APPENDIX C

MOODY'S INVESTORS SERVICE

65 Broadway,
New York 6, N. Y.

January 12, 1953

Mr. Albert R. Miller, Jr.
Maryland State Planning Commission
100 Equitable Building
Baltimore 2, Maryland

Dear Mr. Miller:

Mr. John Sherman Porter, our editor-in-chief has asked me to reply to your recent letter in which you inquire regarding the criteria employed in assigning ratings to state bonds.

No simple answer is possible, for our ratings are not the result of a statistical formula into which specific factors, possible to enumerate and identify, alone figure. Rather, the ratings are the symbolic expression of bond qualities, representing the composite opinion of a group of analysts, and draw heavily on their experience and judgment.

Some of the identifiable factors vary from state to state. For example, in Massachusetts, New York, Michigan and certain other states, state debt is serviced from the state's general fund, and bond quality is importantly related to the present and likely future position of the general fund. In South Carolina, Alabama and Louisiana, most state issues are payable from specific funds which receive earmarked tax revenues, and bond quality reflects special fund rather than general fund condition; that is why, at most times, we have had various ratings on different obligations of one of these states. Finally, debts in West Virginia and Texas are secured by special funds, but certain of these funds are in such insecure position that bond quality is determined, not by the initial source of payment, but by the "guarantor, the state's general fund.

Broadly speaking, in the analysis of general credit we are concerned with the size of demands upon the general funds in relation to its resources. These demands include not only the fixed requirements of debt service, but also the irreducible (as a matter of practical politics) requirements of aid to the indigent and aid to local governments, whether these demands loom large currently or loom more as a future liability. By the resources of a state we refer both to its established tax structure and to such expansion of the taxing powers as may reasonably be anticipated, and we also refer to the likely degree of stability of tax yields under the business forecasts of our economists, bearing in mind the economi background of the state.

Finally, there are such things as changing fiscal habits which, on occasion, find some reflection in our ratings. Thus, Pennsylvania's rating was dropped a notch about two years ago, as you noted. For a century, Pennsylvania had followed a very conservative financial tradition with only minor lapses. State debt was very light, and such debt as was outstanding in 1949 was well secured by earmarked funds. Late that year the voters authorized the state to issue bonds up to $500 million to pay a bonus to war veterans: early the following year the bonds were sold. It is possible that the rating would not have been reduced from Aaa if the bonus bond issue had been the only matter. But the bonds were sold with no specific provision for payment. And about the same time the Legislature authorized, and the state courts permitted, the creation of legally unlimited tax-supported debt by the "authority" method without referendum. We felt that the character of Pennsylvania's credit was lastingly changed, and our rating was reduced as of February 4, 1950.

The cases of Washington and West Virginia were roughly paralleled: too much non-general debt on top of much general debt. The situation in Washington was further complicated by an embarrassed general fund, a matter which seems to defy lasting correction.

You have asked also why we improved Maryland's rating some thirteen years ago. It is difficult to recall the exact circumstances so long after the event. In general, I would say that the change was not inspired by any single development, but rather by a shift in our point of view. I cannot be sure. I have no memory for details even though I personally was one of the people working on this credit at the time. We review all ratings periodically. In our 1940 review of State of Maryland, I believe we found that the state had stood up under the trials of the depression 1930's better than we had appreciated theretofore. Also, as you may recall, it was not until roughly 1940 that people generally could visualize the United States moving forward through war into a new high order of prosperity; through the late 1930's, most people were measuring the risk that the country might lapse back into 1932-33 conditions.

Thus ratings are revised for a variety of reasons. Sometimes the revisions reflect some definite development concerning a particular credit situation. Sometimes the ratings change because we, the makers of the ratings, revise our appraisals of risk.

I trust these comments may prove helpful.

Very truly yours,

MOODY'S INVESTORS SERVICE

David M. Ellinwood

/ s / David M. Ellinwood, Manager
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