Fitch Rates Milford, CT's $18.7MM GOs 'AAA' and $23.8MM BANs 'F1+'; Outlook Stable

Fitch Ratings-New York-23 October 2017: Fitch Ratings has assigned a 'AAA' rating to the following general obligation (GO) bonds to be issued by the city of Milford, CT:

--$18,725,000 GO bonds, issue of 2017.

Fitch also assigns an 'F1+' rating on the following bond anticipation notes (BANs) to be issued by the city:

--$23,795,000 GO BANs, due on Nov. 5, 2018.

The bonds and BANs are scheduled to sell competitively on Oct. 25. The proceeds of the bonds will be used to finance outstanding BANs and provide funding for various public improvement, school and sewer projects. The BANs are being issued to fund city, school and sewer projects.

In addition, Fitch has affirmed the city's Issuer Default Rating (IDR) of 'AAA' and the 'AAA' rating on approximately $115 million of outstanding GO bonds.

The Rating Outlook is Stable.

SECURITY
The bonds and notes are general obligations of the city, backed by the city's full faith and credit and unlimited taxing power.

ANALYTICAL CONCLUSION

The 'AAA' IDR and GO bond rating reflect the city's exceptional financial resilience given its high reserves relative to normal cyclical revenue fluctuations via the Fitch Analytical Sensitivity Tool (FAST), high legal revenue raising power, and solid expenditure flexibility. Fitch anticipates solid economic and revenue growth based on the city's favorable demographic profile and proximity to larger labor markets. Debt and pension liabilities have risen and pressure the city's current low long-term liability burden. The 'F1+' short term rating corresponds to the city's 'AAA' IDR, supporting strong market access for the long-term debt that will take out the BANs.

Economic Resource Base
The city of Milford is located in New Haven County along the Long Island Sound between New Haven and Bridgeport. The city is home to a stable population of roughly 54,000 residents that exhibits high educational attainment and personal income. Economic resources are largely derived from a fairly stable residential tax base, a vibrant manufacturing and retail component and major employment opportunities in local government, schools and healthcare.

KEY RATING DRIVERS

Revenue Framework: 'aaa'
General fund revenues are largely derived from property taxes which have grown strongly over the prior decade due to value appreciation. Fitch expects future tax base performance to be somewhat more modest, which could necessitate a higher level of policy action to maintain revenue growth compared to historical periods. The city maintains unlimited independent legal taxing authority.

Expenditure Framework: 'aa'
Education consumes about 45% of the adopted general fund budget. Education spending has been somewhat stable in recent years, in part due to declining enrollment, but the potential loss of education cost sharing funds related to the state's budget impasse could pressure the city's budget. Debt and pension costs have both risen in recent years but remain moderate overall. The city maintains flexibility to adjust personnel levels as needed, but employee wages are subject to the state's collective bargaining and binding arbitration requirements.

Long-Term Liability Burden: 'aaa'
The city's debt and the Fitch-adjusted net pension liability (NPL) is equivalent to roughly 10% of personal income which is in the upper range of the 'aaa' assessment. Future debt issuance plans are manageable but growth in the NPL, which Fitch believes is likely, could pressure this assessment over time in the absence of commensurate growth in residents' income. The city's principal

amortization rate is rapid.

Operating Performance: 'aaa'
Fitch expects the city to manage through periods of economic decline while maintaining a sound financial cushion on the basis of its superior level of budgetary flexibility and history of prudent financial management that includes limited recent deferrals of required spending.

RATING SENSITIVITIES
Management of Long-Term Liabilities: Fitch expects the city will take action to limit growth in its long-term liabilities by prudently managing execution of its capital improvement plan and notably improving funding of its single-employer defined benefit pension plan.

CREDIT PROFILE

Milford is primarily residential with some commercial and industrial presence represented by retail shopping centers and two power plants. Residents benefit from easy access to the employment market in southern Fairfield County. The city is home to Subway's world headquarters, which employs roughly 1,000 people in the city and has been increasing its workforce. Milford Hospital, and Schick, the razor manufacturer, along with the city and the school district, round out top employers. The top 10 taxpayers make up roughly 8% of total taxable assessed value (TAV), led by the Connecticut Post Shopping Center at 2%.

