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Ratings

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Summary:

Waterbury, Connecticut; General Obligation

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Credit Profile		
US$50.0 mil GO bnds ser 2017A due 10/15/2047		
Long Term Rating	AA-/Stable	New
US$13.59 mil GO rfdg bnds ser 2017B due 09/01/2029		
Long Term Rating	AA-/Stable	New
Waterbury GO		
Long Term Rating	AA-/Stable	Affirmed, Removed from CreditWatch

Rationale

S&P Global Ratings affirmed its 'AA-' long-term rating on Waterbury, Conn.'s general obligation (GO) debt outstanding and removed the rating from CreditWatch with negative implications, where it had been placed on Sept. 28, 2017. At the same time, we assigned our 'AA-' long-term rating to the city's issue of 2017, series A GO bonds and its issue of 2017, series B GO refunding bonds. The outlook is stable.

The removal of the rating from CreditWatch reflects our view that Waterbury has the ability to manage cuts in total state aid, which are expected to amount to approximately $5.6 million in fiscal 2018 and an additional $2.1 million in fiscal 2019 below the city's fiscal 2018 budgeted amounts, as well as the city's stabilization of its internal health benefits fund.

The rating reflects our view of a pledge of the town's full-faith-credit-and-resources and an agreement to levy ad valorem property taxes without limit to rate or amount secures the bonds. We understand that town officials will use the series A bonds to fund multiple public works and school projects, and that series B bond proceeds will be used to refund previously issued GO debt for a net present savings.

The rating additionally reflects our view of Waterbury's:

- Weak economy, with projected per capita effective buying income (EBI) at 71.7% and market value per capita of $54,786, though that benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with "strong" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with break-even operating results in the general fund but a slight operating surplus at the total governmental fund level in fiscal 2016;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2016 of 5.7% of operating expenditures;
- Very strong liquidity, with total government available cash at 10.3% of total governmental fund expenditures and 114.4% of governmental debt service, and access to external liquidity we consider strong;;
- Very weak debt and contingent liability position, with debt service carrying charges at 9.0% of expenditures and net direct debt that is 87.4% of total governmental fund revenue, as well as a large pension and other postemployment

benefit (OPEB) obligation and the lack of a plan to sufficiently address it; and
- Strong institutional framework score.

Weak economy

We consider Waterbury's economy weak. The city, with an estimated population of 108,223, is in New Haven County approximately 30 miles southwest of Hartford and 75 miles north of New York City. It is in the New Haven-Milford MSA, which we consider to be broad and diverse. The city has a projected per capita EBI of 71.7% of the national level and per capita market value of $54,786. Overall, market value grew by 1.4% over the past year to $5.9 billion in 2018. The county unemployment rate was 5.5% in 2016.

Waterbury lies on the convergence of two major expressways, Interstate 84 and Connecticut Route 8, providing easy access to the surrounding areas. The I-84 widening project, a long-sought expansion, is progressing, and officials are already crediting the project with helping economic development in the city. The project is scheduled for completion in late 2019.

The manufacturing, health care, and higher education sectors have significant representation in the economy, providing employment opportunities both locally and regionally. Major employers include Waterbury Hospital (2,000 employees), St. Mary's Hospital (1,903), Naugatuck Valley Community College (951), and Post University (530). The University of Connecticut is also increasing its footprint in the city, and is helping generate redevelopment of downtown properties for student leased housing. Other major developments include the Waterbury Industrial Commons, an industrial park owned by the city, whose presence helped draw King Industries (200 employees), a chemical company, from a nearby town. It is anticipated that the city will continue to develop the site for future tenants. Officials credit the Waterbury Career Academy with providing technical education to the city's students, while also helping to stabilize the manufacturing employment base. Waterbury has seen an uptick in retail development as well. We expect, however, that despite the recent development, Waterbury's wealth and income metrics will remain weak through the two-year outlook period.

