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# Demystifying Financial Ratios

## Why Bother?

Gary Malone, CPA

May 5, 2009



# Why use financial ratios?

- Useful in identifying and developing management strategies to allocate limited resources
- Useful in measuring the effectiveness of those strategies over time
- Useful in communicating the success of those strategies to elected officials, taxpayers, voters and investors

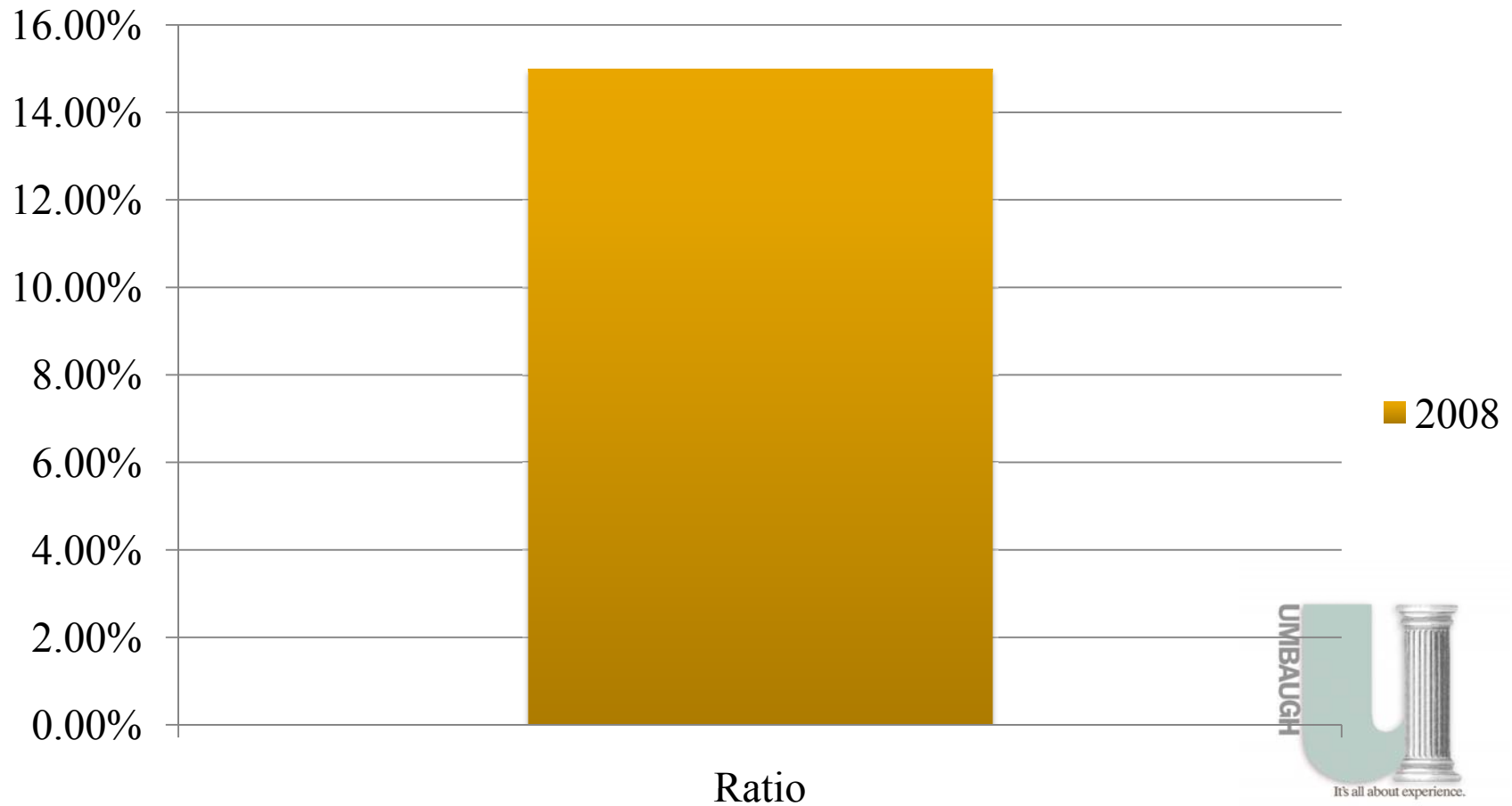


