FitchRatings

Fitch Rates Waterbury, CT's GOs 'AA-', Upgrades Outstanding GOs and IDR; Outlook Revised to Stable

Fitch Ratings-New York-07 November 2017: Fitch Ratings has assigned a 'AA-' rating to the following city of Waterbury, CT (the city) bonds:

--$50.0 million general obligation (GO) bonds, issue of 2017, series A;
--$13.6 million GO refunding bonds, issue of 2017, series B.

The bonds are scheduled for a negotiated sale on November 16th. Proceeds of the series A bonds will be used to finance various capital improvement projects in the city. Proceeds of the series B bonds will be used to refund outstanding bonds for debt service savings.

In addition, Fitch has upgraded the following ratings to 'AA-' from 'A+':

--Approximately $405 million outstanding GO bonds;
--Issuer Default Rating (IDR).

The Rating Outlook has been revised to Stable from Positive.

SECURITY

The bonds are general obligations of the city backed by its full faith and credit and unlimited taxing authority.

ANALYTICAL CONCLUSION

The rating upgrade to 'AA-' from 'A+' reflects the city's improved but still elevated unfunded liability for other post-employment benefits (OPEB), as well as its reduced fixed cost burden. The city's high level of legal revenue-raising authority, adequate expenditure flexibility, solid reserve levels, and elevated but moderate long-term liability burden support the 'AA-' GO rating and IDR. Fitch believes these strengths will position the city to withstand the challenges associated with periodic moderate economic declines.

Economic Resource Base
Waterbury is located in the west-central portion of Connecticut, 21 miles north of New Haven, and has an estimated 2016 census population of about 108,000. Population has seen a decline of approximately 2% since 2010. The city's proximity to Interstate 84 provides easy access to Hartford and major cities north and south and has helped attract new businesses to the city. Waterbury's economy is driven by manufacturing but it also features higher education, health care and retail.

KEY RATING DRIVERS

Revenue Framework: 'aa'
Fitch expects operating revenues to show natural growth below the level of inflation going forward, consistent with expected tax base performance. About half of revenues are derived from property taxes levied on a mixed residential and commercial tax base with the remainder largely generated by state aid. There is no legal limit to the property tax rate or levy.

Expenditure Framework: 'a'
Approximately half of the general fund budget pays for schools. Future spending growth is expected to exceed revenue performance as the city addresses significant underfunding of retiree benefit obligations. Fixed carrying costs are currently manageable, and the city maintains moderate control over wages and benefits in labor contracts, contributing to the adequate expenditure flexibility.

Long-Term Liability Burden: 'a'
The city's long-term liability burden, encompassing debt and pensions, is elevated but still in the moderate range when compared to resident personal income. Additionally, the unfunded liability of the city's OPEB is very high; however, the city has taken action to address the liability through benefit changes.

Operating Performance: 'aaa'

Generally conservative budgeting and steady adjustments in the tax rate have yielded positive budgetary surpluses over the past several years and negated the use of budgeted fund balance appropriations General fund reserves have been consistently maintained at the city's fund balance policy of 5% of working capital, which Fitch considers a more than sufficient reserve cushion relative to historically modest revenue volatility.

RATING SENSITIVITIES

Financial Resilience: The ratings are sensitive to shifts in the city's fundamental credit characteristics, and Fitch's expectation that management will maintain a high level of financial resilience while continuing to make progress to reduce its unfunded OPEB liability.

CREDIT PROFILE

The city is largely industrial with some diversity from the education, healthcare, and retail sectors. Resident income and employment metrics compare unfavorably to the state and nation. The taxable grand list remains below its pre-recession peak and modest growth is expected going forward. Economic development efforts have focused on bolstering the city's healthcare and industrial sectors.

Revenue Framework
Property taxes are the city's largest source of revenue, making up about 57% of general fund revenues in fiscal 2016. State municipal aid accounts for the bulk of remaining general fund sources. The natural pace of revenue growth was slow over the last decade, and Fitch believes future prospects are similar given the city's modest population declines and sluggish recovery from the recession. Credit concerns about limited growth prospects are somewhat offset by the city's unlimited legal revenue-raising authority.

