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Fitch Rates Milford, CT's $10MM Ser 2019 GOs 'AAA' and $24MM BANs 'F1+'; Outlook Stable

Fitch Ratings-New York-17 October 2019: Fitch Ratings has assigned a 'AAA' rating to the following general obligation (GO) bonds to be issued by the city of Milford, CT:

--$9,680,000 GO bonds, issue of 2019.

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

--$23,635,000 GO BANs, due on Nov. 3, 2020.

The bonds and BANs are scheduled to sell competitively on Oct. 23. 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) at 'AAA' and the 'AAA' rating on approximately $116 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 the strength of its fund balance, legal revenue raising power, and expenditure flexibility in relation to its revenue sensitivity through economic cycles. Fitch anticipates solid economic and revenue growth based on the city's favorable demographic profile and proximity to larger labor markets. Long-term liabilities and carrying costs have been manageable given these strengths, although the city's policy decision of paying less than the full actuarial contribution to its pensions on an ongoing basis may erode this currently favorable position over time. 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 54,500 residents that exhibits high educational attainment and personal income. Economic resources are largely derived from a fairly stable residential tax base with employment opportunities focused in local government, retail, education and healthcare.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

General fund revenues are largely derived from property taxes, which have demonstrated strong historical growth driven by 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 44% of the general fund budget and has been somewhat stable in recent years in part due to declining enrollment. Debt and pension costs have both risen in recent years but remain moderate overall as a percentage of budget. 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'

Long-term liabilities, including debt and the Fitch-adjusted net pension liability (NPL), are about 9% of personal income, which is at the high end of the range for an 'aaa' assessment. Direct debt, which is the largest component of the liability burden, is repaid at a healthy pace and future capital plans appear manageable. Growth in the NPL, which Fitch believes is likely absent improved ADC funding levels, could pressure this assessment over time in the absence of commensurate growth in residents' income.

Operating Performance: 'aaa'

Fitch views the city's financial resilience as high basis on its superior level of budgetary flexibility and adequate reserves. The city's financial results have been sound overall and stable through periods of economic decline. Fitch's view of the city's budget management is somewhat tempered by the recent practice of underfunding annual pension contributions, which Fitch views as inconsistent with a 'aaa' assessment.

RATING SENSITIVITIES

Material Long-term Liability Increase: A material increase in the city's long-term liability burden, associated with net pension liabilities and debt, could put downward pressure on the rating.

Prolonged Revenue Weakening: The IDR and GO rating may also be sensitive to expectations for weaker revenue growth, primarily dictated by the level of housing appreciation and new investment supporting the performance of the city's tax base over time.

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 the largest employers in the city. 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

Milford's general fund budget is largely financed from ad valorem property taxes, as is common for Connecticut local governments. The adopted fiscal 2020 general fund budget approximates $217 million, with about 83% funded from ad valorem property taxes. State aid, the bulk of which is received in the form of education cost sharing grants, is budgeted at roughly $12.1 million or 6% of the budget.

General fund revenues have increased at a solid CAGR of 2.9% during the 10-year period ending fiscal 2018. The increase in revenue was largely driven by growth in the city's tax base rather than policy action (i.e., millage rate changes). Property revaluation in Connecticut occurs every five years with tax base changes between revaluations limited to new development or adjustments due to appeals activity. The revaluation effective for fiscal 2008 was phased-in over a two-year period and resulted in an almost 40% gain in the tax base, and the ensuing reassessment effective for fiscal 2013 led to an increase of more than 18%.

Growth slowed to a modest 1.8% for the most recent revaluation effective for fiscal 2018. Fitch expects the regional housing market to remain somewhat tepid, which could hold back natural revenue performance relative to historical trends, despite improved building permit activity. State aid uncertainty may also weigh against the city's revenue performance, although the overall level of dependence on this source is fairly modest.

The city has full independent legal ability to set its property tax levy and millage rate. The strong performance of the tax base has enabled the city to maintain a very steady millage rate over the past decade, with slight declines in each year since fiscal 2016. The millage rate for fiscal 2020 was set at 27.71 mills, a slight decline compared to the prior year.

Expenditure Framework

Education is the largest area of categorical spending, accounting for roughly 54% of the adopted fiscal 2020 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 that align closely with revenue changes and a stable population in recent years have resulted in manageable service demands. Fitch expects future spending pressures to be associated with employee pension contributions, which have risen sharply following reductions in the investment rate of return assumption, and moderate increases in debt service costs.