# How do we use ratios?

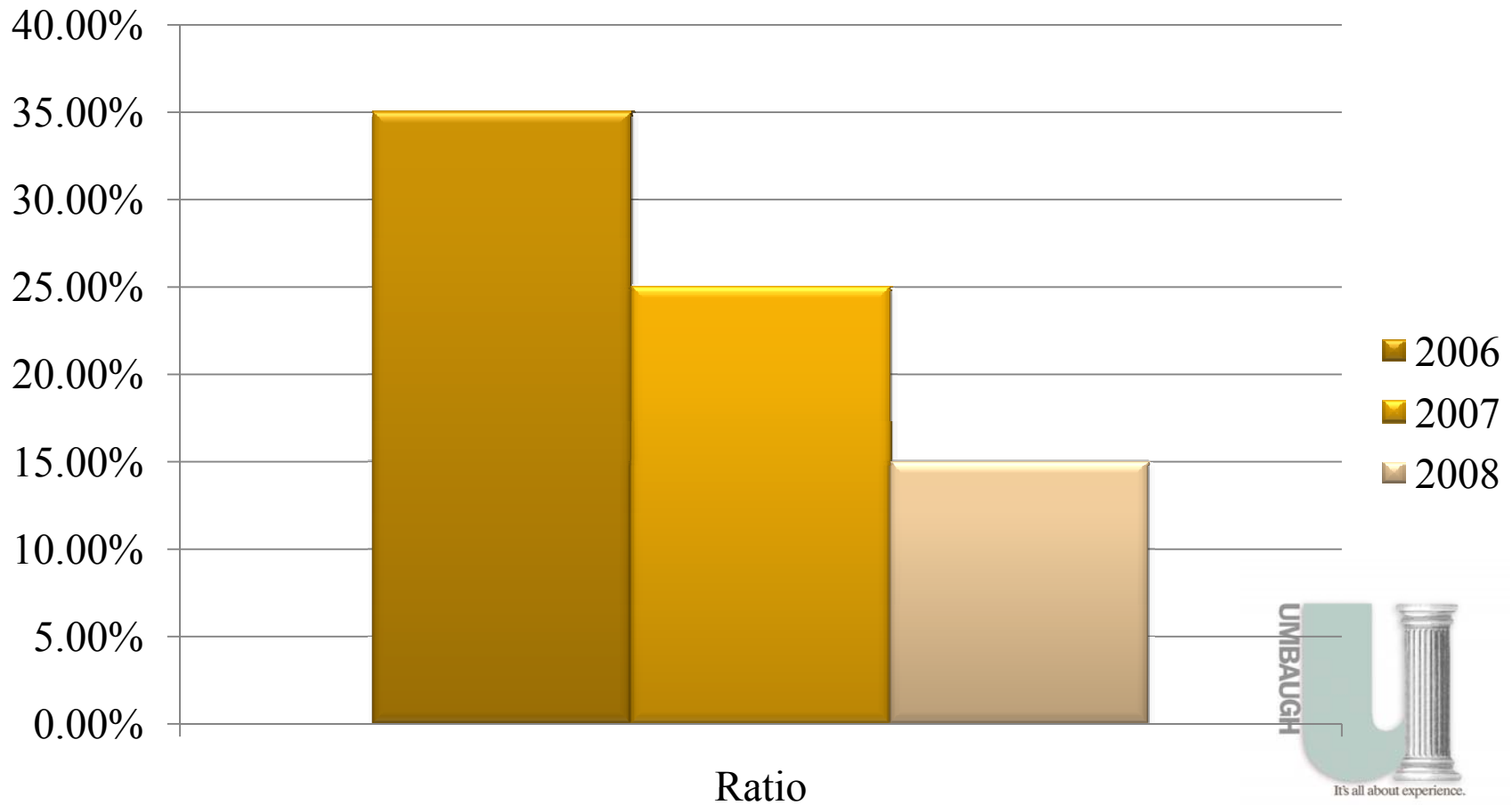
- Ratios can be used to identify and measure financial trends over time.
  - *Trended data gives us insight into the direction we are headed. Are economic and financial conditions improving or weakening and at what pace?*
- Ratios can be used to compare the financial condition of one taxing unit with its peers
  - *Comparative data helps stakeholders evaluate local economic and financial conditions in light of the experiences of comparable units*