Revenue Framework
The city of Milford's general fund budget is largely financed from ad valorem property taxes, as is common for Connecticut local governments. The adopted fiscal 2018 budget totals nearly $206 million with about 85% funded from current and prior year taxes. The bulk of remaining general fund resources are derived from state education grants and PILOT revenue related to the operation of two privately-owned power plants within the city.

General fund revenues increased at a CAGR of 3.3% during the 10-year period ending fiscal 2016. The increase in revenue reflects an even stronger pace of growth in the city's tax base of 4.8% over the same period. The city's net taxable grand list was revalued as of Oct. 1, 2016 for fiscal 2018 at $6.5 billion or a 1.8% year-over-year increase. Property revaluation in Connecticut occurs every five years with tax base changes between revaluations limited to new development or adjustments due to appeals activity. Growth has slowed from the city's prior revaluation effective for fiscal 2013, which resulted in an 18% increase in the net taxable grant list. Median home prices in Milford, about $275,000 according to Zillow, remain roughly 15% below the pre-recession peak and have experienced only moderate annual growth the past five years. Housing price appreciation is expected to remain moderate and could hold back natural revenue performance relative to historical trends, despite improved building permit activity.

The ultimate amount of state aid for fiscal 2018 remains uncertain, given the state budget impasse. Fitch will continue to monitor the impact of the state budget on the city's revenue base. The city received approximately $15.7 million or 8% of its total general fund budget from statutory formula aid in fiscal 2017 (unaudited). Management reduced its assumptions for state aid in its fiscal 2018 budget to approximately $11 million (5% of budget), although recent budget proposals do not result in significant or unmanageable cuts in aid to the city or its schools.

The city has unlimited independent legal taxing authority over residential, personal and commercial property.

Expenditure Framework
Education is the largest area of categorical spending accounting for roughly 45% of the fiscal 2018 general fund budget followed by general government services at 16% (inclusive of employee benefits and insurance), public safety at 13% and public works at 6%.

Historical spending levels have aligned closely with revenue changes and a stable population in recent years has resulted in manageable service demands. Fitch expects future spending pressures to be associated with employee pension contributions following reductions in the plan's investment rate of return and moderate increases in debt service costs. It is unclear at this time how the state budget will impact the relationship between future revenues and expenditures although Fitch believes the city is well positioned with respect to expenditure flexibility and revenue control to address future changes.

The city has the ability to reduce expenses tied to its services, namely through the reduction of non-public safety staff at any time if necessary. General government staff levels today are largely unchanged from a decade ago, while education staffing has exhibited higher volatility in part due to shifts in enrollment. Union contracts are subject to arbitration but a decision may be rejected by a two-thirds vote by city council. A new arbitration panel would then be appointed by the state and their subsequent decisions are required to take into consideration the financial capability of the city.

Carrying costs for debt service, pension and other post-employment benefits (OPEB) were moderate at about 13% of governmental fund spending in fiscal 2016. Debt service, which represented about 6% of this figure, has increased by more than $5 million or 50% since fiscal 2010 to $15.4 million in fiscal 2018. The strong pace of outstanding GO debt amortization (69% over 10 years) combined with feasible borrowing demands should allow the city to manage its debt service burden going forward.

The pension portion of the carrying cost metric is based on the actuarially determined contribution (ADC) to the city's single-employer pension plan for municipal employees which has increased dramatically from $974 thousand in fiscal 2006 to $6.3 million in fiscal 2016 mostly due to a gradual reduction in the plan's investment rate of return from 8.25% to 7.5% over the past four years but also investment return results below expected levels. The city's contribution to the pension plan was below the actuarially-determined level in fiscals 2015, 2016, and 2017 by $1.9 million, $1.8 million, and $2.1 million respectively, a practice that is expected to exacerbate the rising ADC trend and place further pressure on the city's budget. The city has been increasing its pension funding commitment by a minimum of 15% each fiscal year, but Fitch is concerned that this gap will continue to grow if this practice continues. For fiscal 2018, management budgeted 63%, or $6 million, for the plan's $9.5 million ADC.

