



Criteria for Rating
Local and Regional Governments

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Scope of the Criteria

1. The criteria titled '*Criteria for Rating Local and Regional Governments*' ("LRG Criteria"), is intended to illustrate the broad rating guidelines that GCR Ratings ("GCR") follows when according a rating to a local or regional government ("LRG"). GCR defines LRGs as government entities possessing revenue raising capacity that are responsible for the administration of public policy for a given jurisdiction. These include metropolitan councils, local municipalities (of all sizes), district councils and state governments. Certain municipal agencies that are fundamentally intertwined to the functioning of an LRG, and would not have an independent function outside of the LRG, may also be assessed under this criteria (this would apply mainly to entities that receive all of their income as a transfer from the LRG, Rating Adjustment Factor 1: LRG Specific Structural Factors, p.22). However, water and electricity utility companies and other privatised public service companies that maintain an independent transactional relationship with their customers, even if wholly owned by the LRG are not covered by this criterion. Such companies will be analysed under the [Criteria for Rating Corporate Entities](#), although the analysis, particularly in the areas of governance and support, may draw substantially from the principles discussed in this methodology.

Summary of the Criteria Changes

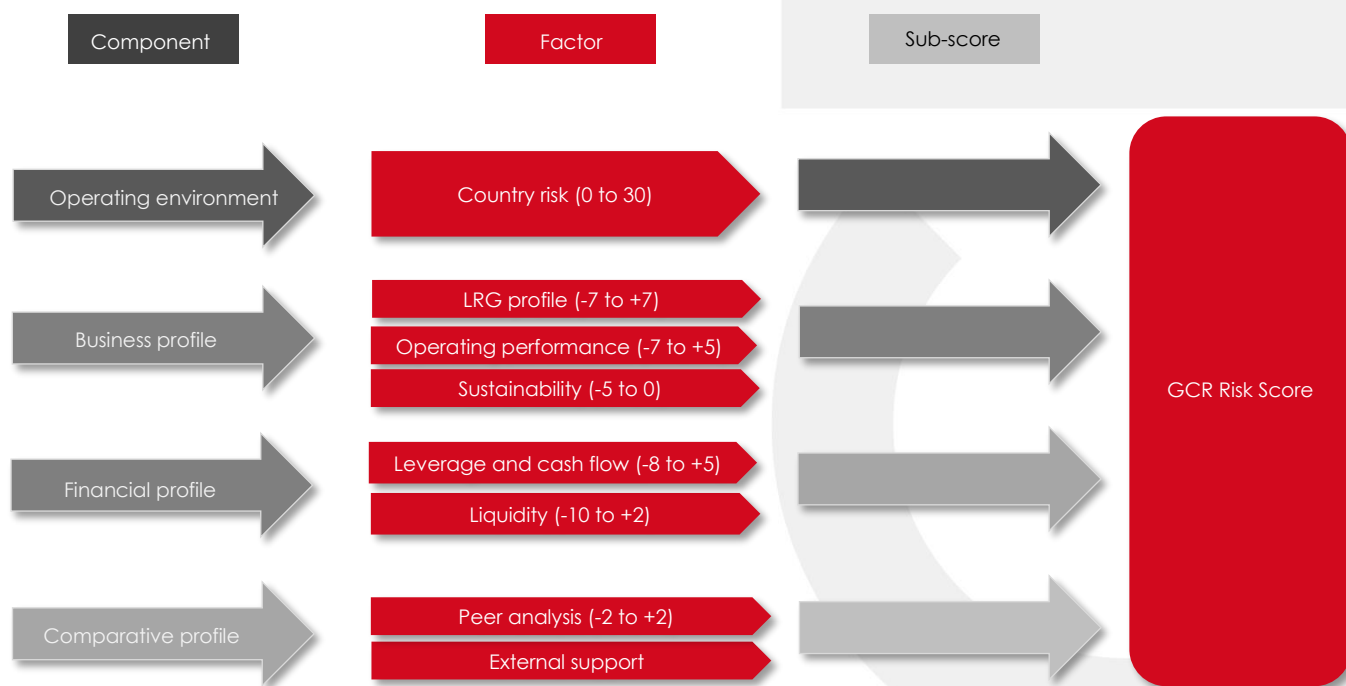
2. The criteria have been updated to include elements of Sustainability, within the sector risk, competitive position, and earnings. For an overview on our thoughts regarding how ESG has been applied throughout the GCR Ratings Framework see the article titled '[How GCR Integrates Environmental, Social and Governance \(ESG\) into Issue\(r\) Credit Ratings](#)'.

An Overview of the Ratings Framework

3. To improve the comparability and transparency of the ratings, GCR has adopted a framework (see below) with publicly available scoring for the major rating components. The goal is to provide stakeholders (issuer, investor, regulator, counterparty etc.) with a view of each of the major rating drivers and ultimately what factors may change the ratings in the future.
4. To achieve this, GCR has adopted four major rating components (operating environment, business profile, financial profile and comparative profile), which are all broken down into two or three major factors and sub-factors, with a public positive or negative score assigned to each. The summation of the scores determines the GCR Risk Score, which is translated using the GCR Anchor Credit Evaluator into the Anchor Credit Evaluation, and then using final rating adjustment factors into issue(r) credit ratings. It is important to note that there are no fixed weightings for the components, factors or sub-factors.
5. The accumulation of the component scores will generate the GCR Risk Score. Typically, this score will range between zero (0: weakest) and forty (40: strongest). The lower the score, the weaker the assessment. Importantly, GCR can use decimal scoring (example 0,25, 0,50 or 0,75) to improve differentiation and rating relativities.

6. To understand the following criteria, GCR recommends that it is read in conjunction with the 'GCR Ratings Framework' and the GCR Rating Scales, Symbols & Definitions and the Anchor Credit Evaluator, which is published on the GCR Website and will help translate the GCR Risk Score to the international and national scale ratings.
7. The way the key rating concepts interact with each other and result in an issue(r) credit rating is best illustrated in Figure 1, below.

Figure 1: GCR Ratings Framework Diagram for Local and Regional Governments



Component 1: Operating Environment

Component 1, Factor A: Country Risk Score

8. The core of the GCR Rating Framework is based on GCR's opinion that the operating environment frames the creditworthiness for all rated entities. This contention is amplified in the case of public entities where the dynamics are likely to be a direct reflection of the overall operating environment in a country. While LRGs may have substantial operating independence, this independence is framed within the overarching legislative environment of a country. Thus, to the extent that LRGs can levy taxes and fees on its residents, it is only because there is legislation at the National Government level that permits it. Where tariffs and fees are set by the LRG, the determination will almost always be based on a formula provided by the National Government or be subject to some oversight by a National Government appointed regulatory body.
9. However, the relationship flows both ways. It can be argued that the economic performance of a country is really only a consequence of the cumulative economic performance of the LRGs within that country. Similarly, social trends in a country will be a reflection of the legislation and targets set at the National Level on the one hand, but completely reliant on the implementation at the LRG level.
10. On another level, the strengths or challenges within a country are likely to be even more apparent at the LRG level. Factors such as governance capacity, strength of legislation, compliance with best management practices or, on the negative side; lack of enforcement, weak management, and high levels of wastage, that are observed at the national level will often be more prevalent at the Local Government level. Accordingly, GCR considers the operating environment for LRGs to largely be indistinguishable from the operating environment of the National Government.
11. As a consequence, whereas the country risk analysis contributes the largest component of the underlying risk score for the GCR rating methodology, the impact has been doubled for LRGs, replacing the sector risk score. Thus, country risk is scored between very low (0) and very high (30) for an LRG. In line with GCR's ratings framework, the Country risk scores are determined as per the global Country Risk Criteria published [here](#).
12. Notwithstanding the above, GCR does recognise that there are other factors that may support or impede the overall creditworthiness of LRGs within a country. To account for these factors, GCR will make positive or negative adjustments to the doubled country risk score, based on whether they are perceived to be strengths, weaknesses or neutral. A positive adjustment may be used to moderate the impact of negative adjustments, but typically an LRG will not be able to achieve a risk score above the doubled country risk score.
13. **Depth of Legislation:** Transparent legislation is key to assessing an LRG's creditworthiness. GCR considers robust legislation to be legislation that most appropriately reflects the operating conditions in the environment, enables the LRG to fulfil its key responsibilities and provides sufficient flexibility to respond to changing demands and financial circumstances. The transparency of legislation supports creditworthiness as it clearly outlines the rights and obligations of all parties to a financial transaction,

