISL RATINGS

CRISL ratings are in local currency and therefore, it does not take into consideration the sovereign risks and foreign currency risk of Bangladesh. CRISL being a domestic rating agency of Bangladesh considers the government of Bangladesh as the highest pay master and all government guaranteed securities are considered as AAA.

CRISL issues several types of rating for the Government and self regulatory entities, corporate. These rating reflects ability and willingness of an entity to discharge its debt obligation when due. It also reflects earning prospects and increase in shareholders value in the long run. The debt instrument rating reflects the inherent features and structures and extent of credit enhancement compared to unsecured creditors. It also reflects all associated risks that may affect the instrument over a period of it life.

at the initial stage and also for implementing various projects are decided by the Government.

TIME HORIZON

CRISL ratings are forward looking and sustainable throughout normal business cycle. CRISL issues normally two types of ratings – short term and long term. Short term rating carries the validity of six months while the long term rating is valid for one year. The change in economic scenario, complexities and change in government policy may have an impact on the ratings assigned over a period of time. CRISL updates the rating periodically with the cooperation of the client. In case the client is not willing to cooperate, CRISL withdraws the rating after due notice to the client. Therefore, CRISL rating are to be read with the time.

RATING DEFINITION

CRISL follows standard definition of ratings in line with the global rating agencies. It follows a eight notch scale with AAA being the highest while lowest rating D reflects default of in discharging its liabilities in time. With the addition of plus (+) and minus (-) signs before the scale the 8 notch scale reflects 18 notches. These plus and minus signs indicates the position of each rating in the scale. The rating scales along with the definition is enclosed at the end of this report.

RATING METHODOLOGY

In order to arrive at a meaningful rating, CRISL considers a large number of qualitative and quantitative factors and applies the same in its analytical rigor. In order to avoid biasness in analysis, CRISL tries to convert the qualitative factors into quantitative which ultimately assist CRISL for back testing of its methodologies. Quantitative factors include appraisal of the historic and projected financials, level of profitability, capacity utilization, capital expenditure need, cash flow adequacy, debt servicing capacity, free cash flow, time series analysis etc. In order to arrive at meaningful assessment, the financial statements are re-casted to make the ratios and analytical factors meaningful in line with the time horizon. All the factors considered by CRISL in rating may be clustered in to broad analytical risk blocks- Industry, Business Risk, Operational Risk, Financial Risk and Quality of Corporate Governance.

MUNICIPALITY RATINGS

Municipalities are quasi regulatory organizations operates under the local government. It has its revenue generating capacities by imposing levy and taxes on the inhabitants within its jurisdictions. However, the government also provides required fund

The Government also mobilizes fund from international organizations and also from its development partners for infrastructure development . However, in order to have fund for its development from the financial market based on its own strength of repayment of loans and other liabilities, rating plays important role. CRISL rating reflects its ability to discharge its obligations in timely manner.

FACTORS CONSIDERED IN CRISL MUNICIPAL RATING METHODOLOGY

CRISL follows a structured methodology of rating. Keeping in view the requirement of identifying risk, CRISL has developed Municipal Rating framework which consists of many qualitative and quantitative factors. The highlights of the framework are as follows:

A: Policy and Institutional framework

Under this framework a number of factors will be considered to identify how the Municipality is being guided by the policy frameworks and its sufficiency to run the ULB independently. The main criterions are- a) Well defined functions and functionary covering Organizational structure and functional domain to enable investors to understand structure; b) decision making process c) Democratic Governance Powers of taxation and levying user charges e) Transparency in operations and links with public and other stakeholders f) Synergizing with other schemes to channelize funds through convergence g) Disclosures of Citizen charter, Annual Budgets Services levels, etc.

B: Economic Base and potential

Rating is always prospective. CRISL considers the economic base and its potential to ascertain how a Municipality proceed with the development. The main factors considered by CRISL are a) Population and its growth b) Sectoral dominance and it's competitiveness c) Level of concentration risk in the economy d) Employment level e) Age profile, per capita income and literacy level f)Regularity of reassessment/interim assessment of investment plan g) Environmental impact etc.

the risks involved. Examples of structural features are

trigger events as well as interest rate and currency exchange risk hedging arrangements. The credit risks of all counterparties who provide credit support to the transaction are also considered in the rating process.

C Financial Strength

The Financial strength measures the ability of the municipality to discharge its obligations in timely fashion. It takes into consideration the sources of income, expenditure, sustainability etc. this ultimately leads the ULB to undertake development programs. The main criterion covers factors such as a) System of accounting b) Financial reporting and its timeline c) Systems and status of Audit d) Financial Investment Plan for Next 5 years e) Tax base and related trends f) Transaction mechanism g) Share of own Revenues sources in total receipts h)Share of tax revenue on total revenuei) Share of grants on total revenue j) % of capital expenditure against total expenditure k) Collection efficiency of tax resources l)Extent of rule based transfers from the Central Government m)extent of Cost recovery of key services n) trend of surplus (deficit) o) trend in debt repayment p) debt services coverage and interest coverage

