

RatingsDirect®

Summary:

Middletown, Connecticut; General Obligation

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Credit Profile

US\$10.0 mil GO bnds ser 2018 due 04/01/2029

<i>Long Term Rating</i>	AAA/Stable	New
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Middletown GO

<i>Long Term Rating</i>	AAA/Stable	Affirmed
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Rationale

S&P Global Ratings has assigned its 'AAA' rating to Middletown, Conn.'s series 2018 general obligation (GO) bonds, and affirmed its 'AAA' rating on the city's outstanding GO debt. The outlook is stable.

The city's unlimited GO pledge secures its bonds to levy ad valorem taxes without limit as to rate or amount on all taxable property within its borders. We understand that the proceeds will be used to finance various capital improvement projects.

Middletown's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the city has a predominately locally generated revenue source, with 68% of general fund revenue derived from property taxes with independent taxing authority and independent treasury management from the federal government.

In our view, the AAA rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund but a slight operating deficit at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 24.4% of total governmental fund expenditures and 3.4x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 7.2% of expenditures and net direct debt that is 45.6% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 89.4% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Middletown's economy very strong. The city, with an estimated population of 47,218, is in Middlesex County in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 117% of the national level and per capita market value of \$104,373. Overall, market value grew by 3.5% over the past year to an estimated \$4.9 billion in 2019. The county unemployment rate was 4.4% in 2016.

Middletown residents have direct highway access to regional employment centers via Interstate Highway 91 and State Highways 9, 17, 66, and 72. The city is home to a number of large private employers in the education and health care sectors. Middletown is also home to a number of aerospace and defense manufacturing companies, notably United Technologies and Kaman Aerospace. The city recently was selected as the site of a new 535,000-square-foot FedEx hub, slated to open in 2018, employing more than 500.

Property values in the city are rising. Since the last revaluation in 2013, grand list values grew by 4%. The city reports no major tax appeals stemming from the revaluation. In addition to the new FedEx facility, city officials note continued smaller developments for residential and mixed-use purposes downtown should aid in additional tax base growth in the near term. The city is also planning investments to promote development along its riverfront, which should cater to further development over time.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

We believe the city maintains conservative budget assumptions, with actual results consistently outperforming budgeted revenue and expenditures. Budget preparation is supported by the use of at least three years of trend data. Monthly budget-to-actual reports are shared with the city's common council, which may amend the budget as necessary throughout the year. The city does not prepare a long-term financial plan but has a four-year capital improvement plan outlining sources and uses on a rolling basis.

The city maintains a formal investment management policy with monthly holdings and earnings presented to the common council. The debt management policy limits debt amortization to 10 years--other than loans from the state Clean Water Fund--but does include affordability metrics outside of state guidelines.

The fund balance policy call for the maintenance of an unassigned general fund balance of 12%-15% of the previous year's operating expenditures to meet cash flow needs. If reserves decline below 12%, the policy requires a plan for replenishment within two years.

Strong budgetary performance

Middletown's budgetary performance is strong, in our opinion. The city had balanced operating results in the general fund of 0.2% of expenditures, but a slight deficit result across all governmental funds of negative 0.8% in fiscal 2017. General fund operating results of the city have been stable over the last three years, with results of 0.3% in 2016 and 0.9% in 2015.

Despite the state's current fiscal challenges and growing uncertainty regarding intergovernmental aid to local governments, the effects on Middletown's overall finances and budgetary performance have been minimal so far. Available reserve balances at the close of fiscal 2018 remain high, and we believe the city has shown a strong track record through its financial management policies and directives of making the necessary revenue and expenditure adjustments to yield balanced operations without impairing future budgetary flexibility.

Our assessment of the city's 2017 operating performance adjusts for capital spending paid for with bond proceeds. Officials attribute continued strong financial performance to better-than-budgeted tax revenues related to delinquent collections and continued streamlining of city operations, allowing for positive expense variance over the past audited year. Middletown derives more than 68% of operating revenues from local property taxes.

Officials expect fiscal 2018 (ending June 30) to end with stable operations, barring unforeseen costs. Expenditures remain stable, and the city continues to budget conservatively for revenues. The city is currently preparing its fiscal 2019 budget, and management intends to hold state aid flat. We anticipate management's adherence to its policies and conservative budgeting practices will allow the city to maintain strong financial performance over the near term.

Very strong budgetary flexibility

Middletown's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 19% of operating expenditures, or \$30.9 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 18% of expenditures in 2016 and 18% in 2015.

Given our opinion of the city's ability to maintain balanced operations, we do not expect to change our view on the strength of available reserves. However, we note the fund balance policy allows for unassigned reserve amounts above 12% to be transferred out for its retirement benefit trusts, for nonrecurring capital expenditures and to reduce the tax rate.

Very strong liquidity

In our opinion, Middletown's liquidity is very strong, with total government available cash at 24.4% of total governmental fund expenditures and 3.4x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We believe Middletown's strong access to external liquidity is supported by its regular debt issuances, including GO debt. We do not view the city's investments as aggressive, with the majority in mutual funds and fixed-income securities. Middletown has consistently had very strong liquidity, and we do not expect to change our score.

Very strong debt and contingent liability profile

In our view, Middletown's debt and contingent liability profile is very strong. Total governmental fund debt service is 7.2% of total governmental fund expenditures, and net direct debt is 45.6% of total governmental fund revenue. Overall net debt is low at 2.5% of market value, and approximately 89.4% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

The city anticipates issuing about \$10 million to \$15 million in additional debt in 2019 to finance several capital projects. Given its low overall net debt and net direct debt levels, we do not expect our assessment of the debt profile to weaken.

Middletown's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 5.8% of total governmental fund expenditures in 2017. Of that amount, 1.3% represented required contributions to pension obligations, and 4.5% represented OPEB payments. The city made its full annual required pension contribution in 2017.

The city is the administrator of the Middletown Retirement System Fund, a single-employer defined-benefit pension system. It has historically contributed 100% of its actuarially determined contribution. The plan is overfunded with a 110.4% plan fiduciary net position of the total pension liability. The city also participates in the state Teachers Retirement Board, but reports no associated liability as school district employers are not required to make contributions to the plan.

The city provides retiree medical benefits for the lifetime of the retired member and covered dependents. We note the city has set up an OPEB trust as part of its plan to manage the associated liability. As of July 1, 2016, the plan had an actuarially determined funding ratio of 4.5%, with an unfunded liability of about \$208 million. Management notes plan assets have increased by more than \$1 million since the last valuation date.

Strong institutional framework

The institutional framework score for Connecticut municipalities is strong.

Outlook

The stable outlook reflects our view of the city's very strong economy, benefiting from Middletown's participation in the broad and diverse Hartford MSA. It also reflects management's conservative practices, which have supported strong budgetary performance and budgetary flexibility. Although unlikely during the two-year outlook period, should financial performance weaken, resulting in a sustained decline in budgetary flexibility, or if economic indicators significantly worsen, we could lower the rating. We do not expect to change the rating within the outlook's two-year period.

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.

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