and particularly the resolution of disputes. No matter the quality of legislation, transparency is critical for investors to make an informed financial decision. Legislation should be easily accessible and clearly define the role of an LRG, as well as its sources of income and access to capital. Where the legislation is difficult to identify and the exact role of LRGs is opaque, a negative adjustment will typically be made.

14. **Accounting standards:** For entities to enjoy the wide access to funding of financial markets, they should employ detailed accrual-based accounting standards that clearly reflect, not only the income of an LRG, but also its assets and liabilities. GCR will generally make a negative adjustment to the risk score where the accounting system for LRGs does not meet the necessary rigor (such as for many municipalities in developing countries where cash-based accounting is employed).
15. **Oversight bodies:** GCR also considers the scope and effectiveness of higher-tier government and statutory bodies in ensuring that LRGs comply with all necessary legislation and meet specific performance objectives. Where these are not met, the oversight body will usually highlight the shortfall, thus providing a critical source of information to the market. The presence of strong oversight bodies also evidences a commitment from the National Government to ensuring that best practices are implemented, and performance metrics are met, while the absence of oversight is often associated with various levels of dysfunction.
16. **Political interference:** Political interference is negatively considered as it distorts the incentives of the LRG's management and will often prevent the LRG from pursuing the best course of action for the organisation. Such interference may arise in numerous ways but is typically carried out through the appointment or removal of specific municipal officials, or the withholding/granting of cash transfers. Conversely, political independence is demonstrated when the management of an LRG is able to pursue the most appropriate course action for the LRG, without regard for potential conflicts with higher level of government or for immediate political consequences.
17. **General performance of LRGs:** GCR may negatively adjust the country risk score where there are factors that are evident across the subnational sector that detract from its creditworthiness. Such factors would include widespread dysfunction in management across the sector, pervasive financial challenges and rising social tensions. Positive adjustment factors are less common but may be associated with particularly strong levels of service delivery or robust financial position (amongst others).
18. **Physical & Social Risks:** GCR will examine exposure to potential environmental or social risk exposures that can cause harm, damage, or disruption to key services and infrastructure for the country in question. Such exposures could be long-term risk such as climatic changes that increase sea-levels or cause global heating. Furthermore, it could be short-term climatic events such as wildfires and flooding. Examples could include tourism or agriculture is low lying coastal areas, which could be impacted by the above. Or the impact of shrinking populations, poor education, poor health care or failing infrastructure on industry.

Component 2: Business profile

19. The creditworthiness of an LRG is closely related to its size, economic diversification, social structure and its importance within the larger country context. Size and diversity are closely related concepts for LRGs because larger population groupings are generally associated with increased economic activity and thus greater GDP. The economies in such areas tend to be more diverse, as the larger populations allow for greater specialisation. This in turn may attract migration into a city (both skilled and unskilled), which could further stimulate economic growth and development. Larger cities, with highly diverse economies and a relatively wealthy population, that contribute significantly to the overall economic health of a country will generally achieve higher risk scores.
20. However, for an LRG to really benefit from the advantages that size and diversification offer, the efficiency of operations and quality of planning and implementation must be high. Where this is not the case, large cities can quickly find themselves overwhelmed by the burden of providing services to a rapidly growing population, compounded by a deterioration in infrastructure. Accordingly, to build a holistic LRG profile, GCR combined an assessment of its inherent strengths and weaknesses, with an analysis of operating performance. GCR primarily assesses the efficiency of operations and the reliability of implementation by analysing and comparing various income and expenditure metrics, as well the attainment of pre-agreed key performance indicators.
21. The subnational sector is structured differently in different countries and each level of local government will have its own unique obligations and challenges. It is only through analysing of the functions demanded of the LRG, against the resources and authority provided by the National Government, that a proper assessment of the impact the legislated structure would have on the potential creditworthiness (or lack thereof) of each layer of local government can be made. Where there appears to be structural conflicts within the makeup of an arm of local government, GCR will make negative adjustments to the risk score. Such an example could arise where an LRG is tasked with developing fixed infrastructure but is not provided with sufficient grants from the National Government and is prohibited from pledging any existing cash flows against debt funding, thus impeding its ability to raise funding from the private sector.

Component 2, Factor A: LRG Profile

22. GCR's LRG profile assessment is based on a series of qualitative factors that are meant to ascertain the robustness of a LRG's economic diversity, population composition, income strength and the quality of management/ governance relative to LRGs in the same country/ region. LRG profile is the first entity specific score based on a scale, from 'very low' (-7) to 'high' (+7) using the five (5) sub factors below as guidance. Each should be benchmarked to peers both locally and globally and no single factor is meant to be more important than the other. Rather the competitive position is an overall assessment reflecting GCR's opinion of those factors (or lack thereof) that would likely contribute to the LRG's financial stability through economic cycles.

23. **Population:** LRGs that have larger populations are generally considered to be stronger entities. From the municipality's perspective it is the greater number of households and businesses that provides the necessary underpin for growth in rates and taxes, as well as the utilisation of the services it provides. Aside from internal considerations, municipalities that are home to a larger portion of the population are likely to be considered more important to the National Government. GCR will utilise the results of the most recent national census to measure population size. However, certain assumptions or adjustments may be added to the raw data to account for the time lag from the last census, or where there are high levels of migration.
24. **Social structure:** GCR's analysis of the demographic composition provides a more nuanced view of the population. Although large populations provide a strong base for economic activity, they can also be a substantial drain on an LRG's resources. Accordingly, GCR assesses the socio-economic status of an LRG, by taking into account the level of economic development, access to basic services, communication and housing, as well as the population growth in the area. This is particularly important in emerging or under-developed economies, where LRGs are often confronted with the dual challenge of having a significant portion of the population who do not contribute to income through rates and taxes, and at the same time have to shoulder the substantial costs of providing social services and infrastructure for this population group. GCR's assessment of social structure will largely be based on data published by the statistical authorities in the jurisdiction under review. Key statistics in this regard include access to housing, electricity, water, and sanitation, as well as the education levels and will be assessed relative to other LRGs, as well as against published internal targets. Alongside this we will look at the risk of social upheaval and dissent, which could raise risks for the municipality.
25. **Economic activity:** GCR's assessment of economic activity considers both the size of the local economy and its diversification. Size and diversification provide an important buffer against economic downturns in that overall income in large diverse municipalities is likely to be less volatile than in smaller municipalities that have a high dependence on a single industry or source of income. Being an important administrative centre for government operations and services is considered an advantage, as it helps underpin a level of economic activity. Size is determined both by the absolute quantum of GDP generated in the LRG (where available), as well as the estimated proportion of national GDP the LRG's economy comprises. Economic diversification metrics are also often published along with general GDP figures and can be used for GCR's assessment. Nevertheless, even without reliable statistics, GCR will make diversification assumptions based on the observed presence of manufacturing enterprises, warehousing, retail destinations, educational facilities, and government offices and institutions.
26. **GDP per capita:** GDP per capita is used to measure the relative wealth of an LRG by comparing its economic output to the population. LRGs with relatively wealthier populations are likely to be financially stronger. This is because wealthier populations are likely to consume more of the services provided by LRGs, while property prices, and thus the rates and taxes charge, are likely to be higher. Moreover, to the extent permitted by law, the LRG will likely have more scope to increase rates, tariffs and other charges in times of necessity. Where GDP per capita figures for a particular LRG is not available, GCR will rank the likely population wealth relative to the broader country based on observed assumptions.