The city has the ability to reduce expenses tied to 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 whose subsequent decisions are binding, but 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 2018. Debt service, which represented about 6% of spending, has steadily increased as the city has addressed school and sewer infrastructure needs over the last several years. The outstanding general obligation amortization pace of 65% over 10 years combined with feasible capital demands should allow the city to manage its moderate debt service burden going forward.

Fitch's carrying cost metric reflects 100% of the ADC to the city's single-employer pension plan for municipal employees, rather than the actual contribution, which has been below the ADC since fiscal 2015. The city's pension system had essentially been fully funded as of the July 1, 2013 valuation date and its annual pension cost was about $324 thousand. The ADC has risen substantially since to more than $11.4 million in fiscal 2020, of which the city has budgeted roughly $8 million or 69% of the ADC. The sharp increase in the ADC primarily reflects a gradual reduction in the plan's investment rate of return from 8.25% to 7.5%, but also investment returns below expected levels and the accumulating impact of past contribution shortfalls.

The city has instituted a plan to fund a minimum of 115% of the prior year contribution until 100% funding is achieved. However, the gap between the ADC and the actual pension payment has widened under this approach, from less than $2 million in fiscal 2015 to more than $3.5 million in fiscal 2018. Fitch considers the $3.5 million difference between the ADC and actual funding level as manageable, at less than 2% of the general fund budget. Continuing to underfund the ADC is expected to exacerbate the rising ADC trend, thereby pressuring the city's budget, and result in additional growth in the ADC and long-term liability burden, which could lead to negative rating pressure.

Long-Term Liability Burden
Fitch estimates the city's combined long-term liability burden of debt and net pension liabilities at about 9% of personal income following issuance, which while still low is in the upper end of the metric range for a 'aaa' assessment. The city's long-term liability burden includes about $189 million of direct debt and a Fitch-adjusted NPL of roughly $135 million. Both the city's direct debt and the Fitch-adjusted NPL have increased in recent years, which could place pressure on the city's IDR if the trend is sustained absent commensurate growth in the city's total personal income. 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, calculated as of July 1, 2018 is about $283 million or a high 8% of personal income, a decrease of about $80 million from the prior year following a shift in the city plan's discount rate assumptions from 4.25% to 7.5%. The city's OPEB obligation may be understated due to this relatively high discount rate compared to other local governments rated by Fitch. The net OPEB liability reflects an OPEB trust with a fiduciary net position of almost $7 million as of the valuation reporting date. The city has made contributions to the trust since fiscal 2007 with the amount budgeted for fiscal 2020 totaling $500 thousand, similar to previous years. The school department has not established an OPEB trust and makes annual pay-as-you-go contributions.

The city's fiscal 2019-2023 capital improvement plan (CIP) totals $119 million. The CIP is driven by various school projects at about $56 million. Future debt plans are currently manageable relative to the city's economic resource base.

Operating Performance
Fitch views the city's resilience to normal cyclical downturns as very high. The city ended fiscal 2018 with an unrestricted fund balance of $43.3 million or 19.3% of spending. Reserves have been steadily maintained through economic cycles, demonstrating a commitment to compliance with a stated policy establishing a minimum unassigned fund balance equal to 5% of spending. The city's inherent budget flexibility is considered superior supported by a legal unlimited ability to raise revenues and solid level of expenditure flexibility.

Fitch's view of the city's conservative budget management and its recent strong financial results is tempered somewhat by recent underfunding of the pension ADC. That said, had the city been making full contributions, the city would have generated operating surpluses in each of the fiscal years since it began to underfund the ADC holding all other financial results equal.

Reserve levels have been built up during this period of economic growth and financial results have not relied on property tax rate increases. The city's efforts to control growth in its health care costs and fund an OPEB trust are other positive budget management considerations.

Unaudited fiscal 2019 operating results provided by the city show a net operating surplus of approximately $4.5 million increasing the unrestricted fund balance to $47.8 million or 21.4% of spending. The fiscal 2020 general fund budget is about $217 million or a 3.0% increase year-over-year. The budget reduces the millage rate by a very modest amount for the fourth consecutive fiscal year. The budget also increases the fund balance appropriation to $9.3 million from $5 million, although results have negated the use of budgeted fund balance. Expenditure drivers are associated with debt service and employee wage and benefit costs.

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ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Short-Term Ratings Criteria (pub. 02 May 2019)
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
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