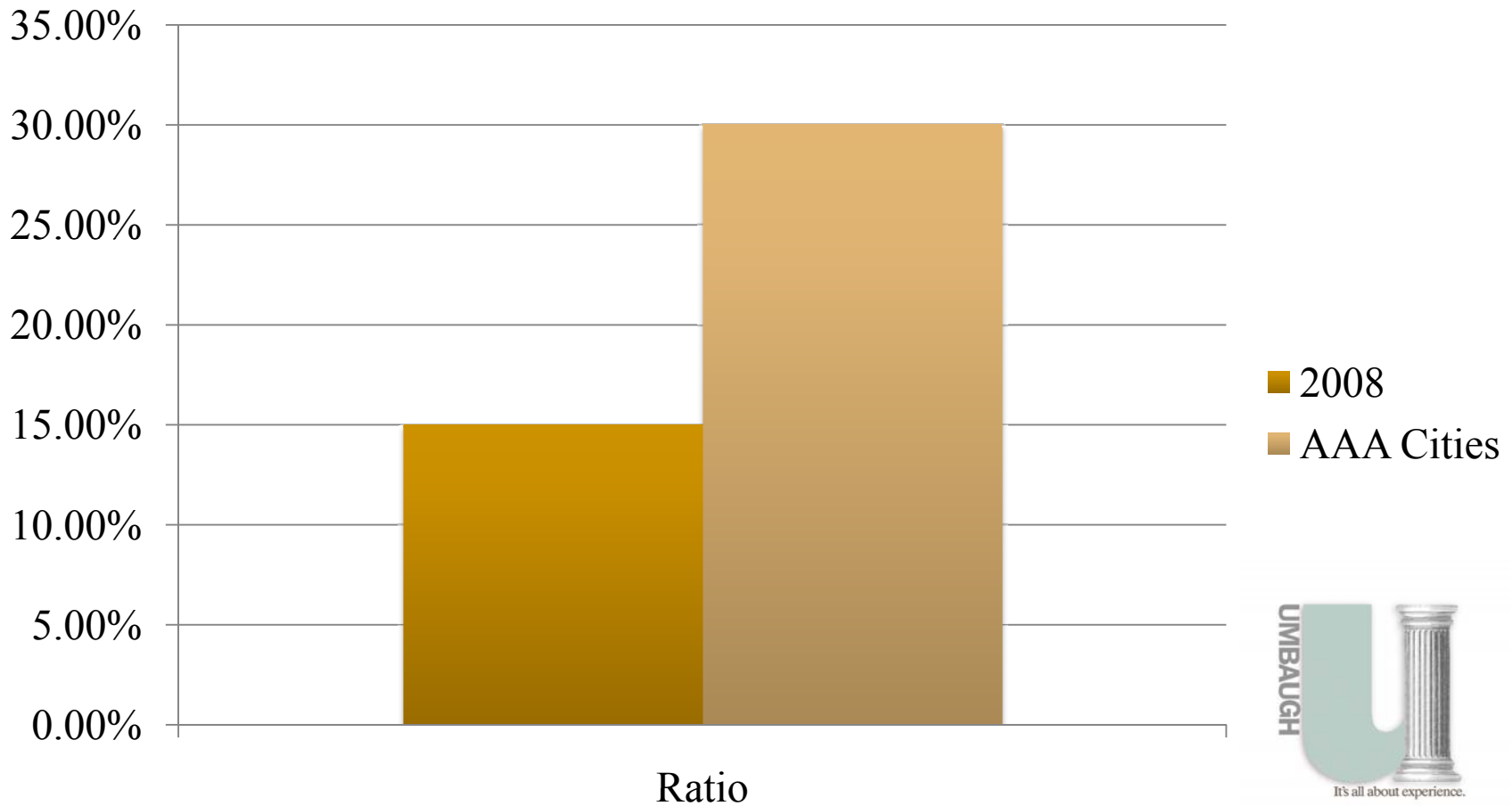
# Ratio of General Fund Balance vs. Expenditures



# Ratio of General Fund Balance vs. Expenditures



# Ratio of General Fund Balance vs. Expenditures



# Why are financial ratios important to bond investors and credit analysts?

- Financial ratios are helpful in making judgments about an issuer's financial health and creditworthiness
  - Liquidity
  - Financial flexibility
  - Financial leverage
- Ratios help bond purchasers evaluate risk among investment alternatives

