FitchRatings

Fitch Rates Hamden, CT's GO Bonds 'BBB+' and BANs 'F2'; Outlook Stable

Fitch Ratings-New York-05 June 2018: Fitch Ratings has assigned the following general obligation (GO) ratings to the town of Hamden, CT:

--$11,400,000 GO bonds, issue of 2018 at 'BBB+';
--$2,000,000 GO bond anticipation notes (BANs) at 'F2'.

Fitch also affirms the 'BBB+' rating on the town's outstanding GO bonds, series 2009B (taxable), series 2011A, series 2011B, series 2012, series 2013, series 2014A, series 2015 and series 2015 (taxable). The town's Issuer Default Rating (IDR) is also affirmed at 'BBB+'.

The Rating Outlook is Stable.

The GO bonds and BANs will be sold on a negotiated basis on or about June 13. Proceeds of the bonds will fund various capital projects in the town. Proceeds of the BANs will cover various remediation and clean-up costs related to a natural disaster event earlier this year.

SECURITY
The bonds and BANs are a general obligation of the town backed by its full faith, credit and unlimited taxing power.

ANALYTICAL CONCLUSION

The 'BBB+' IDR and GO rating reflect the town's weak financial profile given its low reserves and spending pressures associated with higher scheduled debt service costs and the recently achieved ramp-up to full funding of the pension actuarially determined contribution (ADC). Furthermore, Fitch expects the town's natural revenue growth to remain low to stagnant based on expectations for housing appreciation and new development activity. Some combination of tax rate increases or debt restructuring is likely to address near-term budgetary challenges. Millage rates are already considered moderately high relative to other local governments in the state.

The town's long-term liabilities are elevated and further pressured from a very high other post-employment benefit (OPEB) liability despite the town's success in alleviating in recent years. The 'F2' rating on the town's BAN's is linked to the long-term credit quality of the town, as expressed through the IDR.

Economic Resource Base
Hamden is located north of New Haven and about 35 miles southwest of Hartford. The town is primarily residential in nature and had a 2016 census population of 61,125 which is a modest increase since 2010. The town is home to Quinnipiac University and is roughly five miles from Yale University contributing to a notable presence in education. Employment and demographic indices largely reflect those of the state.

KEY RATING DRIVERS

Revenue Framework: 'a'
The town derives the bulk of its revenues from property taxes, for which changes in the levy or millage rate are not restricted by law. The town's tax base has been subject to revaluation-based declines over the prior decade and very modest increases due to new development, necessitating millage rate increases to support spending.

Expenditure Framework: 'bbb'
Spending pressures are evident in the town's escalating debt service structure, expectations for higher pension contributions given the low funded status of the town's single-employer pension plan and history of pension underfunding, and uncertain capacity to achieve cost savings without affecting service levels given the high proportion of debt service, retiree benefits, and critical education and public safety spending to the overall budget.

Long-Term Liability Burden: 'a'
Fitch expects Hamden's long-term liability burden to remain elevated in relation to personal income due to potential growth in outstanding pension liabilities, additional debt plans and slow population gains. Additionally, the town's unfunded other post-employment benefits (OPEB) liability is very high, although the town has made some progress to curb future benefits.

Operating Performance: 'bbb'
The town has maintained reserves at a very low 1%-2% of spending dating back to fiscal 2010 and Fitch does not anticipate a meaningful increase in fund balance in the

near term. The combination of low reserves and limited spending flexibility contribute to a financial profile that is likely to become distressed from unexpected events or a cyclical downturn. Spending deferrals and use of non-recurring revenue sources have been utilized to maintain budget balance.

RATING SENSITIVITIES

Management of Budgetary Pressures: The town faces several budgetary challenges that could lead to negative rating action in the near term. Rating stability is predicated on management's ability to meet these demands while maintaining fiscal balance and avoiding further weakening of already low reserves and liquidity.

Revenue Shift: A change in Fitch's expectation for sustainable growth in the tax base and revenue performance could affect the town's revenue framework assessment and lead to a change in the rating.

CREDIT PROFILE

Hamden's economic resource base largely reflects its position as a residential community. The tax base exhibits good wealth (as measured by a market value per capita of approximately $90,000) and resident income indices approximate those of the wealthy state. However, tax base performance has been somewhat lackluster both in terms of new development and price appreciation and the town's population has grown at a very modest pace. Industry is clustered around healthcare, bioscience and education due to the town's proximity to a number of higher education institutions including Yale University in nearby New Haven. Quinnipiac University is one of the town's largest employers and has roughly 6,500 undergraduate students.