Very strong management

We view the city's management as very strong, with "strong" financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The city's strong management practices are in place to achieve management's clear goal of structural balance. Management examines revenue and expenditure trends and uses the data to make realistic budget assumptions to attain positive operating results. As evidenced by management's recent changes to its health benefits structure, the management team can recognize issues and work to implement changes as necessary. Budget-to-actual results are reviewed frequently and reported to the board of aldermen monthly. The city has a comprehensive rolling five-year capital plan that looks at both facilities and infrastructure improvements and identifies funding sources. The city also maintains a multiyear financial plan where future issues are identified and revenue and expenditure decisions are made from a long-term perspective. The city has its own investment policy and reports holdings and returns to the aldermen semiannually. In addition, it maintains a 5% fund balance policy for its unassigned funds, a level it has historically met, and also maintains basic debt management practices that addresses debt maturity, debt limits, and the debt schedule.

Strong budgetary performance

Waterbury's budgetary performance is strong, in our opinion. The city had break-even operating results in the general fund, but a slight surplus result across all governmental funds of 0.8% in fiscal 2016. General fund operating results of the city have been stable over the last three years, with results of 0.0% in 2015 and 0.0% in 2014.

Waterbury's strong financial performance stems from several factors. The city has raised its tax levy in the past when necessary to accommodate budgetary growth or reductions in state aid, and management is active in working with department heads to keep costs in line with the budget. The city instituted a Cost-Containment and Oversight Committee (CCOC) in cooperation with its department heads in the fall of 2012. The task of the CCOC is to review all Waterbury's hiring and purchasing activities weekly. We note the CCOC has been instrumental in achieving consistently strong operating results.

We adjusted fiscal 2016 performance to account for recurring transfers from the general fund to the debt service fund and nonmajor governmental funds. We also adjusted for one-time capital projects paid from grants and bond proceeds. While the city consistently produces general fund surpluses before transfers out, due to an IRS restriction on unassigned general fund balance, it must transfer out or otherwise restrict any general fund surplus that would result in an increase in unassigned fund balance above 5.0%.

The city is anticipating a modest general fund surplus in fiscal 2017 of approximately $6.8 million. Of this, $6.4 million will be transferred into other funds, including $1.5 million for the capital reserve, $1 million for the workers compensation fund, and $1.3 million for the health benefits fund.

The state of Connecticut recently resolved a prolonged budget dispute. The biennial budget reduced Waterbury's state aid by $5.6 million below the city's budget in fiscal 2018 (3.3% of the city's budgeted state-aid) and an additional $2.1 million in fiscal 2019. The city has indicated that it expects to use a budgeted contingency, cancel general fund contributions to the capital improvement fund, and continue its emergency spending controls to meet the fiscal 2018 state-aid reductions. We expect that management will successfully adjust to the reduction of state aid and produce another year of positive operations in fiscal 2018. In fiscal 2019, we expect that the city will find flexibility in the budget to account for the additional loss of $2.1 million.

Property taxes accounted for 57% of general fund revenue in fiscal 2016, while intergovernmental was 38%.

Adequate budgetary flexibility

Waterbury's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2016 of 5.7% of operating expenditures, or $23.7 million.

The city has a working capital restriction limiting it to a general fund unassigned balance of 5%, a level it has maintained over the past several years. It also has several internal service funds, from which it could get funds for operations if required. As of 2014, the city maintained an OPEB reserve fund, with a balance of approximately $18 million. In fiscal 2015, it closed the OPEB reserve and transferred the funds to the health services fund to stabilize it following several years of deficits. The health services fund expended the entirety of the transfer, reducing budgetary flexibility to adequate from strong. The city undertook actions to stabilize the health services fund, the largest of which was a Medicare enrollment initiative, along with instituting dependent eligibility restrictions, and targeted pharmacy cost containment. For fiscal 2017, unaudited results show that the health services funds operations have stabilized, and it is anticipated that the fund will have a $7 million surplus, resulting in a positive fund balance of approximately $3 million. Management does not intend to reopen the OPEB reserve, but does intend to continue building reserves in the health benefits and other internal funds outside of total governmental funds. Given the strength of the plan to stabilize the health services fund, as well as management's intention to rebuild reserves over the course of several years, we expect that reserves will rise modestly in audited 2017 results, but may remain level in fiscal 2018 as the city adapts to reduced state-aid. While we expect that reserves will increase from fiscal 2016 levels, we do not expect that our view of the strength of the reserves will change during the outlook period. Alternatively, any additional draw on available funds will likely result in a revised rating downward.