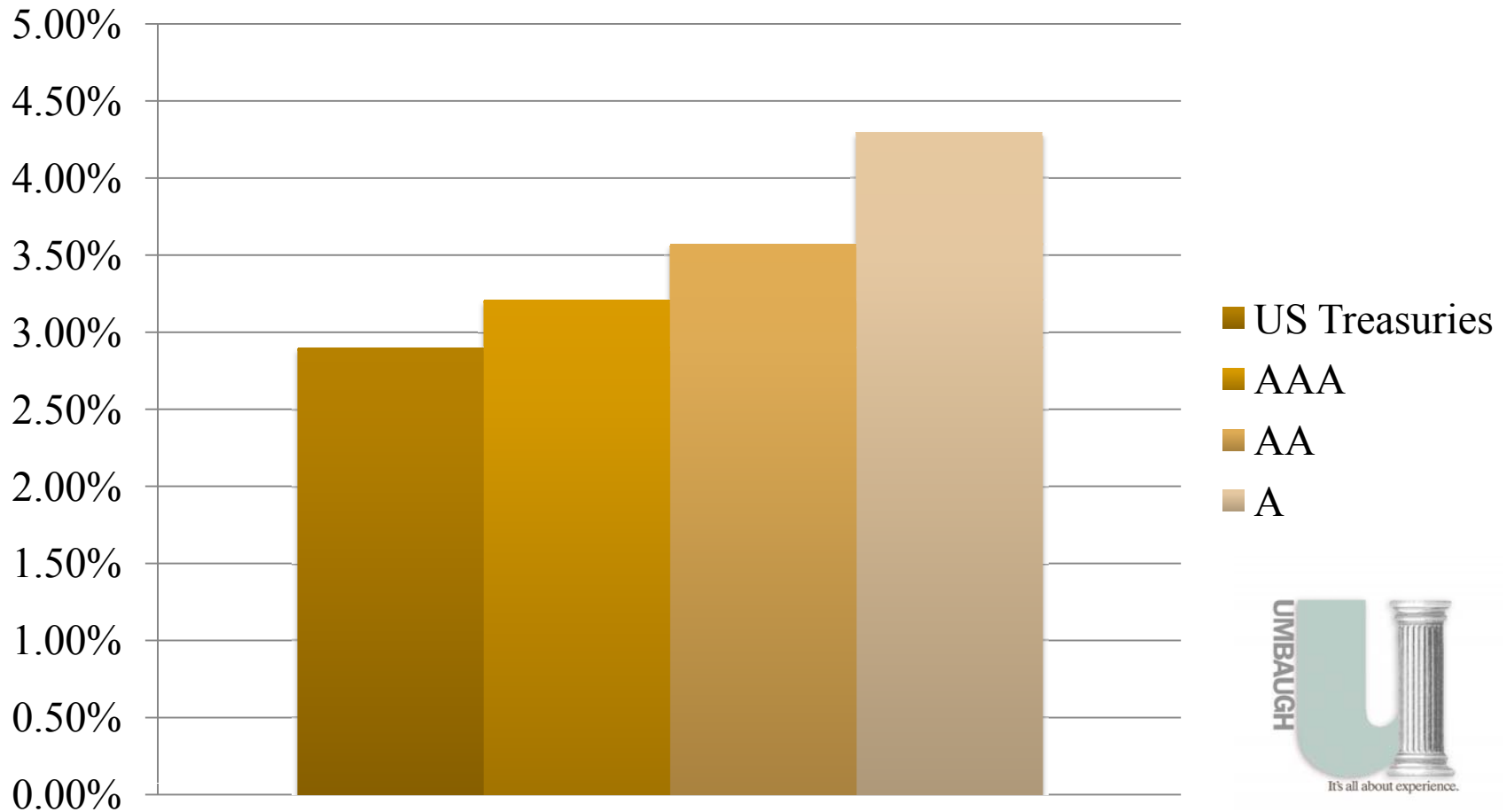


# Impact of Financial Ratios on Credit Costs

- Financial ratios are used by credit rating agencies and investors to measure credit risk
- Risk verses reward: the higher the perceived risk, the more compensation, or “reward”, investors will demand to extend credit to you
- If we can reduce credit risk and improve bond ratings, then we can reduce our borrowing costs



# Risk Premiums for 10 Year GO Obligations



Source: Delphis Hanover Corporation, April 20, 2009.

# Risk and bond pricing

- Interest rates increase with perceived risk
  - Investment risk and interest rates generally increase with the length of time to final bond maturity
  - Interest rates increase as the credit quality of a bond diminishes and investment risk grows



# Risk and Interest Rates

Years	AAA	AAA (insured)	AA	A	Baa
1	0.97%	1.05%	1.25%	1.88%	2.47%
5	2.15%	2.23%	2.43%	3.09%	3.74%
10	3.27%	3.38%	3.63%	4.36%	5.02%
15	4.25%	4.37%	4.60%	5.33%	6.04%
20	4.73%	4.85%	5.11%	5.82%	6.50%

Source: Delphis Hanover Corporation, April 17, 2009.



