



DEPARTMENT OF FINANCE
BUREAU OF LOCAL GOVERNMENT FINANCE

Theories and Concepts: Creditworthiness Rating System



The Bureau of Local Government Finance

- Local Government Code (LGC) of 1991: LGUs have a freehand in raising funds to finance its projects, subject to the 20% of regular annual revenue debt service cap.
- BLGF: tasked to ensure the debts of LGUs are within reasonable limits and within the capacity of the LGUs to pay on time.
- Mandated to “determine the **overall financial health** of all LGUs throughout the country, and each **LGU’s capacity to borrow**”

Background

Creditworthiness

- a measure of a borrower's ability to meet its debt obligations on time
- determine the overall financial health of all LGUs throughout the country, and LGU's capacity to borrow
- it will serve a basis for a comparative creditworthiness assessment of LGUs nationwide and prima-facie basis to favour, caution or curtail proposed borrowings of a particular LGU



Background

Basis of proposed rating system:

1. Statement of Receipts and Expenditures (SRE)
2. Statement of Income Sources (SRS)
3. Statement of Expenditures (SOE)
4. Assessor's Quarterly Report on Real Property Assessments



Area of consideration in the Rating System

1. Revenue generation capacity;
2. Rigidity of expenditures;
3. Financial management capacity;
4. Investment and debt capacity; and
5. Repayment experience.



Annex A. Pro Forma Credit Rating Sheet: Revenue Generation

Criteria	Relationship 1/	Max. No. of Points	Passing Score	LGU Score
I. REVENUE GENERATION		<u>35.00</u>		
A. Revenue Growth		10.00		
Level	DP	5.00	2.50	
Trend		5.00		
B. Stability & Reliability of Revenue Sources		20.00		
% Locally Sourced Revenues to Total				
1 Revenue		<u>15.00</u>		
Level	DP	7.50	3.75	
Trend		7.50		
2 % Recurring Revenues to Total Revenue		<u>5.00</u>		
Level	DP	2.50	2.50	
Trend		2.50		
C. Mobilization Efficiency		5.00		
1 % of Current RPT Collected within the Year				
Level	DP	2.50	1.25	
Trend		2.50		
Sub-Total				



REVENUE-GENERATION CAPACITY

- ability of the LGU to grow its revenue base
- nature, reliability, predictability of the revenue
- stability of its income sources and its revenue mobilization efficiency.



REVENUE-GENERATION CAPACITY INDICATORS

Indicator	Data Required	Formula
a. Revenue Growth	1. Total Revenue	None
b. % Locally Sourced Revenue to Total Revenue	1. Locally Sourced Revenue	Locally Sourced Revenue ÷ Total Revenue
	2. Total Revenue	
c. % Recurring Revenue to Total Revenue	1. Total Recurring Revenue	Total Recurring Revenue ÷ Total Revenue
	2. Total Revenue	
d. % of Current Real Property Tax Collected Within the Year	1. Real Property Tax - Current Collectible for the Year	Current RPT Collected for the Year ÷ Current Year RPT Collectible
	2. Real Property Tax - Current Collected within the Year	



LEVEL AND TREND SCORE

- Level Score: it provides an assessment of a particular LGU's performance in relation to the performance of all the other LGUs in its class
- Trend Score: it provides a comparative assessment of how well the LGU has performed over the three-year period



DIRECTLY AND INVERSELY RELATIONSHIP

- To compute for the LGU level score, the relationship between the variables for a particular should be established to be able to determine the appropriate formula to use.
- Directly Proportional: increasing over time


$$\text{Passing Score} \times \frac{\text{Computed Value for the LGU}}{\text{Computed Average Value of the LGU Class To Which the LGU Belongs}}$$

- Inversely Proportional: declining over time

$$\text{Passing Score} \times \frac{\text{Computed Average Value of the LGU Class to Which the LGU Belongs}}{\text{Computed Value for the LGU}}$$



Annex A. Pro Forma Credit Rating Sheet: Rigidity of Expenditures

Criteria	Relationship ^{1/}	Max. No. of Points	Passing Score	LGU Score
II. EXPENDITURES		<u>25.00</u>		
D. Rigidity of Expenditures				
Personal Services as % of Total				
1 Expenditures		10.00		
Level	IP	5.00	2.50	
Trend		5.00		
2 Debt Service as % of Total Expenditures		10.00		
Level	IP	5.00	2.50	
Trend		5.00		
Personal Services + Debt Service as % of				
3 Total		5.00		
Revenues	IP	2.50	1.25	
Level		2.50		
Trend				
Sub-Total				

RIGIDITY OF EXPENDITURES

- Personal services and debt service are considered the least flexible as they are difficult to avoid
- Delays in debt service not only increase the borrowing cost of the LGU, but also limit its continued access to the financial markets
- The higher the degree of flexibility of its expenditure profile, the more creditworthy an LGU becomes



RIGIDITY OF EXPENDITURES INDICATORS

Indicator	Data Required	Formula
a. Personal Services as % of Total Expenditures	1. Total Personal Services	Total Personal Services ÷ Total Expenditures
	2. Total Expenditures	
b. Debt Service as % of Total Expenditures	1. Principal, Interest and Other Financial Charges	(Principal + Interest + Other Charges) ÷ Total Expenditures
	2. Total Expenditures	
c. Personal Services + Debt Service as % of Total Revenue	1. Total Personal Services	(Total Personal Services + Principal + Interest + Other Charges) ÷ Total Revenue
	2. Principal, Interest and Other Financial Charges	
	3. Total Revenue	