D: Operating Performance

The operating performance measures the efficiency of the operation covering all the operational activities such as water supply, sewerage coverage, solid waste management, street tight, school management, effectiveness of the social development activities. The main criterions factored by CRISL are: a) extent of coverage of water supply b) non- revenue water c) Coverage Sewerage System d) Treatment of solid waste collected e) Road adequacy f) street light g) health and family planning h) educational services and its coverage i) Adequacy of housing facilities J) Decision making and its effectiveness k) tree plantation l) park and recreation facilities m) mosquito control, food quality control mechanism etc

E: Managerial Capacity

The Managerial capacity reflects the efficiency of the management in executing the projects, time and quality management in executing ant project, implementation of decisions etc. Factors considered by CRISL are: a)Track record in executing projects within stipulated cost and time b) Manpower adequacy c) MIS and other IT integration d) stability of top leadership e) Efficiency in tender process

In order to arrive at a credit rating, CRISL identifies risk that may emanate from the sub-factors with appropriate and due weightage of Risk . Higher scoring indicating efficiency represents less risk which lead to higher rating. On the contrary, lower scoring means high risk indicating low rating. The weightage against each sub-factors under the broad five heads mentioned above are carefully tested and considered after detail discussion in the Rating Committee. The ratings are arrived on the above basis. A rationale of rating is also published for the rating users indicating how CRISL has arrived at the above rating. CRISL ratings are always interactive.

CRISL RATING SCALES AND DEFINITIONS

LONG TERM RATINGS OF MUNICIPALITY

RATING	DEFINITION
AAA Triple A (Highest Safety)	**Investment Grade** Municipalities rated in this category are adjudged to be of best quality, offer highest safety and have highest credit quality. Risk factors are negligible and risk free, nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of companies.
AA+, AA, AA- Double A (Higher Safety)	Municipalities rated in this category are adjudged to be of higher quality, offer higher safety and have higher credit quality. This level of rating indicates a municipality with a sound credit profile and without significant problems. Risks are modest and may vary slightly from time to time because of economic conditions.
A+, A, A- Single A (Adequate Safety)	Municipalities rated in this category are adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates a municipality with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
BBB+, BBB, BBB- Triple B (Moderate Safety)	Municipalities rated in this category are adjudged to offer moderate degree of safety for timely repayment of financial obligations. This level of rating indicates that a Municipality is under-performing in some areas. Risk factors are more variable in periods of economic stress than those rated in the higher categories. These Municipalities are however considered to have the capability to overcome the above-mentioned limitations.
BB+, BB, BB- Double B (Inadequate Safety)	**Speculative Grade** Municipalities rated in this category are adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates a Municipality as below investment grade but deems likely to meet obligations when due. Overall quality may move up or down frequently within this category.
B+, B, B- Single B (Risky)	Municipalities rated in this category are adjudged to be with risk. Timely repayment of financial obligations is impaired by serious problems which the entity is faced with. Whilst an entity rated in this category might be currently meeting obligations in time through creating external liabilities.
CCC+,CCC, CCC- Triple C (Vulnerable)	**Non-Investment Grade** Municipalities rated in this category are adjudged to be vulnerable and might fail to meet its repayments frequently or it may currently meeting obligations in time through creating external liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support.
CC+,CC, CC- Double C (Highly Vulnerable)	Municipalities rated in this category are adjudged to be highly vulnerable. Entities might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support.
C+,C,C- Single C (Extremely Vulnerable)	Municipalitiesrated in this category are adjudged to be extremely Vulnerable in timely repayment of financial obligations. This level of rating indicates entities with very serious problems and unless external support is provided, they would be unable to meet financial obligations.
D (Default)	**Default Grade** Municipalities rated in this category are adjudged to be either already in default or expected to be in default.

Note: For long-term ratings, CRISL assigns + (Positive) sign to indicate that the entity is ranked at the upper-end of its generic rating category and - (Minus) sign to indicate that the entity is ranked at the bottom end of its generic rating category. Long-term ratings without any sign denote mid-levels of each group.

SHORT TERM RATINGS OF MUNICIPALITY

ST-1	**Highest Grade** Highest certainty of timely repayment. Short-term liquidity including internal fund generation is very strong and access to alternative source of fund is outstanding. Safety is almost like risk free Government short-term obligations.
ST-2	**Higher Grade** High certainty of timely repayment. Liquidity factors are strong and supported by good fundamental protection factors. Risk factors are very small.
ST-3	**Good Grade** Good certainty of timely repayment. Liquidity factors and company fundamentals are sound. Although ongoing funding needs may enlarge total financing requirements, access to capital/financial market is good. Risk factors are small.
ST-4	**Moderate Grade** Moderate liquidity and other protection factors qualify an entity to be in investment grade. Risk factors are larger and subject to more variation.
ST-5	**Non-Investment Grade** Speculative investment characteristics. Liquidity is not sufficient to ensure discharging debt obligations. Operating factors and market access may be subject to a high degree of variation.
ST-6	**Default** Municipalities is in default or is likely to be default in discharging its short-term obligations. Market access for liquidity and external support is uncertain.