# Illustrative Savings from Improved Bond Ratings

	AA Rating	A Rating
Bond Principal	\$10,000,000	\$10,000,000
Average Interest Rate over 20 years	5.11%	5.82%
Average Annual Payment	\$810,000	\$860,000
Total Interest Cost	\$6,199,000	\$7,183,000

\$ 984,000 in Interest Savings from Improved Bond Rating.

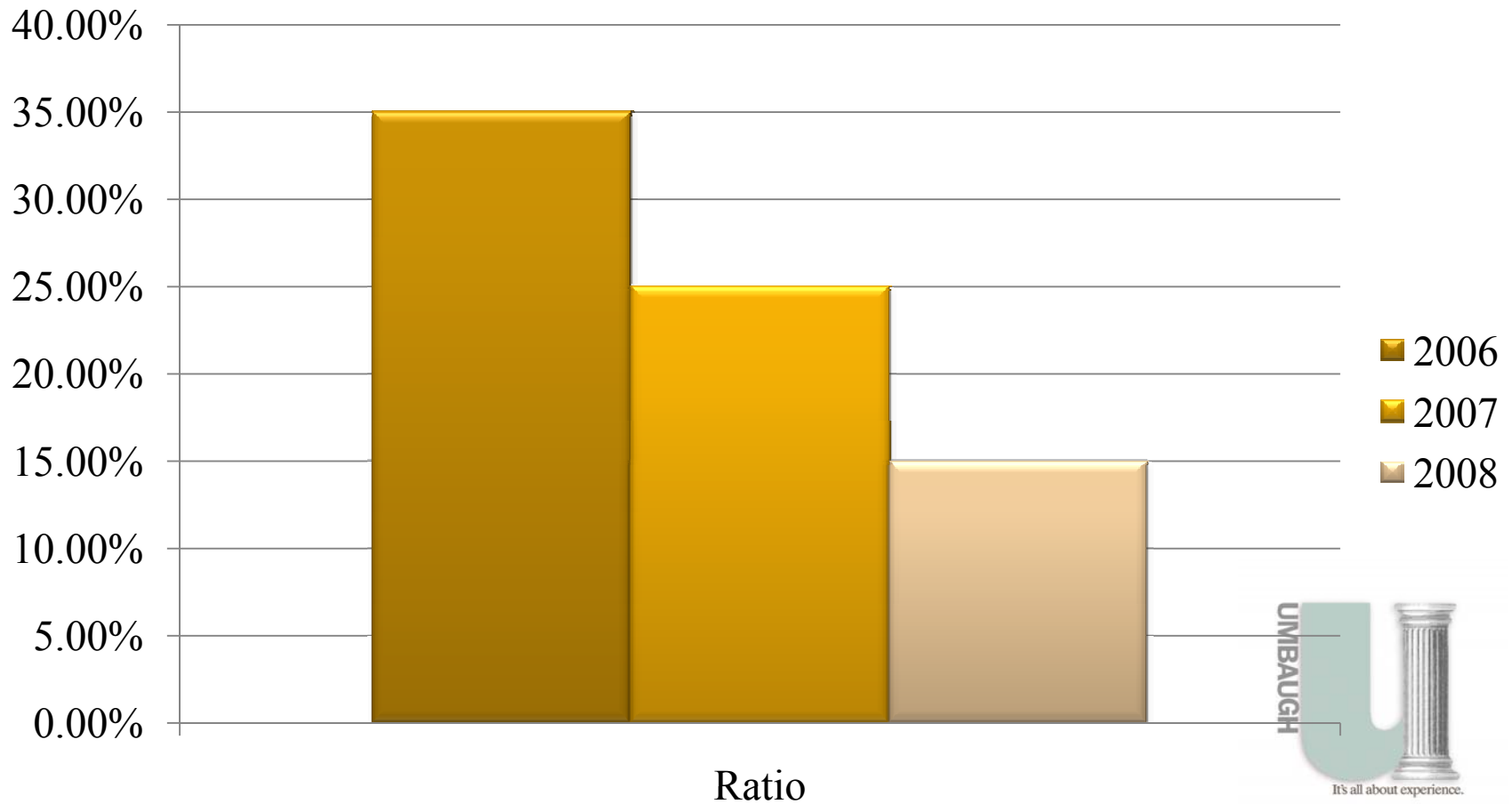


# Managing with Financial Ratios

- By identifying and understanding your key ratios, you can implement a financial plan to improve or maintain your creditworthiness and your bond rating
  - For instance, weak fund balances may contribute to a lower credit rating when compared with your peers. A budget strategy to restore fund balances over a period of time may improve your bond rating and reduce borrowing costs