Annex A. Pro Forma Credit Rating Sheet: FINANCIAL MANAGEMENT CAPACITY

Criteria	Relationship ^{1/}	Max. No. of Points	Passing Score	LGU Score
III. FINANCIAL MANAGEMENT CAPACITY		<u>25.00</u>		
E. Operating Surplus as % of Total Revenues		10.00		
Level	DP	5.00	2.50	
Trend		5.00		
F. Net Operating Surplus as % of Total Revenues		10.00		
Level	DP	5.00	2.50	
Trend		5.00		
G. Uncommitted Cash Balance as % of Total Expenditures		5.00		
Level	DP	2.50	1.25	
Trend		2.50		
Sub-Total				



FINANCIAL MANAGEMENT CAPACITY

- Indicators measure LGU's fiscal effort
- Demonstrates how well LGU manages available financial resources or exercises prudence in its expenditure flows
- LGUs demonstrate capacity when a significant portion of those resources are invested in capital projects that can churn out more income or savings in the future



FINANCIAL MANAGEMENT CAPACITY INDICATORS

Indicator	Data Required	Formula
a. Operating Surplus as % of Total Revenue	1. Operating Surplus ¹	Operating Surplus ÷ Total Revenue
	2. Total Revenue	
b. Net Operating Surplus as % of Total Revenue	1. Net Operating Surplus	Net Operating Surplus ÷ Total Revenue
	2. Total Revenue	
c. Uncommitted Cash Balance as % of Total Expenditures	1. Uncommitted Cash Balance	Uncommitted Cash Balance ÷ Total Expenditures
	2. Total Expenditures	



Annex A. Pro Forma Credit Rating Sheet: INVESTMENT AND DEBT CAPACITY

Criteria	Relationship ^{1/}	Max. No. of Points	Passing Score	LGU Score
IV. INVESTMENT AND DEBT CAPACITY		<u>10.00</u>		
Operating Surplus as % Debt				
H. Service for the Year		5.00		
Level	DP	2.50	1.25	
Trend		2.50		
Debt Service as % of Total				
I. Revenues		3.00		
Level	IP	1.50	0.50	
Trend		1.50		
Capital Investment as % of Total				
J. Revenues		2.00		
Level	DP	1.00	0.50	
Trend		1.00		
Sub-Total				-



INVESTMENT & DEBT CAPACITY

- measure a LGU's capability to service debts or its debt service cover
- measure the LGU's effort in investing in capital assets that either improve the living standards of its constituents or provide infrastructures, facilities and other services that foster economic growth in the area



INVESTMENT & DEBT CAPACITY INDICATORS

Indicator	Data Required	Formula
a. Operating Surplus as % of Debt Service	1. Operating Surplus	Operating Surplus ÷ (Principal + Interest + Other Charges)
	2. Principal, Interest and Other Financial Charges	
b. Debt Service as % of Total Revenue	1. Principal, Interest and Other Charges	(Principal + Interest + Other Charges) ÷ Total Revenue
	2. Total Revenue	
c. Capital Investment as % of Total Revenue	1. Total Capital Outlay	Total Capital Outlay ÷ Total Revenue
	2. Total Revenue	



Annex A. Pro Forma Credit Rating Sheet: REPAYMENT EXPERIENCE

Criteria	Relationship ^{1/}	Max. No. of Points	Passing Score	LGU Score
V. REPAYMENT EXPERIENCE				
K. LGU Debt Repayment Track Record		<u>5.00</u>		
Very Good		5.00		
Good		4.00		
Satisfactory		3.00		
Generally Satisfactory		2.00		
Poor		0.00		
Sub-Total				-
GRAND TOTAL		100.00		-



REPAYMENT EXPERIENCE INDICATORS

- as rated by existing creditors of specific LGUs is a tangible, concrete and impartial measure of a LGUs ability to pay its debts on time.
- a good word from existing creditors is a good indicator of a LGUs ability and willingness to pay.



LGU DEBT REPAYMENT TRACK RECORD

POINTS FOR REPAYMENT EXPERIENCE

Repayment Experience	Maximum Points
Very Good	5.0
Good	4.0
Satisfactory	3.0
Generally Satisfactory	2.0
Poor	0.0



LGU CREDITWORTHINESS RATING

The sum total of all the points earned by an LGU in the various major areas or criteria that determine creditworthiness shall be expressed in a single rating

No. of Points	Credit Rating	Credit Quality	Brief Description
81-100	AAA	Best Quality	<ul style="list-style-type: none"> • Excellent capacity to pay debts on time • Exhibited sustained revenue growth • Has a firm handle on expenditures • Generates high levels of surplus • Has significant investment in capital assets • Given a good credit rating by its creditors
71-80	AA	High Quality	<ul style="list-style-type: none"> • Strong capacity for timely debt repayment • Revenue growth sustainable • Generates operating surplus
61-70	A	Good Quality	<ul style="list-style-type: none"> • Has adequate capacity to meet its debt service commitments • Operating performance is not as good as the higher-rated categories
51-60	BBB	Medium Grade	<ul style="list-style-type: none"> • LGU needs further improvement in its operations to be assured of timely debt service
45-50	BB	Below Medium	<ul style="list-style-type: none"> • Ability for timely debt repayment is doubtful • Capacity is inadequate to meet its payment commitments
<41	B	Weak	<ul style="list-style-type: none"> • Does not have the capacity to pay its debts • New loans should not be extended until such time that LGU is able to improve its operating performance and its rating

RATING METHODOLOGY

- Historical SRE data for a minimum of 3 years
- Indicators have been kept to a minimum
- based on purely quantitative information uniformly applied to all LGUs
- CRI are good for only one year
- Determination of LGU: (a) individual performance and (b) average performance of all other LGUs in its class





THANK YOU

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