Revenue Framework

Hamden's primary source of revenues is property tax, which typically approximates 75% of general fund revenues. Other key revenue sources for the town include state aid, the bulk of which is specifically dedicated for the operation of the town board of education (BOE).

Fitch expects the town's general fund revenues to remain fairly stagnant or to increase below the level of inflation in the foreseeable future absent policy action. The town's tax base continues to contract with a 5% decline based on the five-year revaluation effective for fiscal 2017. The tax base essentially remained flat for both fiscal 2018 and fiscal 2019 at just under $3.9 billion. The value for new building permits experienced an uptick for fiscal 2018, but remains fairly low relative to the total size of the tax base.

The town's weak revenue prospects also reflect recent contraction in state aid, the second largest component of general fund revenues, driven by state's ongoing fiscal challenges. Budgeted at roughly $30 million or 13% of the general fund budget for fiscal 2019, state aid revenues were reduced about $5.5 million (on a net basis) mid-year fiscal 2018. Of the state aid budgeted for fiscal 2019, a total of $24 million is for the BOE, which is designated among the state's Alliance Districts (or low performers) that the state has held impervious to cuts in aid thus far. Fitch is not assuming growth in state aid at this time.

General fund revenue growth has largely been supported by tax rate increases adopted by the town. The town has full legal control over its property tax levy and rate. The town's millage rate increased in seven consecutive years from fiscal 2010-2017 or 54% in aggregate. The tax rate was reduced modestly in fiscal 2018 before a $2.7 million, or roughly 6%, increase was approved for fiscal 2019. The town's equalized millage rate was eighth-highest in the state out of 169 municipalities and 149% of the state median according to the Municipal Fiscal Indicators report published by the state's Office of Policy and Management (OPM) in December 2017. However, the town's tax levy per capita was only slightly above the state median.

Expenditure Framework

BOE spending, excluding related employee pension and medical insurance costs, consumes roughly 37% of the approximately $232 million fiscal 2019 general fund budget. Medical and pension benefits for town and BOE employees account for another 30% of spending of the budget followed by public safety expenditures at about 13%. Scheduled debt service payments are more than $28 million or 12% of spending; however, the town expects to trim its near-term annual debt payments by $12 million-$13 million via debt restructurings to be consummated during the upcoming fiscal year. Scheduled debt service payments have risen dramatically in the last several years, largely due to the issuance of $125 million in GO pension obligation bonds (POBs) in 2015.

Fitch expects the town's overall spending needs will increase above the pace of the town's mostly stagnant natural revenue growth. The combination of increased debt service and full funding of the actuarial determined contribution (ADC) for the town-administered pension plan are key drivers of the town's rising costs. The town was required by state law to increase funding to its pension plan to equal 100% of the ADC within 4 years after issuance of its POBs (or fiscal 2019). A recent amendment to state law now allows the town to fund only 70% of the $22.6 million ADC in fiscal 2019 increasing to 100% by fiscal 2021. The town has indicated it has budgeted the full ADC for fiscal 2019 as required under the old state law; however, the town may consider deferring a portion of the ADC in order to alleviate other budget stresses that may arise.

The town continues to rely on refunding savings and restructurings for budget relief. The town's current debt structure features a roughly $8 million (more than 3% of budgeted spending) increase in debt service costs in fiscal 2019 over the prior year budget. Debt service costs would then remain at or close to that level through 2023. However, as noted above, the town is contemplating a debt restructuring that would achieve $12 million-$13 million in debt service savings in fiscal 2019, at a net present value cost. These debt service savings are already assumed in the fiscal 2019 budget. The town's annual debt service requirements would then be scheduled to increase anywhere from $6.5 million to $10.5 million through fiscal 2024 (or the equivalent of approximately 3% to 4.5% of the fiscal 2019 budget) under the various restructuring proposals under consideration. The increased debt service costs would likely require some other form of debt or budget maneuvering absent higher than anticipated growth in the tax base.

In fiscal 2017, the town's actual debt service and OPEB payments, together with the full required pension ADC, accounted for a relatively high 21% of total governmental spending. As noted above, Fitch expects the town's annual debt service obligations to increase over the next several years based on its current debt schedule and restructuring plans. The town's charter limits annual debt service costs for capital projects to no greater than 10% of the town's budget and 4% for non-capital related projects (such as for pension obligation bonds), unless otherwise approved by voters. Total capital and non-capital debt service levels for fiscal 2018 were roughly 6% and 4% of the budget, respectively. The current scheduled fiscal 2019 debt service related to capital projects is closer to 9% of budget.