27. **Infrastructure:** GCR considers a well-developed, modern infrastructure to be an indication of a highly functioning municipality. Having a more developed infrastructure benefits LRGs in two ways. Firstly, an extensive infrastructure is necessary to facilitate robust economic activity and high standards of living within the jurisdiction, with the associated benefits of increasing taxes and services income. Secondly, municipalities with well-maintained existing infrastructure are likely to face lower capital development cost pressures going forward.

28. **Physical & Social Risks:** GCR will examine exposure to potential environmental or social risk exposures that can cause harm, damage, or disruption to key services and infrastructure for the LRG versus peers in the country.

Table 1: LRG profile

Score description	Score	LRG profile (typical descriptors)
Highest	5 to 7	Major economic and/or political centre of the country, as well as being considered an international 'Gateway' city. LRG accounts for more than 10% of the country's GDP. Highly diverse economy with the proven ability to attract both local and global businesses. Large population that continues to attract national and international migrants. Strong GDP per capita by global standards, combined with a high standard of living for residents and minimal social challenges. Extensive modern fixed infrastructure throughout the LRG.
/High	2 to 4	One of the largest economic and/or political centres of the country. Significant contribution to a country's GDP. Diverse economy with the proven ability to attract new businesses. Large population that continues to attract migrants. GDP per capita and living standards are above the national average, with a lower proportion of population requiring free social services. Extensive fixed infrastructure and typically will house critical national infrastructure.
Intermediate	-1 to 1	Important regional city, with a moderately diverse economy, but may be underpinned by one or more key industries wherein it has a competitive advantage (manufacturing centre, regional government centre, large education institutions). A moderate to large population, with GDP per capita in line with the national average, but may vary. Living standards are in line with the national average, as is the proportion of population requiring free social services. Good, fixed infrastructure to support economic activity and higher living standards.
Low	-2 to -4	Average to small municipality as measured by population size and GDP, contributing negligibly to the national GDP. Low levels of economic diversification, with the economy sometimes dependent on a single industry, (such as mining or agriculture), or a single large private sector employer. May evidence a stagnant or slightly declining trend in the population. GDP per capita and living standards below the national average but may vary. Proportion of the population requiring free social services is above the national average. Fixed infrastructure is sufficient to support economic activity and to support living standards, but there may be signs of deterioration. This band may also be applicable to well performing but small LRGs.
Lowest	-5 to -7	Small municipality with highly concentrated economy that is in structural decline. Consistently weak management and governance outcomes. Little ability to implement capital expenditure and to deliver services. Sustained deterioration in existing infrastructure. Declining population.

The above boxes highlight typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristic across different boxes. GCR will use analytical discretion to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score the entity is likely to reflect a number of cumulative strengths. Conversely, any one risk can bring the score down to a weak level.

Component 2, Factor B: Operating performance

29. Income and expenditure metrics are important in assessing how efficiently an LRG is utilising its financial resources to deliver upon its core mandate, and the sustainability of these resources. To achieve this, GCR's analysis first considers sources of income, the stability of such income, and then how the financial resources are being utilised (expenditure). Various comparative metrics are analysed to provide an indication of progress in service delivery compared to projections and the actual needs, as well as the future outlook for financial resources. Overlaying GCR's analysis is an awareness of the sometimes-competing responsibilities of the municipality in terms of service/ infrastructure delivery versus financial sustainability. For example, robust capital implementation is positively considered in terms of operational performance, but it may lead to operating deficits and higher gearing. Conversely, a reduction in expenditure may support liquidity but will be to the detriment of service delivery.
30. **Income:** GCR considers a well performing LRG to be one that is able to generate income growth above the inflation rate. To this end, overall growth is considered relative to inflation and tariff escalations to isolate the extent of growth that can be attributed to successes in expanding the rates base and the uptake of services. A distinction is made between internally and externally generated sources of income and the relative contribution from each source. Internally generated funds (such as rates and taxes) are those income streams that are directly under the control of the public entity, or where the pricing mechanism is determined by a regulatory body in a sufficiently transparent manner (such as water or electricity tariffs). A greater proportion of internally generated funds is indicative of a stronger financial position and enhanced flexibility. On the other hand, LRGs that are more reliant on external sources of revenue (such as grants or subsidies) are considered more vulnerable, as grants are subject to the discretion of the National Government. If funding at the national level is insufficient, grants to public entities will likely be curtailed. This is particularly true for governments that rely heavily on commodity sales for tax revenue, as this income is inherently linked to economic cycles and volatile commodity prices. However, there are exceptions to this; for example, GCR would consider it favourable if such external revenue sources were guaranteed for a certain minimum period of time. Government grants also reduce the administrative burden and credit risk associated with consumer debtors, allowing entities to focus on service delivery and infrastructure development.
31. **Expenditure:** The assessment of expenditure revolves around fixed versus variable expenses, and whether these expenses are consumptive or for investment purposes. The greater the level of consumptive expenditure the less cash will be available for productive purposes. At all times, comparison is made to the public entity's historical trends, as well as local and national norms. Staff costs often make up the single largest portion of expenditure, and special attention is placed on the public entity's ability to manage these. GCR considers a staff cost to total cost ratio of around a third to be prudent. Levels higher than this suggest that service delivery and long-term planning are being compromised by short term consumption. Other key variable costs are also analysed in a similar manner. While non-cash costs may not have an immediate effect on liquidity, how they are treated provides some insight into future cash flows. Thus, where provisioning for items such as staff pensions, and environmental damage are not

adequate, such funding deficits will need to be corrected in future periods, resulting in cash outflows in those periods.

32. **Operating surplus:** Typically, the analysis of how LRG performance relates to creditworthiness has focused on the entity's ability to report an operating surplus over the long term, and the quantum thereof. GCR does consider the ability to generate a surplus on average over the medium to long term as critical to creditworthiness, whilst persistent deficits are likely to result in liquidity challenges. Nevertheless, the presence of a surplus may not imply strong performance. In many instances the surplus may indicate a lack of capacity on the part of the LRG to carry out its core services adequately and to address the infrastructure expenditure needs as it is required. Alternatively, an operating deficit may be indicative of increased investment or service spend in a period.