# Ratio of General Fund Balance vs. Expenditures

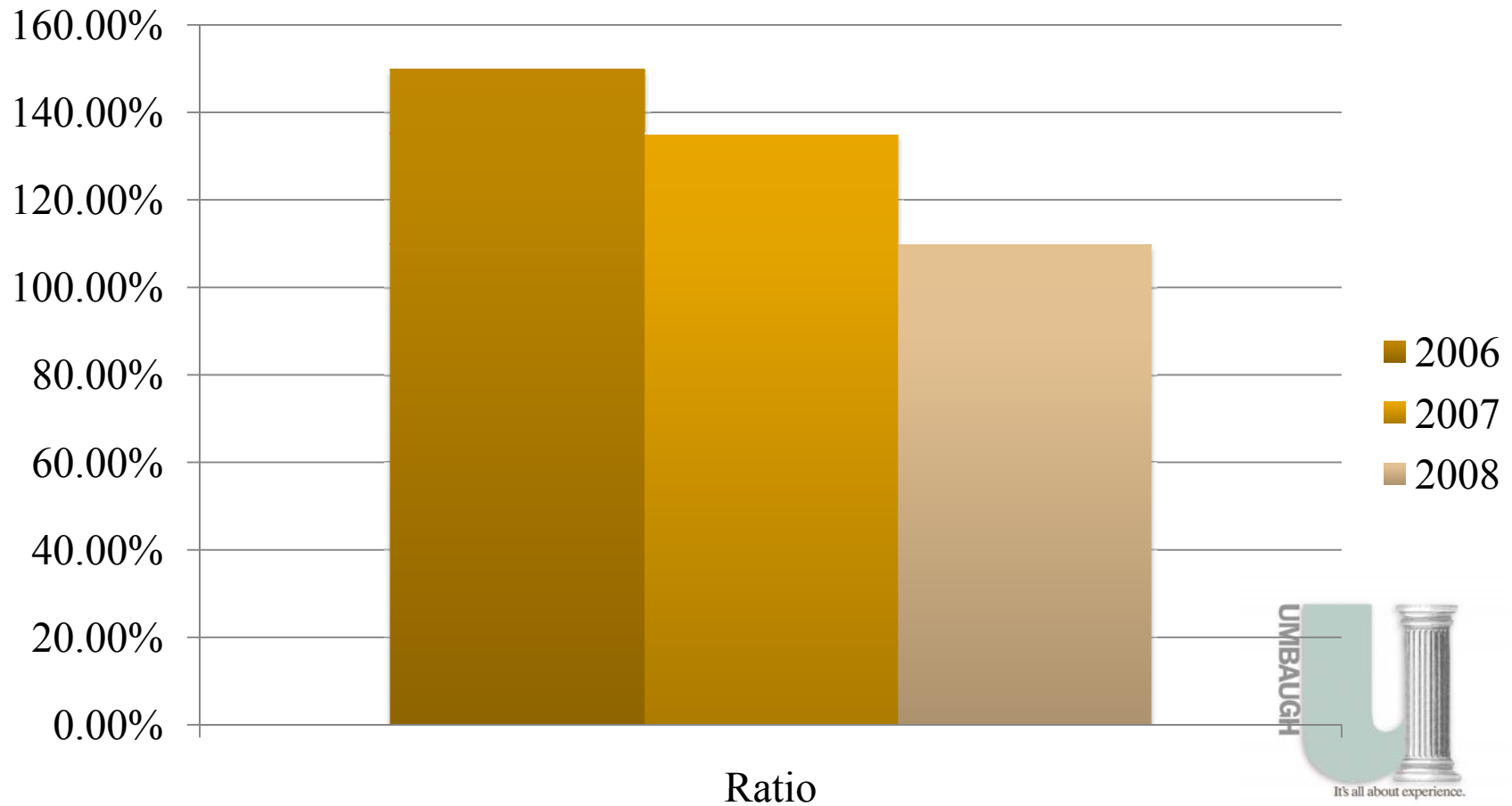


# Managing with Financial Ratios

- Weak coverage ratios for your water utility may suggest that it is time for a rate adjustment.
- Improving bond coverage ratios can influence bond ratings and reduce interest expense on new borrowing
- Many bond resolutions require minimum debt service coverage ratios



