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Research Update:

City of Hamilton 'AA' Ratings Affirmed On Low Debt Burden And Stable Budgetary Performance; Outlook Stable

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Research Update:

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Overview

- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the City of Hamilton.
- The affirmation reflects our view of the city's exceptional liquidity, very strong economy, and low debt burden that we do not expect to increase materially in the next two years.
- The stable outlook reflects our expectations that, throughout the two-year outlook horizon, Hamilton will maintain exceptional liquidity balances, tax-supported debt will remain less than 60% of consolidated operating revenue, and after-capital deficits will not exceed 10% of total revenues.

Rating Action

On June 24, 2015, Standard & Poor's Ratings Services affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings and on the City of Hamilton, in the Province of Ontario. The outlook is stable.

Rationale

The ratings on Hamilton reflect Standard & Poor's view of the city's exceptional liquidity, its very strong economy, and the "very predictable and well-balanced" local government framework. We believe the very low level of contingent liabilities and strong financial management also bolster the credit profile. As well, the ratings reflect our view of the city's low debt burden, which we do not expect will increase materially in the next two years. We believe Hamilton's average budgetary flexibility partially constrains the rating and budgetary performance, while strong, will continue to experience after-capital deficits not exceeding 10% of total revenues.

In our view, Canadian municipalities benefit from a very predictable and well-balanced local and regional government framework that has demonstrated a high degree of institutional stability. Although provincial governments mandate a significant proportion of municipal spending, they also provide operating fund transfers and impose fiscal restraint through legislative requirements to pass balanced operating budgets. Municipalities generally have the ability to match expenditures well with revenues, except for capital spending, which can be intensive. Any operating surpluses typically fund capital expenditures and future liabilities (such as postemployment obligations and landfill closure costs) through reserve contributions.

In our opinion, Hamilton demonstrates strong financial management. Disclosure and transparency are very good, annual financial statements are audited and unqualified, and the city prepares robust annual operating and capital budget documents. Well-defined financial policies also guide debt and liquidity management.

Hamilton's economy is what we view as very strong. We estimate that the city's GDP per capita is in line with the provincial average in 2011-2013 of about US$50,000, given its broad base and continuing diversification into sectors such as health care, construction, and educational services, which has counterbalanced a gradual decline in the contribution from its traditional manufacturing base. Although population growth has been slower than that of Ontario, unemployment remains lower than the provincial level and we believe that the city has fair prospects for growth and further diversification.

We expect Hamilton's budgetary performance to be strong in the 2013-2017 base-case forecast period, with strong operating balances averaging almost 11% of operating revenues (all figures Standard & Poor's-adjusted) and modest after-capital deficits averaging just less than 5% of total revenues. A decline in provincial operating grants and high capital expenditures in the next several years could stress these ratios, but overall, we expect that budgetary performance will be fairly stable.

Constraining the ratings on Hamilton partially is what we view as average budgetary flexibility relative to that of its domestic peers. While modifiable revenues are high, averaging about 85% of operating revenues, the city, like other Canadian municipalities, is constrained in its ability to meaningfully cut expenditures due to several factors, including high capital requirements, provincially mandated service levels, labor contracts, inflation, and political pressures. Although the ability to set property taxes, utility rates, and user fees gives municipalities significant revenue-raising tools, political and economic pressures also limit the degree to which a city will employ these. This is particularly true in Hamilton's case, given the lower average household income of its residents and a large infrastructure deficit that limits its ability to materially defer capital spending, which will account for about 21% of total expenditures over the forecast period.

At the end of 2014, the city had C$438.5 million of tax-supported debt outstanding. This equaled 31.4% of consolidated operating revenue generated during the year, a level we view as low compared with that of peers. We expect that Hamilton's medium-term debt burden will be fairly stable, reaching about 33% of consolidated operating revenues by 2017, but interest costs will remain very modest, at much less than 5% of operating revenue.

The city owns one large holding company, Hamilton Utilities Corp. (HUC), whose primary business activity, through its subsidiaries, is electrical distribution. However, we view this entity as self-supporting and do not believe that the city would be required to provide material support to the company in case of financial distress. We view Hamilton's contingent liabilities, stemming largely from standard employee benefits and landfill postclosure liabilities, as very low. They represent about 11% of consolidated operating revenues at year-end 2014 (only 9% net of dedicated reserves), and do not have a significant impact on the city's credit profile.