GCR will typically calculate the operating surplus by considering all sources of recurring income. These would include, internally generated revenue, general purpose operating grants from the National Government, endowments or demonstrated ongoing budget support from external organisations such as development agencies. This will be considered against operational expenditure, including the cost-of-service delivery and repairs and maintenance. However, to the extent possible GCR will consider earmarked capital grants and the projects that they finance outside of operational expenditure.

33. **Capital expenditure implementation:** Ensuring that there is a robust physical infrastructure in a given area that facilitates the critical daily needs of the population is perhaps the most important function of many LRGs (albeit that the exact responsibilities will vary from country to country). In most cases the LRG will develop a capital budget, covering both the short and medium term. GCR will analyse actual capital expenditure outcomes against the budgets to get a better understanding of the LRG's capacity to adequately plan ahead and to implement projects. Consistently increasing real capital spend, whilst maintaining gearing metrics at moderate levels is indicative of well-functioning LRGs.

34. **Debtors' performance:** Although revenue growth is important, it is meaningless if the amounts being billed cannot be collected. An analysis of the actual debtors' book is performed in order to ascertain the quality of the book, and to determine the trends therein. While ensuring that bad debt recognition and provisioning policies are adequate is important, GCR places greater emphasis on current collections versus current billings. Gross debtors that increase ahead of internally generated revenue is usually indicative of deficiencies in the debtor's collection process. Thereafter, the ratio of debtors (or collection) days outstanding is calculated in order to determine the entity's ability to collect on its longer-term debtors. Other indicators of credit quality may be derived by comparing the ratio of gross and net debtors (by value) to revenue.

Table 2: Operating performance

Score description	Score	Operating performance (typical descriptors)
Highest	4 to 5	Sustained robust income growth above inflation, driven by IGR sources. Expenditure typically increasing below the rate of income growth. Demonstrated ability to control staff and other expenditure, without impacting high service delivery levels. Sustained strong surpluses reported. Capex spend is increasing, planning closely matches requirements and implementation is above 90% of budget on average. Strong debtors' policies leading to collection rates close to 100%, with policies to address long outstanding debtors.
High	2 to 3	Sustained income growth, in line with or above inflation, largely underpinned by IGR. Expenditure increasing slightly below the rate of income growth, with some demonstrated controls over staff costs and other consumptive expenditure. Sustained surpluses reported, combined with high levels of service delivery. Capex spend is increasing and is adequate to partly dress backlogs, with implementation is above 80% of budget on average. Strong debtors' policies ensuring to collection rates above 90%, with policies to address long outstanding debtors.
Intermediate	-1 to 1	Income growth in line with or slightly below inflation, underpinned by a mix of IGR and grant income. Some pressure on staff costs and other consumptive expenditure may be evidenced, resulting in expenditure increasing at or slightly above the rate of income growth at times. Average surplus over the review period is positive, but there may be deficits at times. Service delivery is adequate. Capex spend is flat with some annual variations due to capacity constraints and/or available cash flows. Backlogs may be substantial. Adequate debtors' policies are in place to support collections of around 85%, but overall debtor continues to increase above the rate of revenue.
Low	-2 to -4	Sustained Income growth in line with or slightly below inflation, underpinned by a mix of IGR and grant income. Some pressure on staff costs and other consumptive expenditure may be evidenced, resulting in expenditure increasing at or slightly above the rate of income growth at times. Average surplus over the review period is positive, but there may be deficits at times. Service delivery is adequate. Capex is decreasing due to cash flow constraints, with rising infrastructure backlogs. .
Lowest	-5 to -7	Negligible or negative income growth that is insufficient to cover operating expenses. Persistent operating deficits and weak debtors' collection rates. Little ability to implement capital expenditure and to deliver services. There are clear sustained negative trends in all key performance metrics.

The above boxes highlight typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristic across different boxes. GCR will use analytical discretion to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score the entity is likely to reflect a number of cumulative strengths. Conversely, any one risk can bring the score down to a weak level. GCR can use decimal scoring (example 0,25, 0,50 or 0,75) to improve differentiation and relative credit ranking.

Component 2, Factor C: Sustainability

35. GCR expects that all rated entities maintain high levels of corporate governance, even if specific requirements may not be applicable. To this end, the LRG criteria has adopted the universal GCR Sustainability criteria (for more information on how this score is derived please see [here](#)).
36. However, corporate governance for public entities must also be considered in terms of the legal and institutional framework in place. Typically, GCR will rely on the findings of oversight bodies into the quality of the financial statements, management processes and compliance. Cognisance is taken of the propensity for malfeasance and other corrupt activities in public institutions, given the (often) vast size of such institutions and the large sums of money involved. The incidence of malfeasance, as well as the extent to which corrupt or wasteful activities are investigated and guilty parties held to account, are amongst the best indicators of the importance accorded to good governance within a public entity.

Component 3: Financial profile

37. Debt financing is commonly utilised by LRGs to fund their infrastructure requirements. Such funding enables the entity to match the cost of infrastructure to the relatively stable long term expected cash flows or benefits to be derived, rather than burdening the current resident base with projects whose benefits will only yield over the long-term. However, the fact that the benefits may not be clearly measurable, as there is often no income stream attached (as in the case of a road), or that the income streams are often projected based on long term usage forecasts (which are notoriously inaccurate) introduces the possibility that municipalities could use excessive gearing. Accordingly, it is critical to ensure that the funding profile of an LRG appropriately matches its potential income streams, without the debt service costs placing undue pressure on service delivery. Financial flexibility derives primarily through lower levels of gearing, but factors such as the diversification of funding sources and the structure of existing debt maturities also impact on overall financial flexibility.

Component 3, Factor A: Leverage and Capital Structure

38. GCR's assessment of leverage and capital structure utilises a mix of quantitative debt service and cash flow metrics, combined with a more subjective assessment of the appropriateness of the capital structure. The quantitative assessment of gearing focusses mainly on debt service coverage metrics, but as earnings are not relevant to LRGs, the metrics measure the extent to which income and operating cash flow cover debt service obligations. Historical debt service coverage trends are extrapolated, along with expected cash flows, to determine two-year forecasted ratios (where possible). In general, GCR will use net gearing (gross debt minus cash and unpledged liquid assets) to calculate gearing metrics for LRGs, but in cases where cash may be earmarked for capex purposes, gross gearing metrics may be applied. GCR will also make adjustments for differences in the accounting treatment of certain items, as well as substituting proxy ratios where the usual ratios used cannot be accurately calculated (dependent on the accounting system being used by the LRG).