# Debt Service Coverage Of Waterworks Revenue Bonds



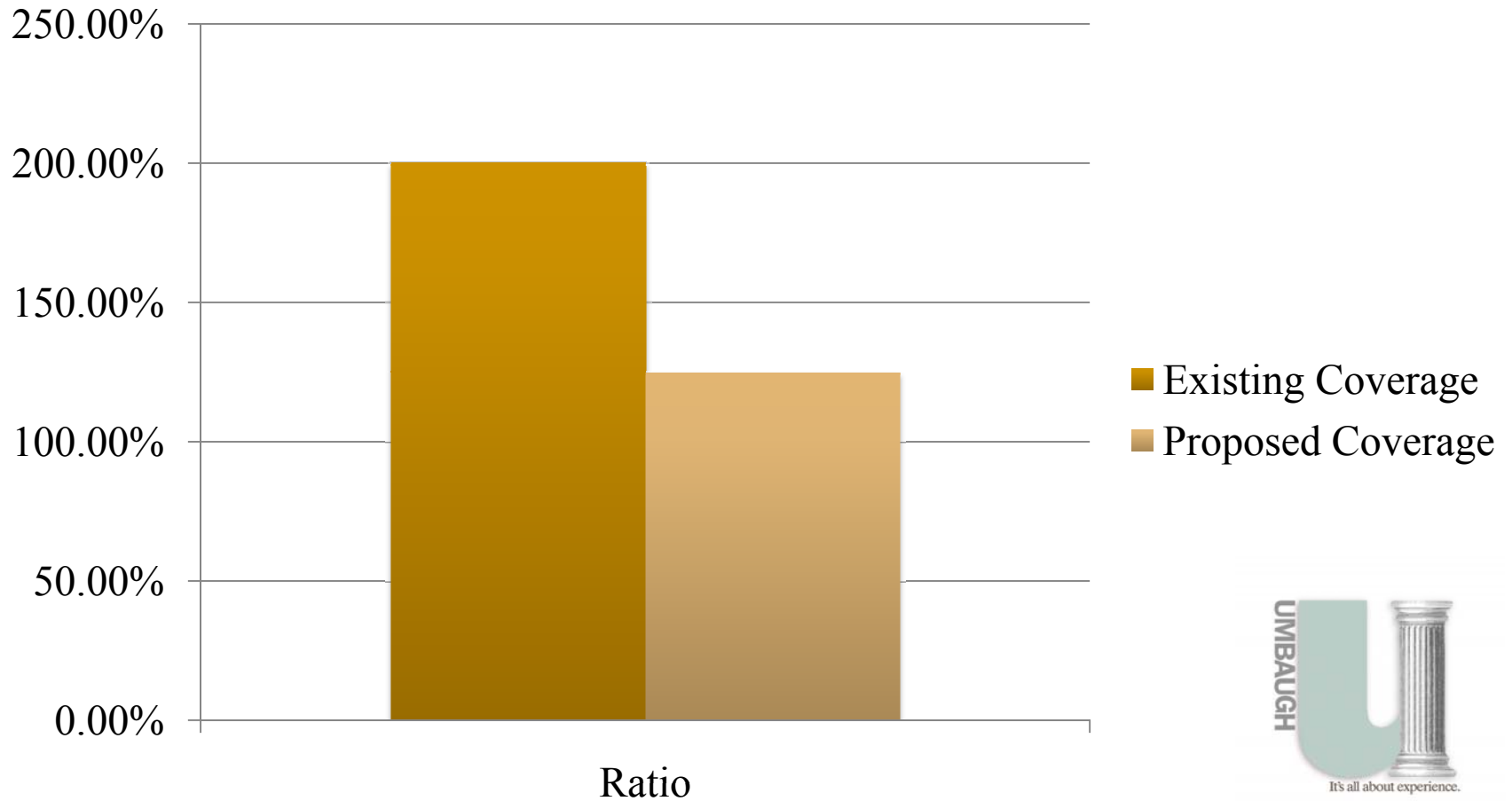
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# Managing with Financial Ratios

- Declining debt service coverage ratios within a Tax Increment Area may suggest the need to pledge additional revenue sources before issuing new debt