Liquidity

Hamilton has maintained what we view as exceptional liquidity, which has a positive impact on its credit profile. We estimate that adjusted free cash and liquid assets will decline to about C$650 million by the end of 2015 from C$777 million at the end of 2014, as the city uses previously amassed reserves to finance some capital projects and interest and principal payments increase. This covers almost 9x our forecast debt service payable in 2016 and we believe that Hamilton's liquidity will remain exceptional.

In our view, the city has satisfactory access to external liquidity given its proven ability to issue into various markets, including that for public debt, and the presence of a secondary market for Canadian municipal debt instruments.

Outlook

The stable outlook reflects our expectation that, in the next two years, Hamilton will maintain exceptional liquidity balances, budgetary performance will not deteriorate such that after-capital deficits exceed 10% of total revenue, and tax-supported debt will remain less than 60% of consolidated operating revenue. We could revise the outlook to positive or raise the ratings in that period if Hamilton were to generate after-capital surpluses, likely through greater-than-expected revenue or a significant reduction in capital requirements, or tax-supported debt were to fall below 30% of operating revenue. Although we view it as unlikely in the next two years, we could revise the outlook to negative or lower the ratings if the city does not meet these expectations and long-term trends indicated continuing erosion of its credit profile.

Key Statistics

Table 1

City of Hamilton -- Economic Statistics					
	--Fiscal year ended Dec. 31--				
(%)	2010	2011	2012	2013	2014
Population (total)	516,161	519,949	524,038	528,705	534,432
Population growth	0.6	0.7	0.8	0.9	1.1
Unemployment rate	7.6	6.4	6.5	6.4	5.9

Table 1

City of Hamilton -- Economic Statistics (cont.)

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include Statistics Canada.

Table 2

City of Hamilton -- Financial Statistics

	--Fiscal year ended Dec. 31--				
(Mil. C$)	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	1,339	1,396	1,428	1,457	1,491
Operating expenditures	1,181	1,232	1,271	1,310	1,355
Operating balance	158	164	158	147	135
Operating balance (% of operating revenues)	11.8	11.7	11.1	10.1	9.1
Capital revenues	90	171	110	100	126
Capital expenditures	272	364	347	315	397
Balance after capital accounts	(24)	(30)	(80)	(69)	(136)
Balance after capital accounts (% of total revenues)	(1.7)	(1.9)	(5.2)	(4.4)	(8.4)
Debt repaid	40	40	52	58	64
Balance after debt repayment and onlending	(64)	(70)	(132)	(127)	(200)
Balance after debt repayment and onlending (% of total revenues)	(4.5)	(4.5)	(8.6)	(8.2)	(12.4)
Gross borrowings	0	99	0	83	143
Balance after borrowings	(64)	29	(132)	(44)	(57)
Operating revenue growth (%)	2.0	4.3	2.3	2.0	2.3
Operating expenditure growth (%)	2.1	4.3	3.1	3.1	3.5
Modifiable revenues (% of operating revenues)	86.2	86.6	86.9	87.1	87.4
Capital expenditures (% of total expenditures)	18.7	22.8	21.5	19.4	22.7
Direct debt (outstanding at year-end)	380	438	387	411	491
Direct debt (% of operating revenues)	28.4	31.4	27.1	28.2	32.9
Tax-supported debt (% of consolidated operating revenues)	28.4	31.4	27.1	28.2	32.9
Interest (% of operating revenues)	1.1	0.9	1.1	1.2	1.5
Debt service (% of operating revenues)	4.1	3.8	4.7	5.2	5.8

Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. Base case reflects Standard & Poor's expectations of the most likely scenario. Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Upside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with an upgrade. bc--Base case.

Ratings Score Snapshot

Table 3

City of Hamilton -- Ratings Score Snapshot

Key rating factors	**Assessment**
Institutional Framework	Very predictable and well-balanced
Economy	Very strong
Financial Management	Strong

Table 3

City of Hamilton -- Ratings Score Snapshot (cont.)	
Budgetary Flexibility	Average
Budgetary Performance	Strong
Liquidity	Exceptional
Debt Burden	Low
Contingent Liabilities	Very low

Note: Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the foreign currency rating on the government.

Key Sovereign Statistics

Sovereign Risk Indicators, March 31, 2015. Interactive version available at http://www/spratings.com/sri

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014

Related Research

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Feb. 5, 2015
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Hamilton (City of)	
Issuer credit rating	AA/Stable/--
Senior unsecured debt	AA

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