39. Before calculating the cash flow metrics, it is necessary to ascertain the quality of operating cash flows. LRGs have a greater ability than commercial entities to inflate operating cash flow by withholding payments to suppliers and contractors. Thus, while the overall working capital movement can appear neutral or even positive, this can mask a negative underlying trend. Such is the case where a rising debtor's absorption is offset by higher creditors. On the one hand the rising debtors balance implies some shortcomings in collection, which impacts current cash flows. Conversely, the higher creditors suggest that there will be future cash outflows. To measure the impact of working capital, GCR will calculate the cumulative absolute value of working capital movements as a proportion of revenue and/or cash generated by operations, with higher values being indicative of underlying fluctuations that need to be more closely examined. Where there are concerns as to the quality of cash flows, GCR may adjust the operating cash flow prior to performing the ratio calculations or may adjust the calculations downward to account for the negative trends.
40. There are three main metrics that are utilised when assessing debt, with the typical scoring bands, (from a minimum of -8 to a maximum score of +5) detailed in the table below. An average or median score will then be computed to establish a base leverage score. For LRGs to attain the highest scoring of (4) or (5), they must demonstrate ongoing superior access to funding from a wide variety of sources, in addition to low gearing metrics. Conversely, capital structure considerations may also be used to adjust the risk score downwards.
41. **Net Debt to income:** In GCR's experience, LRGs have tended to prioritise debt service obligations ahead of general expenditure in periods of financial stress. Thus, GCR considers it appropriate to measure debt against total income where an LRG has wide scope to service its debt from income. Adjustments to income will, however, be made if a portion of the cash income is restricted for specific purposes, for example where a conditional grant is provided for a particular capex project, or where a portion of revenue is ring-fenced to cover the cost of provision. Similarly, adjustments may be made for once-off income items.
42. **Operating cash flow coverage of total debt:** Measures the capability of the LRG to pay back its debt using the cash flow after meeting its operating costs. The advantage of this ratio is that it measures the real cash available for debt servicing after taking into account operating requirements, although it could be temporarily skewed by working capital movements (as above). GCR utilises gross debt because cash reserves are often maintained specifically to meet operational requirements and can quickly be depleted. Cash holdings that are specifically ring-fenced for the repayment of debt will be netted off the gross debt balance. In jurisdictions where cash flows are not reported, this metric will not be relevant and GCR will focus on the other the other two gearing metrics.
43. **Cash flow coverage of net interest:** Examines the ability of the LRG entity to honour its recurring debt service obligations, namely interest payments. Cash flow coverage is considered more relevant as this is the best measure of financial resources available for interest payments after meeting operational requirements (as the overall surplus is highly dependent on capex or the lack thereof). However, for LRGs that do not report cash flows, GCR will utilise **operating surplus coverage of net interest** as its coverage metric. Typically, GCR will offset interest income against the interest charge, but non-cash interest income

and other interest risk mitigants such as hedging instruments and capitalised interest on development funding will be excluded from the calculation. These mitigants may, however, be included in alternate coverage metrics.

Table 3: Leverage, Cash Flow, Coverage

Scoring	Net debt to Income	Operating cash coverage of gross debt	Operating cash flow coverage of interest
4 to 5	LRGs that demonstrate ongoing access to diverse sources of funding may receive an uplift to the score implied by the credit protection ratios of up to two notches. Accordingly, entities that achieve the highest leverage and cash flow coverage scores may receive further uplift to a credit risk of 4 or 5.		
2 to 3	<20%	>150%	>12x
-1 to 1	20% – 50%	50% - 150%	3x – 12x
-2 to -3	50% to 150%	Slightly negative cash coverage - 50%	1x – 3x
-4 to -5	>150%	Substantially negative	<1x
-6 to -8	The lowest risk scores are applicable in instances where an LRG has high gearing, but does not have clear refinancing arrangements in place, or where GCR is of the opinion that lines of credit will not be made available.		

Capital structure assessment

44. In evaluating suitability of the capital structure, GCR considers the laws that govern the purposes for which debt may be issued and the amount that may legally be borrowed. For public entities, legal restrictions may impede access to borrowings due to the need to get approvals from higher levels of government, or to comply with specific municipal finance approval and tendering regulation. GCR will consider any contravention of the funding regulations akin to a covenant breach (see paragraph 55), and could significantly adjust the risk score downwards if the contravention could lead to accelerated repayments or being locked out of funding markets. Similarly, any attempt by an LRG to suspend debt service obligation by citing potential infringements to legislation will also be viewed negatively and could result in a substantial downward adjustment to the risk score or even a default. On the other hand, the additional oversight may be positive in that it may provide some comfort that debt levels will remain within an acceptable range.
45. High debt concentration represents a key risk for LRGs, particularly as the legislative and political environment may impede their financial flexibility. Concentration is measured both by source and by maturity. To achieve a high risk, score an entity should maintain debt facilities with a wide range of institutions, and demonstrate access to capital from both private and public sector financing institutions, as well as capital market sources. Having access to private sector funders provides a strong signal of creditworthiness, as such counterparties tend to be more risk averse. On the other hand, the presence of strong relationships with development finance institutions is also supportive of credit strength as these entities have the ability to provide much longer tenors (up to 20 years) and often provide concessional interest rates. Moreover, along with funding, development institutions often provide technical assistance,

which can be very valuable for entities in underdeveloped jurisdictions and lacking substantial management capacity.

46. GCR also places strong emphasis on the maturity profile of the capital structure. Typically, LRGs are able to access much longer debt facilities (10-20 years) than commercial entities, which adds to funding stability. Nevertheless, GCR could make an adjustment if there are material refinancing risks in the short to medium term, or if the weighted-average-maturity is low compared to other LRGs. A more severe negative adjustment could be considered if there are sizable maturities of less than six months with no clear redemption or refinancing plans in place.
47. GCR is particularly concerned about rapid growth in debt for LRGs, and could also bring down the initial leverage score, depending on the nature of the growth. The risk is that the LRG could quickly find itself with a significantly higher debt service burden, while the expected economic benefits of the new debt may take a long time to materialise or may not be tangible.
48. Sustainability linked funding: Sustainability-linked funding provides a unique opportunity to consider environmental, social, and governance (ESG) factors alongside traditional financial metrics. By incorporating sustainability targets and performance indicators into the funding structure, companies can demonstrate their commitment to responsible business practices and long-term sustainability. Furthermore, by integrating sustainability into their business strategies, corporates can achieve greater funding stability and access funding at lower costs. Evidence of these advantages could support the assessment.

Component 3, Factor B: Liquidity

49. GCR applies a zero-tolerance approach to a lack of liquidity. This is because an LRG with the healthiest balance sheet and strongest position can still fail if it does not have appropriate levels of, and control over, its liquidity. As a result, GCR's assessment of weak liquidity can bring the ratings down to the lowest levels should there be concerns.
50. LRGs have an important liquidity advantage over commercial entities in that a large portion of their income is fairly certain. This is because, regardless of operating performance, LRGs will continue to receive grant income from higher levels of government (where this is legislated and determined by a formula) and will continue to collect rates, taxes and other fees from its residents (who are legally obligated to continue making payments). In many jurisdictions, particularly in developing countries, LRG funding may primarily derive from direct transfers from the National Governments, which adds a level of certainty. Accordingly, even under stressed financial circumstances, these entities will most often still be able to generate (or will receive) sufficient income to service their debt obligations. This would likely be at the expense of lower maintenance and infrastructure spending, but the consequences of this neglect would only have a tangible negative impact over the longer term.
51. On the other hand, liquidity problems can quickly arise from external factors such as delayed grant receipts or transfers, or because it may be very difficult to reduce costs quickly in response to declining revenue due to political considerations. Accordingly, GCR considers it crucial that LRGs maintain sufficient cash resources available to cover 60 to 90 days of operating expenditure. However, GCR is cognisant that this ratio can be somewhat manipulated in any given period, by the timing of payments to trade creditors and for capex. Accordingly, GCR will focus on the trend in the figures, or may moderate the cash balance when there is concern as to the sustainability of the cash holdings. Cognisance is also taken that with cash-based accounting, the measure is less meaningful as the entity should not be retaining cash, and any surplus is thus likely relate to unpaid creditors.
52. GCR's analytical is based on a simple view of the entity's ability to meet its liquidity requirements over a rolling one to two-year period. However, GCR gives consideration to the fact that in most jurisdiction, LRGs are required to produce a balanced budget. Operating and capital expenditure cannot exceed projected income, whilst all projected income should be used for service delivery or capital expenditure. Therefore, by design forward looking liquidity will be around 1x. This may limit an LRG's ability to achieve a high liquidity score.
53. As per the sources versus uses approach to assessing liquidity, GCR includes the following in sources where applicable:
- GCR calculates non-pledged, non-restricted cash. Included in restricted cash is unspent conditional grants and sinking fund that are ring-fenced for specific issuances, both of which are subtracted from available cash resources.
 - GCR will include cash flow from operations. Where possible, GCR will calculate expected cash flows from internally generated revenue separately from conditional grant funding. While both aspects are important contributors to the liquidity resources, it is important to distinguish between those resources

