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Summary:

Middletown, Connecticut; General Obligation

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Credit Profile

US\$18.0 mil GO bonds iss of 2019 due 04/01/2030

Long Term Rating AAA/Stable New

Middletown GO

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' rating to Middletown, Conn.'s series 2019 \$18.0 million general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on the city's GO debt outstanding. The outlook is stable.

The city's unlimited GO pledge to levy ad valorem taxes without limit as to rate or amount on all taxable property within its borders secures the bonds. 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), the city has a predominantly locally generated revenue source, with 71% of general fund revenue derived from property taxes, with independent taxing authority and independent treasury management from the federal government.

The city's strong operating results and consistent budget reserves that have been maintained over several years support the 'AAA' rating. Despite credit pressures related to weak growth in the region and pressures related to state funding, management has done well, budgeting conservatively and producing several years of general fund surpluses. Prudent financial management and adherence to its long-established reserve policies underpin this.

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 slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 20% of operating expenditures;
- Very strong liquidity, with total government available cash at 29.7% of total governmental fund expenditures and 3.6x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 8.2% of expenditures and net

direct debt that is 53.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 91.0% 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 46,933, is located in Middlesex County in the Hartford-West Hartford-East Hartford MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 118% of the national level and per capita market value of \$105,296. Overall, the city's market value grew by 3.7% over the past year to \$4.9 billion in 2019. The county unemployment rate was 4.1% in 2017.

Middletown residents have direct access to regional employment centers throughout mid-Connecticut. 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. In addition, it is home to a new FedEx hub.

Property values in the city are rising. Since the last revaluation in 2017, grand list values grew by .44%. 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. With the recent completion of its water/sewer capital project, Middletown anticipates expansion of its riverfront properties. The additional developments on the waterfront and in the downtown area will continue the steady trend of grand list growth and support the city's very strong economic base.

Strong management

We view Middletown'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. The use of at least three years of trend data supports budget preparation. 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.

Middletown maintains a formal investment management policy, with holdings and earnings presented to the common council monthly. 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 calls 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 slight operating surpluses of 0.6% of expenditures in the general fund and of 0.8% across all governmental funds in fiscal 2018. General fund operating results have been stable over the past three years, with a result of 0.2% in 2017 and a result of 0.3% in 2016.

Our assessment of the city's 2018 operating performance adjusts for capital spending paid for with bond proceeds as well as ongoing transfers out. 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. In addition, the city experienced an increase in charges for services, which further supported strong operations. Middletown derives more than 71% of operating revenues from local property taxes.

Officials expect fiscal 2019 (ending June 30) to end with stable operations, barring unforeseen costs. Expenditures remain stable, and the city continues to budget conservatively for revenues. Included in the 2019 budget was a 3.1% increase in the mill rate compared with 2018. Middletown is preparing its fiscal 2020 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 2018 of 20% of operating expenditures, or \$33.6 million.

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 the city's 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 29.7% of total governmental fund expenditures and 3.6x governmental debt service in 2018. 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; the majority are 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 8.2% of total governmental fund expenditures, and net direct debt is 53.2% of total governmental fund revenue. Overall net debt is low at 2.8% of market value, and approximately 91.0% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Middletown has \$93.9 million in authorized but unissued debt. The city anticipates that a portion of the total amount authorized will be offset by grants and financial assistance from Connecticut. 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 benefits (OPEB) contributions totaled 6.4% of total governmental fund expenditures in 2018. Of that amount, 1.5% represented required contributions to pension obligations, and 4.8% represented OPEB payments. The city made its full annual required pension contribution in 2018.

The city administers 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 109.33% plan fiduciary net position of the total pension liability as of the measurement date of June 30, 2018. 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. 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 its participation in the broad and diverse Hartford MSA. It also reflects management's conservative practices that have supported strong budgetary performance and budgetary flexibility. Although not expected during the outlook period, should financial performance weaken, resulting in decreased budgetary flexibility, or if economic indicators significantly worsened, we could lower the rating. We do not expect to change the rating within the two-year outlook period.

Related Research

- 2018 Update Of Institutional Framework For U.S. Local Governments

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