Long-Term Liability Burden
Fitch estimates the city's combined long-term liability burden of debt and net pension liabilities at roughly 10% of personal income following issuance which is at the upper range for a 'aaa' assessment. The metric includes about $190 million of direct debt and a Fitch-adjusted net pension liability (NPL) of roughly $155 million assuming a 6% return. The NPL reported by the city in accordance with GASB 68 requirements of approximately $75 million is based on the pension plan's 7.75% return assumption for fiscal 2016.

Both the city's direct debt and NPL have increased in recent years, and the long-term liability burden would likely become more consistent with a 'aa' KRF assessment if the trend is sustained without commensurate growth in personal income. The city has a five-year $156 million capital improvement plan, mainly comprised of school and sewer projects and a new proposed police station. Future borrowing plans have not been finalized and the capital plan is generally viewed as flexible.

The ratio of fiduciary net position to total pension liability for the general employee pension plan was reported at 81% as of June 30, 2016 or 67% on a Fitch-adjusted basis. Pension benefits for the city's board of education employees are provided by the state's Teachers' Retirement System (TRS); at present, the state is statutorily required to fund 100% of the required contribution to TRS.

The combined city and school department net OPEB liability is considerable at $267 million or 8% of personal income. Management expects the liability to decline in future years as a result of recent negotiations with labor that shifted more of the premium cost sharing burden to employees and the movement of new employees to health savings account plans. The city has made contributions to an OPEB trust since fiscal 2007. The city reports a balance in the OPEB trust totaling $6.7 million as of Aug. 31, 2017. The OPEB trust fund deposit budgeted for fiscal 2018 was $500,000, similar to previous years.

Operating Performance
Fitch views the city's resilience to normal cyclical downturns as very high. The assessment reflects the city's low historical revenue volatility with FAST yielding a minimal -1% potential change in general fund revenue under the standard -1% U.S. GDP scenario. In the FAST scenario the city could tap a portion of its unrestricted general fund reserves which stood at close to $30 million in fiscal 2016 or 13% of spending. Reserves have been steadily maintained through economic cycles, demonstrating a commitment to compliance with a stated fund balance policy of 5% of spending. The city could also offset cyclical revenue declines by increasing its property tax millage rate and levy, neither of which are subject to charter or statutory cap. The city's expenditure profile represents a lesser source of budgetary flexibility but is still viewed as solid given the city's legal control on staff size and moderate debt and pension costs.

Fitch's view of the city's budget management and its recent financial results is tempered by recent underfunding of the pension ADC. The city would have generated operating surpluses in the three years that it underfunded the ADC holding all other financial results equal. Periodic operating deficits have been modest (approximating 1% of spending) and the city has taken swift action to return the budget to balance while maintaining compliance with a reserve fund policy that provides an exceptional level of protection against cyclical revenue declines. The city's efforts to control its health care costs and fund an OPEB trust are other positive credit factors.

Unaudited results for fiscal 2017 provided by the city show a very strong $9 million budgetary surplus equivalent to 4.5% of spending compared to the budgeted use of $3.5 million in reserves. The strong results reflect, in part, very strong tax collection efforts including proceeds from a tax lien sale, increases in building and conveyance fees, and expenditure controls as well as the underfunding of the ADC. The fiscal 2018 general fund budget of $206 million benefits from 1.8% growth in the tax base, a modest reduction in the millage rate and a reduction in state aid. Expenditure drivers are associated with debt service and employee related costs. The budget includes an appropriation of $5 million from fund balance. Management has indicated to Fitch that results to date are tracking as expected.

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Applicable Criteria
Rating U.S. Public Finance Short-Term Debt (pub. 08 Feb 2017) (https://www.fitchratings.com/site/re/893974)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

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