that are provided for a specific purpose and the resources that are available to meet general operating requirements and discretionary spending. Adjustments may also be made where there is some legal ring-fencing of certain cash flows to fund specific projects or to meet debt service obligations.

- iii. Government allocations or grants are particularly important sources of income for LRGs. For many smaller LRGs such allocations can account more than 90% of income. In some countries the quantum of the allocation is often publicised and unlikely to change, but in others it may be dependent on an external factor like commodity prices. In such cases, GCR will calculate projected allocation based on our expectation of market fundamentals. Another concern is the timing of payment, which are often delayed. Where there is a history of delayed payments we may adjust our projected allocation downwards.
- iv. GCR includes the undrawn and available portion of committed facilities maturing after 12 months. This source may be negligible for LRGs, as legislation often limits their ability to raise general purpose debt or to utilise short term facilities such as overdrafts. Nevertheless, we will positively consider entities that have access to overdrafts or other short-term facilities, that can bridge cash flow gaps in situations where government transfers are often delayed.
- v. GCR may include committed grant funding from development finance institutions. This source of income is particularly important in underdeveloped economies, where grant funding from highly rated international institutions may be more reliable than government grants. Non-committed grants may also be included, where a longstanding relationship between the LRG and the development finance institution is demonstrated and there is a reliable track record of project implementation. Before including such external grants, GCR will assess the terms and conditions of the grant funding to ensure they are being complied with and to identify the risk and consequences of non-compliance.
- vi. GCR may include liquidity from contracted asset sales. Although there may be circumstances where asset sales will progress the development agenda of the municipality, ongoing asset sales are viewed negatively. For example, the sale of vacant municipal land for development would fit into the municipality's core mandate. However, if asset sales are being undertaken to support operational requirements, GCR could notch the liquidity score down as the sales are unlikely to be sustainable.

54. When examining uses, GCR considers the following:

- vii. GCR will first look at debt service costs over a one year and two-year period, including upcoming maturities, presuming they will not have access to refinancing those funds. Debt service costs include both interest and principal amortisation payments and is considered more relevant for an LRG as debt is usually weighted towards amortising facilities.
- viii. GCR includes all planned capital expenditures requirements over the one to two year period. Again, to gain a better understanding of the real liquidity position, the distinction is made between the capex that is directly funded by grants and the capex that the LRG will need to fund from internal resources. We may temper the capex projections provided based on an entity's historic spend, or implementation ratio. Particularly where there are cash flow or operational capacity constraints, capex will likely fall below the levels indicated in medium term budgets.

- ix. GCR will include the expectation of future outflows due to creditors, or unfunded liabilities (such as pensions or potential legal action). In jurisdictions where LRGs utilise cash-based accounting, outstanding trade creditors (often referred to as pending bills) may have the first right to payment from future government allocations. GCR may utilise the full outstanding amount in our calculation, or a proportion thereof.
- x. Any contracted extraordinary outflows and other discretionary elements of cash outflows. GCR may also include any quantifiable contingent liabilities.
55. **Covenants:** The presence and proximity to covenants is an important factor when assessing the uses of liquidity. These covenants are typically financial, but for LRGs they could also relate to management and governance indicators. Where these covenants can lead to an acceleration of debt repayment or event of default, this will significantly increase risk for the LRG and constrain financial flexibility. The risk becomes more acute the closer an entity's metrics come to the covenant levels and, as such, the risk score should be penalised. The extent of the negative adjustment would be dependent on the severity of the breach and the solutions that are contractually available to both debtors and creditors.
56. **Control over resources:** In many less developed economies, LRGs do not have effective control over their financial resources. One example is where LRGs are required to retain all their cash balances within the central bank. In even more restrictive scenarios, LRG requirements are met directly through transfers from National Treasury. Depending on the perceived lack of autonomy, GCR could reduce the liquidity risk score by one or more notches where such structures are in place, as they effectively subordinate the financial commitments of the LRG to those of the National Government, as well as introducing uncertainty as to the timeliness of payment. Considerations in this regard would be the past track record of payment, transparency of the mechanism for payment and the financial health of the National Government.
57. **Encumbrances:** Although LRGs generally do not evidence high levels of asset encumbrances, a number of factors may restrict financial flexibility and access to debt capital. In particular, there are often legislative restrictions that prevent LRGs from pledging assets as security. Moreover, many of the assets owned by municipalities, such as roads and sewerage infrastructure, cannot practically be used to provide credit support. Encumbrances do, however arise, where there are project finance arrangements or other structural ring-fencing of cash flows. In such cases, cash flow projections may have to be adjusted to exclude the ring-fenced portions.

Table 4: Liquidity

Score description	Score	Liquidity (typical descriptors)
Highest	2	If the entity has over 250 days unencumbered cash coverage. If the entity has sources of liquidity that cover more than 1.5x its uses over a one-year period and 1.2x over a two year period. Furthermore, there is significant headroom in its debt covenants above acceleration of its longer-term funding or event of defaults. The entity has complete control over financial resources. Funding relationships with banks of good creditworthiness are strong and stable. Few restrictions on encumbering assets and substantial assets suitable to be pledged.

Intermediate	-1 to 1	If the entity has between 45 and 250 days unencumbered cash coverage. If the entity has sources of liquidity that cover between 1x and 1.5x its uses over a one-year period, and no major unfunded debt maturities over between 12 and 24 months. Comfortable covenant headroom and there are typically no rating triggers in the debt packages. The entity has substantial control over financial resources. Funding relationships are strong and stable. Some restrictions on encumbering assets and a moderate amount of assets suitable to be pledged.
Low	-2 to -5	If the entity has between 10 and 45 days unencumbered cash coverage. If the entity has sources of liquidity that cover below 1x its uses over a one-year period. There is limited covenant headroom, which could cause a material acceleration or event of default should the performance of the entity deteriorate. There are some restrictions over the entity's financial resources. Over-reliance on development institutions for funding, with questionable relationships with private sector sources. Substantial restrictions on pledging assets and few assets suitable to be pledged.
Lowest	-6 to -10	Less than 10 days unencumbered cash coverage or if encumbered cash exceeds actual cash on hand. If the entity has little control over the use of financial resources. If the entity has sources of liquidity that are insufficient to cover one years' use. Both public and private sources of funding are questionable. Negligible assets suitable to be pledged. At the lowest levels there may be a covenant breach, or flouting of legislation that is material, significant and plausible. Funding partners are refusing to provide access to funds.