# Debt Coverage Ratios Within TIF Area

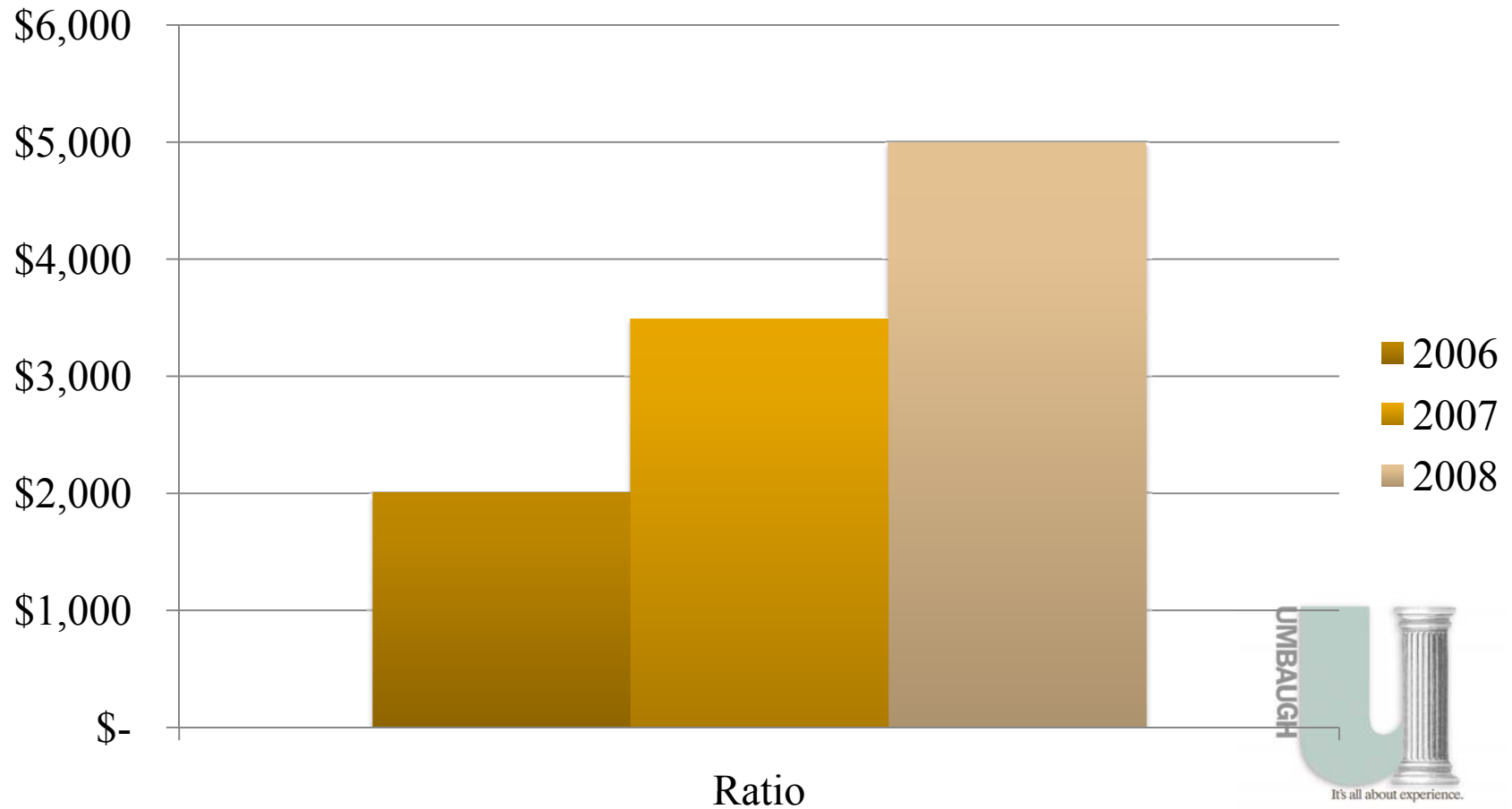


# Managing with Financial Ratios

- High net debt per capita and high net debt as a % of market value may suggest the need to develop a coordinated capital plan that utilizes existing revenues to fund capital needs on a “pay-as-you-go” basis rather than rely solely on borrowing
  - Reducing financial leverage can improve bond ratings and reduce borrowing costs for those projects where borrowing is necessary



# Net Debt Per Capita



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# Managing with Financial Ratios

- High concentrations in credit risk stemming from a limited number of large taxpayers may suggest a need for an economic development strategy to diversify tax base.
  - A diversified tax base will improve credit quality and reduce borrowing costs



# Managing with Financial Ratios

- Most financial ratios cannot be changed overnight. But understanding your financial trends will provide an opportunity to develop a long range strategy for improvement
- Demonstrating that you understand your financial and economic challenges and developing a business plan to address these issues, are a significant factors in the evaluation process