The city's tax base grew at a compounded annual rate of 1.6% between fiscals 2007 and 2017. The most recent revaluation (effective fiscal 2014) reflects a 24% drop from peak value, capturing recessionary housing and commercial property value declines. Post-recession growth has been modest with limited new construction activity or appreciation of housing values. The city depends on state aid for city and school related operations, and based on the recently approved state biennium budget the city received generally the same level of aid for fiscal 2018 as it did in fiscal 2017; aid will increase modestly in fiscal 2019.

The city has independent legal ability to raise property taxes without limit. The motor vehicle tax rate was previously capped at 37 mills by the state but as part of the state's biennium budget the rate was increased to 39 mills.

Expenditure Framework
The city is responsible for the provision of public education, the cost of which is funded by a combination of local contributions and state aid. Approximately half of the city's general fund spending is related to education, followed by public safety at 12%.

Fitch expects the city's spending needs to slightly exceed stagnant revenue growth in the absence of policy action. The city has the ability to reduce expenses tied to its services, including the ability to reduce staff at any time if necessary. 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, and their subsequent decisions are required to take into consideration the financial capability of the city.

Carrying costs related to debt service, pension actuarially required contributions, and OPEB contributions were moderate at roughly 20% of governmental fund spending in fiscal 2016. Recently enacted changes to the city's OPEB plan have reduced costs in fiscal 2017 by about $11 million (or 2% of spending).

Long-Term Liability Burden
The city's long-term liability burden is elevated but still in the moderate range at roughly 23% of resident personal income. Direct debt obligations make up about 56% of the total. Future debt plans, combined with a moderate amortization schedule and stagnant expected resident income growth, indicate that liability levels will remain moderately elevated in future years.

The city's defined benefit pension plan for general employees had a net pension liability at fiscal 2016 year-end of approximately $361 million (or about 10% of personal income) when adjusted by Fitch to reflect a 6% investment rate of return assumption. The Fitch adjusted ratio of assets to liabilities was 52%. The plan's funded ratio was very low prior to the city issuing pension obligation bonds of roughly $313 million in 2009.

The city's OPEB liability represents a larger burden than debt and pension combined, at $894 million (25% of personal income) as of June 30, 2016. The city has taken actions to reduce the liability by shifting all eligible retirees to Medicare coverage and requiring the majority of active employees to enroll in a high deductible health savings plan. These changes reduced the OPEB liability, although several assumption changes limited the size of the reduction and it remains very high.

Operating Performance
The city exhibits exceptionally strong gap-closing capacity based on an unlimited legal ability to raise revenues, adequate flexibility of main spending items and solid reserve levels. Unrestricted general fund balance approximated $23 million or roughly 5% of spending at the end of fiscal 2016, a sufficient cushion given the city's minimal historical revenue volatility.

Covenants associated with the city's outstanding special capital reserve funding (SCRF) bonds require the city to operate with certain financial constraints, contributing to the city's general fund stability over the past several years. The provisions for the SCRF bonds require the city to continue to appropriate any reserves in excess of 5% of spending for pay-as-you-go funding of capital and transfers to other funds requiring subsidies. If the city were to not comply with these provisions, an early redemption mandate would be triggered. The SCRF bonds mature in 2022. Management has indicated its intention to maintain its conservative budgetary management practices following final maturity.

Unaudited fiscal 2017 general fund results were positive with a net budgetary surplus of roughly $7 million. Management continued its practice of transferring budgetary surpluses over and above the minimum 5% unrestricted fund balance level to support internal service funds, capital initiatives, and other contingencies.

The city's adopted fiscal 2018 budget of $435 million maintains the millage rate at 60.21 (the second highest in the state) and includes a $3 million appropriation of fund balance. State aid assumptions in the city's budget were roughly $6 million above the amount of aid included in the recently adopted state budget. The city expects to address the shortfall by using a combination of spending controls, budgeted contingency reserves, and by canceling budgeted contributions for vehicle contributions that were substituted by state grants. The city has a consistent history of positive operating variances, due to stronger than budgeted tax collections and sound expenditure management.

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

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1031960)
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