The above boxes highlight typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristic across different boxes. GCR will use analytical discretion to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score the entity is likely to reflect a number of cumulative strengths. Conversely, any one risk can bring the score down to a weak level. GCR can use decimal scoring (example 0,25, 0,50 or 0,75) to improve differentiation and relative credit ranking.

Component 4: Comparative Profile

58. The last risk score factor allows GCR to make a series of qualitative changes based on external or idiosyncratic factors. The most common one being extraordinary sovereign support.

Component 4, Factor A: Government support

59. For LRGs support can only be provided by higher levels of government. This would, however, have to be support beyond the establishment of a conducive legislative and operating environment, which is considered in the operating environment and entity profile sections. Government support factors can be explicit or implicit. Where there is explicit support for an LRG's debt or for specific issues, the LRG or the issue credit rating can be equalised with the arm of government providing the guarantee.

60. Implicit support is more subtle. Even where the National Government does not guarantee the financial obligations of an LRG, GCR deems the likelihood of operational support in times of need to be high. This is because the National Government has an equally strong incentive to ensure that a minimum level of services are being provided to the population, both from the point of view of being ultimately responsible for the living standards of all people in the country, and from more narrow political considerations. Where this level is not being met, it is likely that the National Government will step in and take over aspects of service delivery. In most jurisdictions such interventions are provided for by legislation. Alternatively, the National Government may be forced to provide funding to ensure that service delivery continues, even in instances where it does not have a legal obligation to do so.

61. As a result, GCR has created a government support level for all entities where GCR considers such extraordinary support to be likely. For GCR, the level is the operating environment score (i.e. the combined country risk and sector risk score) of the entity in question. The level only starts to contribute to the overall GCR Risk Score when the creditworthiness of the entity is below that of the implied operating environment score. For example, if issuer LRG A has a total risk score of 8 and the operating environment score is 12, then GCR could uplift the final score by up to 4 scores, assuming that there are grounds to add government support (i.e. can the government support and does the entity qualify for support).

62. Only LRGs in countries where the government has a track record of intervention and the capacity to support (as signified by a country risk score more than 3), should benefit from uplift. Domiciles with fiscal constraints, or legal/operational blockages to support typically have no uplift.

63. For full details on country support please see the universal [country risk criteria](#) (in the GCR Ratings Framework).

Component 4, Factor B: Peers analysis

64. GCR allows two positive or negative risk score changes to create greater credit differentiation. Typically, these notches should be used when an entity is a generally better or worse performing entity than its peer group across a number of fields, but no one factor has created ratings differential.

Final Rating Adjustment Factors

Rating Adjustment Factor 1: LRG Specific Structural Factors

65. Once the risk score and the ACE has been established, on either/ both the national or international scale GCR can then create the formal ratings on different legal entities. Typically, the ACE of an LRG will equate to the credit rating, as group considerations are not relevant. Nevertheless, it is common for an LRG to carry out certain operations through municipal entities, which may be analysed separately and accorded standalone ratings.
66. Municipal entities that carry out the core functions of the LRG and whose financial management is indistinguishable from the LRG are accorded the same rating as the LRG. For example, certain municipalities have created quasi-privatised companies to manage electricity distribution, water provision or refuse removal and waste management. While these companies may have a distinct Board of Directors and management team, the billing is part of the general municipal services account a resident receives and payments are made directly into municipal bank accounts.
67. LRGs may also establish commercial entities that provide a service to the private sector or residents on a for profit basis, but which are substantially owned by the LRG. Even if the commercial entity receives subsidies from the LRG, the intention is for it to operate profitably and to eventually be self-funding and provide dividends or other returns to the LRG. Such entities are rated on a standalone basis and then allocated support uplift, if appropriate. For example, a city may operate a convention centre to attract business tourism to its jurisdiction, but the centre itself can operate profitably.

Rating Adjustment Factor 2: Issue Rating(s)

68. The notching from the legal entity rating will depend on the nature of the instrument, whilst always respecting the credit hierarchy.

Table 5: Instruments		
Debt Rating Types	Notching	Typical Characteristics
Secured Liabilities	+1 or more notches	See Structurally Enhanced Corporate Bonds Rating Criteria (known as Secured Bond Expected Loss Credit Ratings).
Senior Unsecured	0	Reflects the relevant legal entity rating on the financial institution issuing the debt, including the government support uplift (if applicable) if not in a resolution market.
Senior Subordinated	-1	Contractually subordinated debt and may have a discretionary/ mandatory/ statutory non-payment or write down clauses.

68. An Irrevocable Standing Payment Order (ISPO) is an instrument utilised by LRGs (mainly in under-developed jurisdictions) as a means to offer some security to investors in their issued debt. An ISPO is usually provided by a higher level of government, and typically undertakes to honor the obligations to

debt investors by diverting the scheduled transfers of funds designated for the LRG to the investors. For example, a National Government could agree to settle obligations to investors in the debt issued by a particular City or State directly. These settlement costs would then be deducted from scheduled grant transfers from the National Treasury to the City or State. Similarly, a city or state could support the debt issuance of a service provider by issuing an ISPO against contracted service payments. Typically, the ISPO from the higher-level government entity is confirmed in the form of an official letter.

69. Although many of the features associated with security structures will not be present with an ISPO, and it does not directly guarantee the repayment of debt, an ISPO can significantly improve the likelihood of debt investors receiving their interest and principal in a timely manner, relative to the reliance on the debt issuing entity. Therefore, GCR may increase the Issue rating by up to three ratings notches, depending on the terms of the ISPO and the credit quality of the issuing entity.

Glossary of terms/acronyms used in this document as per GCR's glossary

Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
Amortisation	From a liability perspective, the paying-off of debt in a series of instalments over a period of time. From an asset perspective, the spreading of capital expenses for intangible assets over a specific period of time (usually over the asset's useful life).
Annuity	A contract that provides a series of payments for a specified period of time which may or may not be contingent on the survival of the annuitant.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Benefits	Financial reimbursement and other services provided to insureds by insurers under the terms of an insurance contract.
Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
Borrower	The party indebted or the person making repayments for its borrowings.
Callable	A provision that allows an Issuer the right, not the obligation, to repurchase a security before its maturity at an agreed price. The seller has the obligation to sell the security if the call option holder exercises the option.
Capital Expenditure	Expenditure on long-term assets such as plant, equipment or land, which will form the productive assets of a company.
Capital Markets	The part of a financial system concerned with raising capital by dealing in shares, bonds, and other long-term debt securities.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Claim	1. A request for payment of a loss, which may come under the terms of an insurance contract (insurance). 2. A formal request or demand (corporate finance).
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Commodity	Raw materials used in manufacturing industries or in the production of foodstuffs. These include metals, oil, grains and cereals, soft commodities such as sugar, cocoa, coffee and tea, as well as vegetable oils.
Concentrations	A high degree of positive correlation between factors or excessive exposure to a single factor that share similar demographics or financial instrument or specific sector or specific industry or specific markets.
Conditions	Provisions inserted in an insurance contract that qualify or place limitations on the insurer's promise to perform.
Conglomerate	A company made up of subsidiaries that operate in several business sectors that are unrelated to each other.
Contract	An agreement by which an insurer agrees, for a consideration, to provide benefits, reimburse losses or provide services for an insured. A 'policy' is the written statement of the terms of the contract.
Corporate Governance	Refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Correlation	A term that describes the degree to which two variables move together. A correlation of 1 means that they move together exactly, while a correlation of minus 1 means that they move in exactly the opposite direction from each other.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country and may also include negative effects on financial institutions and borrowers in the country.
Coupon	The interest paid on a bond expressed as a percentage of the face value. If a bond carries a fixed coupon, the interest is usually paid on an annual or semi-annual basis. The term also refers to the detachable certificate entitling the bearer to the interest payment.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Coverage	The scope of the protection provided under a contract of insurance.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.

Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Credit	A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Creditor	A credit provider that is owed debt obligations by a debtor.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Currency Risk	The potential for losses arising from adverse movements in exchange rates.
Debt Service Coverage	Measures the ratio of cash available for debt servicing to interest, principal and lease payments.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Debtor	The party indebted or the person making repayments for its borrowings.
Default Risk	The probability or likelihood that a borrower or issuer will not meet its debt obligations. Credit Risk can further be separated between current credit risk (immediate) and potential credit risk (deferred).
Default	A default occurs when: 1.) The Borrower is unable to repay its debt obligations in full; 2.) A credit-loss event such as charge-off, specific provision or distressed restructuring involving the forgiveness or postponement of obligations; 3.) The borrower is past due more than X days on any debt obligations as defined in the transaction documents; 4.) The obligor has filed for bankruptcy or similar protection from creditors.
Derivative	A financial instrument that offers a return based on the return of another underlying asset.
Distribution Channel	The method utilised by the insurance company to sell its products to policyholders.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Downstream	Downstream refers to the processing of raw materials into a product required by end users and consumers.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exchange Rate	The value of one country's currency expressed in terms of another.
Experience	A term used to describe the relationship, usually expressed as a percent or ratio, of premiums to claims for a plan, coverage, or benefits for a stated time period.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Fair Value	The fair value of a security, an asset or a company is the rational view of its worth. It may be different from cost or market value.
Financial Flexibility	The company's ability to access additional sources of capital funding.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Fix	The setting of a currency or commodity price for trade at a future date.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They include tangible assets, such as land and equipment, stake in subsidiaries and other investments, as well as intangible assets such as goodwill, information technology or a company's logo and brand.
Fixed Costs	Company costs such as rent, administrative overheads and depreciation, which do not vary with the level of production or sales.
Forecast	A calculation or estimate of future financial events.
Gearing	Gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
Going Concern	An accounting convention that assumes a company will continue to exist and trade normally for the foreseeable future. In practice this is likely to mean at least for the next 12 months.

Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Haircut	The percentage by which the market value of an asset is reduced. The size of the haircut reflects the expected ease of selling the asset and the likely reduction necessary to realised value relative to the fair value.
Hedge	A form of risk management aimed at mitigating financial loss or other adverse circumstances. May include taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
Hedging	The act of managing risk, aimed at mitigating financial loss or other adverse circumstances. May include taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
Hybrid	A form of security that has characteristics of various types of transaction or product.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
Income	Money received, especially on a regular basis, for work or through investments.
Insolvency	When an entity's liabilities exceed its assets.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
International Scale Rating.	An opinion of creditworthiness relative to a global pool of issuers and issues.
Issuer	The party indebted or the person making repayments for its borrowings.
Junior	A security that has a lower repayment priority than senior securities.
Lease	Conveyance of land, buildings, equipment or other assets from one person (lessor) to another (lessee) for a specific period of time for monetary or other consideration, usually in the form of rent.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidation	Liquidation is the process by which a company is wound up and its assets distributed. It can be either compulsory or voluntary. It can also refer to the selling of securities or the closing out of a long or short market position.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Long-Term Rating	A long term rating reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Long-Term	Not current; ordinarily more than one year.
Loss	1. A tangible or intangible, financial or non-financial loss of economic value. 2. The happening of the event for which insurance pays (insurance).
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.

National Scale Rating	National scale ratings measure creditworthiness relative to issuers and issues within one country.
Notching	A movement in ratings.
Obligation	The title given to the legal relationship that exists between parties to an agreement when they acquire personal rights against each other for entitlement to perform.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Offset	A right (Right of Offset) to set liabilities against assets in any dispute over claims.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Lease	A lease where the risk and reward are not transferred.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Option	An option gives the buyer or holder the right, but not the obligation, to buy or sell an underlying financial asset at a pre-determined price.
Performing	An obligation that performs according to its contractual obligations.
Pledge	An asset or right delivered as security for the payment of a debt or fulfilment of a promise, and subject to forfeiture on failure to pay or fulfil the promise.
Policy	The legal document issued by the company to the policyholder, which outlines the conditions and terms of the insurance.
Preference Share	Preference or preferred shares entitle a holder to a first claim on any dividend paid by the company before payment is made on ordinary shares. Such dividends are normally linked to an interest rate and not determined by company profits. Preference shares are normally repayable at par value in the event of liquidation. They do not usually carry voting or pre-emptive rights. Preference shares can be redeemable or perpetual.
Preference Shares	A source of long-term equity funding that has no voting rights and higher pay-out priority than common shares.
Pricing	A process of determining the price of a debt security.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Private	An issuance of securities without market participation, however, with a select few investors. Placed on a private basis and not in the open market.
Property	Movable or immovable asset.
Ranking	A priority applied to obligations in order of seniority.
Real Estate Investment Trust	A REIT is a company that owns or finances income-producing real estate. REITs are subject to special tax considerations and generally pay out all of their taxable income as distributions to shareholders.
Real Estate	Property that consists of land and / or buildings.
Redemption	The repurchase of a bond at maturity by the issuer.
Refinance	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
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Rent	Payment from a lessee to the lessor for the temporary use of an asset.
Repayment	Payment made to honour obligations in regard to a credit agreement in the following credited order: 3.) Satisfy the due or unpaid interest charges; 4.) Satisfy the due or unpaid fees or charges; and 5.) To reduce the amount of the principal debt.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Secured Debt	Debt backed with or secured by collateral to reduce lending risk and thus the interest rate charged.
Security	One of various instruments used in the capital market to raise funds.
Senior Unsecured Debt	Securities that have priority ahead of all other unsecured or subordinated debt for payment in the event of default.

Senior	A security that has a higher repayment priority than junior securities.
Servicing	The calculation of interest and repayments, collection of repayments, advancing of loans, foreclose procedures, maintaining records and seeing that the proceeds of each loan are passed on to the respective party.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Statutory	Required by or having to do with law or statute.
Subordinated Debt	Debt that in the event of a default is repaid only after senior obligations have been repaid. It is higher risk than senior debt.
Total Risk	Both systematic and unsystematic risks.
Trust	A third party that acts in the best interest of another party, according to the trust deed, usually the investors. Owner of a securitisation vehicle that acts in the best interest of the Noteholders.
Unsecured Claim	Debt securities that have no collateral.
Upstream	A term referring to the exploration and extraction of a commodity, in contrast with the downstream manufacturing and processing.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.
Weighted Average	An average resulting from the multiplication of each component by a factor reflecting its importance or, relative size to a pool of assets or liabilities.
Weighted	The weight that a single obligation has in relation to the aggregated pool of obligations. For example, a single mortgage principal balance divided by the aggregated mortgage pool principal balance.
Working Capital	Working capital usually refers to the resources that a company uses to finance day-to-day operations. Changes in working capital are assessed to explain movements in debt and cash balances.

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