Retiree costs are also likely to rise if the town continues to underfund its pension ADC and if pension plan assumptions are not met. The town has successfully negotiated changes to its pension plan for public safety bargaining units and medical coverage for all labor groups. Pension changes include a reduction in the COLA cap and an increase in the employee contribution, and on the medical side all labor groups now participate in a high-deductible health plan. The town's current pension and OPEB disclosure does not reflect the entirety of benefit reductions agreed to; for example, the town estimates a minimum of $2 million in savings in the pension ADC alone that has not been incorporated in the fiscal 2019 budget.

Union contracts are subject to arbitration but a decision may be rejected by a twothirds vote by the town's legislative body. A new arbitration panel would then be appointed by the state and their subsequent decisions would be required to take into consideration the financial capability of the employer. The town made cuts to full-time positions over the previous recession through layoffs, combining positions and privatizing certain services and indicated that additional expenditure flexibility above this remains in order to address a future downturn.

Long-Term Liability Burden

Long-term liabilities for debt and unfunded pension obligations are estimated at a moderate 19% of personal income. Fitch expects pension liability levels to increase gradually, while debt levels are expected to remain fairly level based on future new money issuance plans (estimated at $10 million annually through fiscal 2022) and the likely extension of the weighted average maturity of bonds outstanding due to debt restructuring. The 'a' assessment also reflects the town's very high unfunded OPEB liability at more than $485 million as of the July 1, 2016 actuarial valuation date, or the equivalent of 14% of personal income.

The town maintains a single-employer pension plan that was closed to new hires July 1, 2007. All non-teacher hires since then participate in the state-operated Connecticut Municipal Employees Retirement System (CMERS). Teachers participate in the Connecticut State Teachers' Retirement System for which the town has no financial obligation. The town plan was severely underfunded due to a combination of poor investment results and years of underfunding of the ADC. To address this status the town issued $125 million in POB's in February 2015. The combined net pension liability (NPL) for the town plan and CMERS was reported at $303.4 million (or 9% of personal income), with an asset to liabilities ratio of 56% as of June 30, 2016. The Fitch-adjusted NPL (applying a 6% discount rate) was approximately $359 million or 10% of personal income and the funded ratio was 44%. As long as the POBs are outstanding the town must provide annual reporting to the state, including demonstrated funding of the required pension contribution and an annual actuarial valuation of the pension plan.

Operating Performance

Hamden's financial position remains very narrow and its operating performance would likely be stressed in an economic downturn. Inherent budget flexibility is assessed as midrange largely due to the town's unlimited legal authority to increase its property tax revenues; expenditure cuts are viewed more cautiously given the extent of spending measures introduced by the town during the last recession and subsequent slow economic recovery (which included departmental consolidations, privatization of certain services, and staff reductions). Furthermore, political and/or taxpayer pressure may inhibit the town from assessing this source of flexibility given its existing tax burden. That said, Fitch expects the town would take actions necessary to keep financial resilience from deteriorating significantly as has been the case historically.

The town's recent financial performance reflects a mix of very modest surplus and deficit results; near break-even results are anticipated for fiscal 2018. However, the town's financial results reflect utilization of one-time measures (albeit not exclusively) and there has been little to no progress improving its reserve position relative to spending. Fitch believes the town's unrestricted fund balances will remain at very low levels given expectations for tepid tax base and revenue growth, and ongoing pressure associated with higher debt servicing costs, among other expenditure pressures. The town has budgeted to pay the full pension ADC in fiscal 2019 for the first time in well over a decade. Outside of the general fund the town continues to report moderate current fund deficits in its internal service funds on an aggregate basis; however, cash flow from operating activities turned positive for the first time in several years in fiscal 2017.

The 2019 general fund budget totals nearly $232 million or a roughly 2.5% increase over the fiscal 2018 budget. Revenue highlights include a 2.7 mill or roughly 6% increase in the property tax rate year-over-year, an increase in PILOT revenue from Quinnipiac University to $1.35 million from $600,000, and introduction of a new tipping fee to cover the cost of operation of the town's waste transfer station. Revenue exposure to the state is now somewhat limited as the fiscal 2019 budget assumes only $6 million in aid to the town excluding the BOE.

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Applicable Criteria

U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017) (https://www.fitchratings.com/site/re/905637)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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