Very strong liquidity

In our opinion, Waterbury's liquidity is very strong, with total government available cash at 10.3% of total governmental fund expenditures and 114.4% of governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

Waterbury has demonstrated strong external liquidity by issuing GO bonds in the past 20 years. The city does not currently have any contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. While we do not anticipate deterioration in liquidity, should a decline occur, we could revise the rating downward.

Very weak debt and contingent liability profile

In our view, Waterbury's debt and contingent liability profile is very weak. Total governmental fund debt service is 9.0% of total governmental fund expenditures, and net direct debt is 87.4% of total governmental fund revenue.

Following this issuance, the city will have approximately $474 million in outstanding direct GO debt, of which we consider $4.5 million self-supporting through user fees. We understand that the city may issue debt in November 2019, but that the principal amount will be approximately the amount paid off in fiscal years 2018 and 2019, so we do not anticipate any effect on the debt profile.

In our opinion, a credit weakness is Waterbury's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. Waterbury's combined required pension and actual OPEB contributions totaled 11.8% of total governmental fund expenditures in 2016. Of that amount, 3.3% represented required contributions to pension obligations, and 8.5% represented OPEB payments. The city made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 63.7%.

The city is the administrator of the City of Waterbury Retirement System, a single-employer public employee retirement system (PERS). While the funded ratio of the system improved dramatically following the issuance of pension bonds in 2009, we believe pension costs will continue to rise over the medium term. Waterbury's pension plan had a funded ratio of 63.7% as of June 30, 2016, with a net pension liability of $222 million. However, the July 1, 2015 valuation shows an improved funded ratio of 71.5% and a net pension liability of $169 million. The city lowered the discount rate to 8.0% from 8.2% for the July 1, 2016 valuation. As a result, we anticipate the funded ratio will decrease and the net pension liability and actuarial determined contribution will rise.

Waterbury provides OPEBs in the form of health care and other benefits to retirees and their spouses. The city included OPEBs in its effort to address rising health care costs and liabilities. The unfunded actuarial accrued liability (UAAL) rose between the 2012 and 2014 valuations from $890 million to $988 million. However, following the efforts to address the OPEB liability, the city expects to report a UAAL of $894 million, as of July 1, 2017. OPEB is funded on a pay-as-you-go basis. While Waterbury's efforts helped reduce the liability by $94 million, the city had been projecting as much as $125 million in reduced liability. Additionally, it is unclear what additional steps it could take to have a meaningful impact in reducing the total liability and its effects on the annual budget. We expect that pension and OPEB costs will continue to pressure the city's budget over the next several years.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

The stable outlook reflects our view of Waterbury's consistently strong operating performance, supported by a modestly growing economic base and very strong management. Additionally, we expect that management will slowly rebuild reserves given its stabilization of the health benefits fund and successfully incorporation of state-aid cuts into the budget, without affecting budgetary performance or flexibility. We do not expect to revise the rating during the two-year outlook period.

Downside scenario

If the city is unable to absorb the fiscal year 2018 and 2019 reductions in state aid; or faces budget pressures from increased health care, pension and/or OPEB costs, leading to reduced budgetary performance; or experiences any decline in budgetary flexibility or liquidity, we would lower the rating.

Upside scenario

We believe that the city's very weak debt and liability profile currently constrain the rating. In our view, despite the significant steps initiated by management to reduce the city's future pension and OPEB obligations, rising costs associated with these long-term liabilities could challenge the city. Should the debt profile improve, coupled with higher wealth and income levels and strengthened reserves, we could raise the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Ratings Detail (As Of November 8, 2017)		
Waterbury pension oblig (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed, Removed from CreditWatch

Ratings Detail (As Of November 8, 2017) (cont.)		
Waterbury GO		
Long Term Rating	AA-/Stable	Affirmed, Removed from CreditWatch
Waterbury GO (ASSURED GTY)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed, Removed from CreditWatch
Waterbury GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed, Removed from CreditWatch
Waterbury GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed, Removed from CreditWatch
Waterbury GO		
Long Term Rating	AA-/Stable	Affirmed, Removed from CreditWatch
Waterbury GO		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed, Removed from CreditWatch

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.